



## Highlands & Islands ENTERPRISE

HIE 2004/04955

18 November 2005

Sandy Cumming CBE Chief Executive  
Direct Telephone 01463 244204  
Direct Fax 01463 244201  
e-mail [sandy.cumming@hient.co.uk](mailto:sandy.cumming@hient.co.uk)

DG Competition  
State Aid Greffe  
SPA 3, office 6/5  
B-1049 BRUSSELS  
Belgium

Dear Sirs

### CONSULTATION: STATE AID FOR INNOVATION

1 Highlands & Islands Enterprise Network (HIE) is government funded and is responsible for economic and community development across a diverse geographical area which covers more than half of Scotland and is home to around 425,000 people.

The aim of the HIE Network is to enable people living in the Highlands and Islands to realise their full potential on a long-term sustainable basis. The HIE Network engages both financially and intellectually with both business and communities, guided by four strategic objectives:

Strengthening Communities  
Growing Business  
Making Global Connections  
Developing Skills

2 As the EU State Aid rules are designed to regulate public interventions into competition and trade, this has a significant impact on the Network's activities in each of its objectives, especially in Growing Business. We have considerable experience of the application of the rules and a keen interest in the revisions currently under consideration in the Commissions consultation on "State aid for Innovation".

#### The HIE Network's Response:

3 HIE welcomes the Commission's intention to revise state aid rules and procedures concerning innovation. Having a responsibility for economic development in a region with lagging development due to peripherality and dispersed population we are keenly aware of the significant benefits of European state aid policies that help foster both competition and cohesion. We see the constraining of aid levels in richer regions and allowing differentiated aid levels for the disadvantaged regions as vital to the EU, even in the so called 'horizontal' forms of aid such as may be used for Innovation. The HIE Network's response to your specific questions is below:

State aid for innovation consultation – HIE response



Highlands & Islands Enterprise  
Cowan House Inverness Retail & Business Park Inverness IV2 7GF Scotland  
telephone 01463 234171 fax 01463 244469  
[communications@hient.co.uk](mailto:communications@hient.co.uk) website: [www.hie.co.uk](http://www.hie.co.uk)



INVESTOR IN PEOPLE

### **Question 1**

*Do you think that it is appropriate not to create a separate Framework for Innovation and that the new possibilities for State Aid target selected innovation-related activities?*

#### **Answer**

4 We agree that there should not be a separate framework for innovation for the reasons advanced by the Commission. However, it is necessary, in our view, to recognise that within the Risk Capital Guidelines a higher level of aid is justified for innovative business start-up and early stage growth. This does require that an "innovation" category of Risk Capital Aid should be identified.

### **Question 2**

*Do you think that the problems presented in the Annex and the market failures identified by the Commission as hampering the innovation process are accurate? If so, why? If not, why not?*

#### **Answer**

5 We agree with the identification types of market failure by the Commission. We consider that the fundamental failure is due to the presence of positive externalities from innovation that the market mechanism does not reward. We observe market failures particularly in: a) failure of the financial market in providing finance; and b) a failure in entrepreneurial innovation because of the lack of reward from the market. It is the presence of significant externalities from innovation that justifies a higher level of aid for Risk Capital for innovative projects than other Risk Capital investments.

### **Question 3**

*The measures described in this Communication provide ex-ante criteria on the basis of which State Aid for innovation would be approved. Do you think that such an approach is adequate?*

#### **Answer**

6 We agree that the Commission 3 criteria for approving innovation aid. The criterion requiring the aid to be proportionate to the problem means, in our view, that approved aid levels must be capable of being adapted to the local circumstances, resulting potentially in different levels in different regions.

### **Question 4**

*Stakeholders are invited to provide empirical evidence about the appropriateness of authorising State Aid to large companies, in particular in connection with the objective of developing clusters around poles of excellence in the EU. Do you think that the Commission should develop ex-ante rules allowing State Aid for Innovation to the benefit of large companies, or that such type of aid should always be subject to a case-by-case stricter analysis on the basis of a notification to the Commission? As far as support to innovation (or other State Aid) is concerned, would it be appropriate to distinguish between different categories of large companies? If so, on the basis of which criteria? And for which purpose?*

#### **Answer**

7 As a general principle, we consider that it is in the normal run of business that all large firms must invest in product and process development in order to remain competitive. In these situations,

State Aid is counter-productive. There are, however, numerous situations where there is market failure even for large firms and the results of innovation have significant benefits for Europe as a whole. It is often only larger firms that have the capacity to undertake both the technological development and the business innovation. In these situations it should be possible to provide State Aid in proportion to the non-market benefits. We consider that the Commission should be able to authorise both individual cases, as well as aid Schemes for large firms for such cases. In appraising aid Schemes, we believe the criteria used by the Commission should be to agree the objectives of the Scheme and the ability of the Member State procedures to carry out additionality analysis and reach objective judgements on individual cases.

