

EAPB Position on the Commission Communication “Consultation Document on State Aid for Innovation”

The European Association of Public Banks – EAPB would like to thank the Commission for the opportunity to contribute its views on the “Consultation Document on State Aid for Innovation”. The EAPB represents the interests of 20 public banks, funding agencies and associations of public banks throughout Europe, which together stand for some 100 public financial institutions with a combined balance sheet total of about EUR 3,000 billion and over 173,000 employees, i.e. a European market share of approximately 10%. Amongst the EAPB members, public development banks in particular have great interest in State aid questions and innovation, as they have the public mandate for business promotion and for the improvement of the competitiveness of the countries and regions they operate in.

Significance of State aid for innovation and competitiveness

In the opinion of the European public banks, effective competition in the internal market is a key to improving Europe’s competitiveness and its position on the global markets. State aid for innovation, however, can be a fruitful response to market deficiencies in this area, which hamper competitiveness at present. Against this background, we welcome the intention of the Commission to stimulate investment in innovation and to enhance the attractiveness of support schemes.

Question 1: separate State aid framework for innovation

We follow the Commission in the observation that a separate framework for State aid for innovation is not necessary. A separate new framework would, on the contrary, impede achieving the objective of simplifying European State aid rules and enhancing their coherence and legal certainty. It would imply even increased administrative burdens for the administrations in charge, the executive bodies, such as development banks, and the recipients of aid. We therefore support the approach of taking action in innovation-related fields and amending existing EC rules or introducing innovation aspects in planned new rules, such as the present and envisaged block exemption rules, the framework for research and development or the communication on risk capital and its upcoming revision.

Question 2: market failures

“Market failure” as a principle governing State aid control

Amongst the principles which are to govern the control of State aid for innovation, that of “market failure” plays a central role in the Communication. While “market failure” as a criterion can be substantiated on an abstract level, it is hardly to be proven factually. Applying it as a principle of State aid control would, therefore, be very difficult to realize on the practical level. It would lead to a considerable increase in time and energy needed for a

notification, for all parties involved, and would counteract the simplification of procedures aspired by the Commission.

Additionally, market failure as a term, in our eyes, needs a clear definition. We suggest regarding a market failure not as the absence of supply and demand, but as an inefficiency of the market in question. Insufficient investment in research and development, for example, is a result of inefficient markets. This inefficiency lies in the fact that there is a discrepancy between the relatively low individual benefit of research and development activities for an enterprise, due to high costs/low return on investment, and their relatively high benefit for the economy as a whole. Public support through State aid can bridge this market inefficiency by contributing to balancing out costs and returns. As this particular inefficiency tends to be higher the earlier the development phase and the greater the remoteness from the markets, support through State aid is especially necessary.

Problems affecting innovation in Europe

As regards the list of barriers to innovation in Europe, only the shortcomings in the capital markets, especially for venture capital, and mismatches in the labour markets can actually be regarded as market failures. Risk aversion, as one of the “systemic” barriers, is not a market failure as such, but can be addressed by State aid, for example in the form of guarantees.

The larger part of the problems listed, however, may well be seen as impediments to innovation, but can certainly not be resolved through intervention in the form of State aid, as stated in the Communication. This, indeed, is particularly true for the issues related to legislation, taxation, social security, policy coordination and most of the “systemic” inefficiencies. All of those issues deserve greater investigation. Regarding the adoption of ICT in business activities, the development and adoption of environmental technologies and the protection of intellectual property rights, for example, the EAPB members suggest that this is not considered as being valid for all European countries. As bureaucracy in public funding is mentioned in this context, we would again like to express our support for the Commission’s endeavours to simplify the EC State aid rules, outlined in the State Aid Action Plan. This will importantly contribute to resolving this issue.

Question 3: Ex-ante criteria for approval

We support the Commission in its intention to simplify the procedural requirements for small and medium sized enterprises (SMEs), and for activities in the earlier development phases which are farther away from the markets, and to exempt them from the notification obligation. Indeed, in these cases the distortions of competition are less than in the case of larger enterprises and of activities close to the markets.