#### **Question 5**

*Stakeholders are invited to provide empirical evidence about the appropriateness of authorising State Aid to non-technological innovation, notably in services sectors.*

#### **Answer**

8 We agree with the use of the term "Technological Innovation" as defined in the Oslo Manual as referred to by the Commission. Our reading of this definition in the consultation paper suggests that it would be perfectly possible for innovation in the service sector and in many other sectors to meet this definition.

#### **Question 6**

*Should the rules on State Aid for innovation include regional bonuses for cohesion purposes? Should they differ according to the geographical situation of the region, irrespective of cohesion issues?*

#### **Answer**

9 Firms in disadvantaged regions such as peripheral ones suffer higher costs and consequently reduced profits in any sector competing with firms with lower costs due to their location. Until such time as the true costs of concentration (over-crowding etc) are reflected in the prices paid by firms in central locations, there must continue to be regional bonuses to create a more level playing field between firms in different regions and to ensure they have the opportunity to contribute to EU growth and competitiveness. There are also regional infrastructural weaknesses, such as the availability of science and technology centres or lack of suitable business partners that may need to be addressed via State Aid as well as by other means.

#### **Question 7**

*Are some types of aid more suited to specific situations and specific innovation activities (ex: tax rebates, secured loans, repayable advances)?*

#### **Answer**

10 Regional and National circumstances vary considerably, such that each of these types of aid may be appropriate – for example, tax rebates are more effective at stimulating small firms to undertake R&D, but in areas where large firms deliver most R&D such as the UK, other incentives will also be needed to increase the overall participation in R&D. From our own experience, direct grants are most useful, and loans are less so because of uncertain commercial returns from R&D. Repayable advances are a useful tool to optimise the use of public funding, but for State Aid purposes will generally be the equivalent of a direct grant of the same amount.

### Question 8

*Do you agree with the proposed criteria to define innovative start-ups, with the approach of not defining eligible costs, with the amounts of aid and cumulation rules? Do you think that different eligibility criteria should be established for high-tech sectors like biotech and pharmaceuticals which have long time-to-market and product development cycles?*

### Answer

11 Criteria: we strongly support the restriction to firms with up to 50 employees. In our view, Eligibility should be for "Technological Innovation" as in the Oslo Manual referred to in our answer to question 5 above. We do not think eligibility should be too tightly defined, as it is very difficult to say in advance which innovation will bring the greatest benefit in practice. For example, would clever use of new telecommunications technology to deliver remote business services providing significant cost savings be any less desirable than an equivalent investment in an innovation in telecom's technology itself?

12 Eligible Costs: We strongly agree that all of the costs should be considered eligible because it is important to consider the entire project in order to optimise on out-puts rather than in-puts. We believe this would need to be combined with an assessment of additionality and limiting the aid to the minimum aid necessary on a case-by-case analysis.

13 Innovative Start-Up Aid: We agree that the 1million Euro limit over 3 years should be applied to the project, but not necessarily to the beneficiary. If the same beneficiary were to be able to start up a further innovative business, separate from the first, then a second possibility of up to €1m should be allowed, subject to additionality considerations. This would require the condition of once only for a particular firm to be abandoned (we also propose this to support long term innovation projects (see below).

14 Long Product Development Cycles: We are not convinced that giving a greater selective advantage to sectors with long development cycles is desirable as it would tend to favour sub-optimal use of scarce public resources. If the suggested restriction to receiving aid of this type once was rejected, projects longer than 3 years could then be assisted by a second tranche of aid. This would reflect the timescale but not provide different treatment for these sectors. However, we are aware that when products need to be tested to avoid harmful health or environmental impacts (i.e. the presence of negative externalities) there could be a case for subsidy of mandatory testing. This could be identified as a special eligible cost for higher levels of aid where there exists an adequate control mechanism to prevent harmful products being produced. Market failure and additionality would also need to be demonstrated.

### Question 9

*Beyond the proposed rules, empirical arguments are welcomed that demonstrate the need for State Aid: (i) for start-ups independently of the innovativeness criterion, and (ii) for innovative SMEs established for more than [5 years].*

### Answer

15 As referred to above, we would regard a wide range in types of innovation as worthy of support. In addition, we are aware that there remains a market failure in the provision of private investment funds for small firms with viable business plans in our region. In our experience small firms can take considerably longer than 5 years to become fully established, and this often involves them in undertaking serial innovation steps. We judge there to be a continuing failure of the market to

provide finance for growth in these subsequent development periods beyond 5 years from starting. Where a region such as ours is relatively disadvantaged in its costs base due to peripherality, climate and geology, private funding is difficult to compete for. Such regions need to increase the rate of new business creation in order for the market to generate the economic restructuring through innovation and increased competitiveness. There is therefore a cohesion argument for a relatively higher level of start-up aid. The proposed Innovation Start-Up Aid for small firms, if applied to all new starts, would be a valuable tool in such regions. Whilst the availability of investment finance is a problem for all small firms in relatively disadvantaged regions within all Member States, it is our experience that it is particularly acute for small start-ups. This type of aid targeted in this way meets the EU objectives for aid well. It is focused where the additionality is greatest, where the competitive distortion is least (due to size and location of firms) and it involves very small amounts total value of State Aid (due to the relatively low population of firms in such regions).