The Commission could consider introducing ex-ante rules for the granting of aid aiming at non-technological innovation to larger enterprises, if they are clearly defined and

proportionate (cf. answer to question 4). In these cases, however, there should be the additional possibility to obtain approval for further aid through an individual notification, if this is desired. We do not consider a differentiation between branches as feasible, because innovation always has a positive effect for the development of the economy as a whole.

As regards technological innovation, we welcome the approach taken in the Communication, which follows the OECD Oslo Manual of 1997 and differentiates between product and process innovation. This means furthermore that innovation is seen as a continuum or life-cycle which begins with early research and development activities and ends with the introduction to the markets, i.e. “technological experimentation”. The latter comprises not only the acquisition of licences and technical equipment necessary for the production of a new product, but also staff training and marketing measures. To extend the support of innovation to an integrated “life-cycle” approach covering all these phases would be highly beneficial and lead to sustainable results.

This should not mean, however, that the possibilities of supporting innovation and innovative activities should be limited to technological innovation only. As many providers of services invest into innovation as well, as acknowledged in the present Communication, these enterprises should also be able to benefit from such a policy. Aid should also not be limited to technical aspects. Business, marketing and management activities should be eligible as well, always bearing in mind the commercialisation of a product or service.

Question 4: appropriateness of authorising State aid to large companies/clusters and poles of excellence – empirical evidence

Larger enterprises active in R&D form crystallisation cores in regional clusters and innovation networks. An empirical example from Germany shows that the support of larger enterprises in the micro-electronic sector in the Dresden region has effected the creation of 8000 jobs directly in the participating businesses and has led to the creation of 35000 further jobs with related service providers and technical suppliers. Additionally, the regional economy has benefited from increased purchasing power.

Question 6: regional dimension

Although the support of innovation may have a regional component (when financing regional clusters, for example), the distinctions between the EU’s regional policy and the support of innovation should not be obscured, as the objectives differ largely. While EU regional policy aims at economic cohesion across the member states and regions as such, measures in support of innovation should follow the particular aim of increasing innovative activities and the innovative structures to reap the expected benefits.

Yet, in order to pay proper respect to the regional dimension of innovation support, there should be a possibility to cumulate innovation aid and regional aid. Innovation aid should not lead to a prohibition of regional aid granted in parallel. Establishing appropriate upper limits for the cumulating of aid could prevent an excessive use of State aid and guarantee the necessary flexibility at the same time.

Question 7: form of innovation aid

The adequate form of innovation aid depends largely on the size of an enterprise and the business phase it is in. Tax rebates, for instance, do not appear feasible for young and small businesses, as their returns are low or non-existent. In general, revolving systems to us appear as being favourable. We advise against assigning specific forms of aid to specific situations and activities. This would not agree with the identified aim of the Communication to grant aid in a targeted and efficient manner.

Questions 8 and 9: defining innovative start-ups; not defining eligible costs, amounts of aid and cumulation rules

In our opinion, eligibility should not be restricted to small start-ups younger than 5 years. For the benefit of more innovation for the economy as a whole, enterprises of medium size (according to the definition of SMEs) should be eligible as well. We see a certain contradiction of the rules proposed in paragraph 38 to the other parts of the Communication, where SMEs are mentioned as target group. Furthermore, especially in the high-technology sector (e.g. in biotechnology, the pharma industry, new material etc.), the start-up phase should be considered as the first eight years of a company's existence, as the procedures of approval, certification and registration are longer or more cumbersome, respectively. Again, in a time-perspective as well, eligibility not be treated in a too restricted manner to reap the full benefit of innovation aid for the economy as a whole.

Having highly innovative medium-sized enterprises in mind, the limit of €1 million within three years appears insufficient. Similarly, we advise against the prohibition of a cumulation of aid. State aid for innovation should incite new as well as renewed and additional innovation activity and investment. To prohibit a cumulation would mean that an enterprise would only be able to receive support for innovation once in its entire life-cycle. As mentioned above, we see a certain value in a cumulation with regional aid, for instance.

We warmly welcome the intention not to define eligible costs and aid amounts, as this will contribute to greatest possible flexibility. All costs related to innovation should be eligible for support.