#### **Question 10**

*Do you think that other types of State Aid apart from those currently granted in respect of risk capital are required in order to help European SMEs grow beyond the start-up phase? If so, which ones?*

#### **Answer**

16 We consider that there has been a recent increase in the market failure in the supply of risk capital for mid-sized growth companies requiring investment in the range £2m - £20m.

#### **Question 11**

*Do you think that these provisions would produce the expected effects in terms of encouraging SMEs to launch innovative products in the market? If not, what changes should be made to these rules?*

#### **Answer**

17 We note a continuing difficulty, in our region at least, in financing the launch of products that have been successfully proto-typed. Private investment funds select growing companies who have already launched innovative products and who are likely to feature very high rates of return. This means most small firms do not have access to adequate risk capital at critical periods in their development.

#### **Question 12**

*Is there evidence that these provisions should be extended to large companies? Do you think that notification should be required for measures granting substantial amounts of aid to individual firms or individual sectors? If yes, above what amount? What empirical evidence should then be requested by the Commission?*

#### **Answer**

18 We consider that for large firms the need for aid at this stage immediately prior to full commercial operation is more likely to be because of poor viability than supply of capital. Additional eligibility should be reserved for SMEs except in exceptional cases, which should be notified. The basis for approval could be a cost-benefit analysis of externalities (non-market benefits) versus subsidy.

### **Question 13**

*How would you regard specific support for innovation intermediaries which merge or develop a joint venture to reach critical mass in a technological field of specialisation? Should investment aid be permitted in this context? If so, on what conditions? What other measures could be envisaged?*

#### **Answer**

19 Intermediaries acting as innovative businesses should be treated like other firms. Their activities as an intermediary would need to be adequately financially separated.

20 The proposal to permit up to €200,000 over 3 years for support services for innovation for SMEs is welcomed, as is the guidance on the 'non-aid' status of support for intermediaries making minimal profit.

### **Question 14**

*Is there evidence that the recruitment by SMEs of other types of highly skilled personnel should be also aided?*

#### **Answer**

21 "Qualified Researchers and Engineers" may be a limiting term when trying to facilitate knowledge transfer. "Individuals with specialist knowledge" is suggested.

### **Question 15**

*Should the Commission adopt specific rules for cases where a researcher chooses not to return to his/her home university or where the university no longer intends to hire him/her back?*

#### **Answer**

22 It is not clear why it is proposed to allow full subsidy of a researcher working in an SME when he / she is employed by the university, but only 25% subsidy when employed directly by the firm.

### **Question 16**

*What definition of cluster/clustering activities should be followed and what criteria should be used to distinguish clusters from the broader category of innovation intermediaries?*

#### **Answer**

23 We do not see a need to distinguish between the two. State aid eligibility would be determined by the nature of the activity being aided (i.e. supporting a cluster of companies to establish in proximity or in the provision of innovation services).

### **Question 17**

*Do you think that State Aid should be allowed to promote European centres of excellence? If so, what type of State Aid, for what reasons, and subject to what conditions? What other, possibly better, measures could be envisaged?*

**Answer**

24 Yes, in principle. Through public institutions and the use of intermediaries, some support could be given without recourse to State Aid. We could envisage how existing State aid guidelines such as R&D, Regional and SME aid could be used but do not have any basis to say whether new measures would be desirable

**Question 18**

*Are additional criteria needed to avoid State Aid being fragmented and to encourage the concentration of resources in a limited number of poles of excellence?*

**Answer**

25 No. Concentrations on poles of excellence would almost certainly constrain the development of innovation generally.

**Question 19**

*What are your views more generally about the need for additional provisions for infrastructure that supports innovation (e.g. in the field of energy, transport etc)?*

**Answer**

26 Infrastructure investment is necessary for supporting innovation, and the Commission's proposals for intermediaries and innovation services voucher, as well as the R&D and SME powers to individual firms, appear between them to provide the means.

**Question 20**

*Do you think that large firms should be entitled to State Aid e.g. to establish research facilities in a European pole of excellence? Should the Commission try and develop specific criteria to control such State Aid? What type of economic evidence should be requested to analyse the necessity of such State Aid?*

**Answer**

27 We believe there should be scope to approve innovation aid to large firms where there are positive externalities. The aid should be to an extent no greater than the costs that cannot be financed by the market, and subject to not exceeding the minimum necessary for the project to proceed. The appropriate type of aid would be R&D aid.

*Yours sincerely*  
*S-1*