While we support the intention of not granting innovation aid to firms in difficulty, it should be acknowledged that newly started businesses often have to meet bottle-necks in liquidity, without necessarily being in difficulty according to the "Community guidelines on State aid

for rescuing and restructuring firms in difficulty”. We would therefore highly appreciate if this fact was taken account of in the future rules and if the guidelines for firms in difficulty would not be applied in these instances.

Question 10: types of aid for SMEs beyond the start-up phase

Amending the current “Communication on State Aid and Risk Capital” to allow for greater flexibility for the safe-harbour investment tranches and a block exemption is a very useful approach, in our opinion. Additionally, the revised “Communication on State Aid and Risk Capital” should also be extended to comprise mezzanine finance and similar financing forms. Mezzanine finance is of growing importance for the financing of innovation.

The intention to support enterprises in the post-seed phase with the provision of risk capital – and not only in the start-up phase, as is foreseen in the present rules – finds our explicit support, as not only young enterprises face a gap in the supply of venture capital. We would also welcome an increase of the thresholds for public ownership in funds targeting investment at the seed stage to 50% and 70%. Here, a market failure in the provision of private capital is clearly discernible.

Question 11: support for technological experimentation and risks of innovative products: effects on SMEs

At present, there is a clear gap of public support for SMEs with innovative product ideas or projects in those phases of the innovation process which are close to the market. Public support now has to end long before the market entry. In the intermediate period, SMEs in particular have to overcome various problems. As explained in our answer to question 3, we would like to extend support mechanisms to include later innovation phases and therefore warmly welcome the Commission’s intention to make the “experimental development stage” eligible for support. The promotion of innovation by SMEs should not only cover technical aspects, but management and marketing ones as well. The commercial exploitation should be kept in mind from the first phase of promotion onwards. Aid should always have a specified purpose.

As regards aid intensities, we suggest applying the limit of 25% used in the Community Framework for R&D for pre-competitive activities to the “experimental development stage”. This would lead to more transparent aid schemes and to an appropriate and continuous provision of finance throughout the entire innovation process.

Questions 14 and 15: mobility and recruitment of research personnel

Young and small enterprises often lack highly qualified personnel, a deficit which can be a great obstacle to a company’s success. To allow a granting of aid for the recruitment of such personnel and for training measures for employees therefore could be a promising

amendment of the existing rules, especially when it comes to the areas of marketing, sales, finances and controlling.

Should the Commission envisage specific rules for cases in which a researcher cannot or does not intend to return to their home university, they would only be of added value if they were clearly worded, to avoid misuse on either side.

Questions 16–20: poles of excellence, collaboration and clustering

We explicitly welcome a support of the development of poles of excellence and clusters. Clusters are important catalysts for the exploitation of innovation potential through the transfer of know-how they bring about. Clusters contribute to reducing transaction costs and trigger a spill-over of technological knowledge through creating favourable and stimulating surroundings for the participating actors.

Clusters are formed when competencies of one field gather in a regionally limited area, which are not necessarily linked or which not necessarily cooperate. There should be clear definitions of clusters, co-operations, networks, centres of competence and innovation intermediaries to allow for a proper distinction between the different entities.

We are of the opinion that there should be a possibility to grant State aid for the promotion of European centres of excellence. European centres of excellence not only strengthen the European Research Area, but also have regional structural effects. However, aid should not be limited to regional or sectoral centres of excellence. Furthermore, aid should not be limited to enterprises within clusters. Businesses which are not part of a cluster should be eligible as well, as there is not only innovative potential in regional or sectoral clusters or poles of excellence, but also in enterprises outside of clusters as well. The concentration of resources on poles of excellence should be complemented by a support of these broad potentials to guarantee for a balanced economic and demographic development. To avoid fragmentation of aid, poles of excellence could be evaluated on a periodic basis with respect to their excellence and their contributions to a knowledge based economy.

As regards additional provisions for infrastructure supporting innovation, we consider the existing provisions as being sufficient and do not see a need for additional ones.

Larger firms should also be entitled to State aid to promote clustering. They are one of the supporting pillars of European centres of competence. However, the support of large enterprises should follow other criteria than the support of SMEs. The eligibility criteria, for instance, could cover the amount of investment, regional structural effects, the employment policy and the degree of networking with SMEs and research centres.

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