Communication from the Commission
Consultation Document on State Aid for Innovation

INDUSTRY RECOMMENDATIONS

By EuropaBio – The European Association for Bioindustries

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1. General Introduction

This document has been executed by EuropaBio, the European Association for Bioindustries, and provides industry recommendations on the Consultation Document on State Aid for Innovation published by the Commission (DG Competition) on September 21, 2005. The Commission's consultation document outlines specific improvements of the rules on State Aid for innovation. The intention of the Commission is to integrate the accepted improvements in the existing frameworks for R&D and Innovation, the Risk Capital guidelines, the Environmental guidelines and in the general Block Exemption regulations. The Commission has proposed six measures to stimulate innovation, economic growth and job creation by i) supporting risk-taking and experimentation and by ii) improving the general business environment for innovation.

EuropaBio welcomes the overall scope of the consultation paper, including most of the rules proposed by the Commission. However, we do have a number of sector-specific concerns and suggestions for improvement which are described below.

2. Industry Recommendations

2.1. Proposals of interest

In **Paragraph 34** of the consultation document, the Commission correctly indicates that one of the main barriers in today's successful innovation is the lack of internal capital and/or the shortage of appropriate collateral to obtain funding (i.e. debt financing), resulting in very tight funding constrains. Furthermore, the Commission recognizes that despite the existence of a number of market-driven solutions, additional State Aid might be required to support the funding of innovative start-up companies.

In **Paragraphs 38** and **39** of the consultation document, the Commission defines and proposes specific criteria and rules for granting State Aid to innovative start-up companies, including a 50% exemption of social contributions and other local/regional taxes (i.e. not linked to profits) for up to 5 years, and the possibility to grant aid of up to €1 million over a

3-year period. Eligible companies should have less than 5 years of existence, should spend at least 15% of its expenditures on R&D and should have not more than 50 employees.

2.2. Relevant industry background

Small and Medium Sized Biotechnology Companies ("biotech SMEs") play an important role in the discovery and development of new technologies and products in the life sciences area. Without the intervention of biotech SMEs over the past two decades, there would certainly have been less progress in the development of medicines for unmet medical needs and the development of new agri-food processes and products. Europe currently counts over 1,900 innovative biotech SMEs, which all have the potential to become key drivers of public welfare and economic growth, but which also have high requirements in terms of capital, business environment, people, and public and political support.

Today, one of the main barriers in Europe to successful biotech entrepreneurship, innovation and product development is indeed **the lack of different forms of finance along the 'capital chain'** (i.e. from seed capital to IPO and secondary offerings). Besides the European market fragmentation, this lack of available capital (i.e. EU-money invested in European companies) has a great impact on the economic and industrial evolution of the European biotech industry. With approximately the same number of companies as in the European sector, the US biotechnology industry employs almost twice as many people, spends almost 3 times as much on R&D, raises 3 or 4 times as much venture capital, and has access to 4 times as much debt finance. Furthermore, the US industry generates roughly twice the revenue of the European sector (€42 billion versus €19 billion).

Given the high cash requirements linked, for example, to the discovery and development of new drug therapies (according to a most recent Deutsche Bank report the cost and time to market for small molecule therapeutics have today increased to €900 million [pre-tax and including failures] and 15 years, respectively), it is not surprising that the **lower R&D expenditures in Europe negatively impact the number of products in clinical development** (which, in turn, is often considered as a good barometer for future revenues). Today, the number of products in clinical development is more than double in the US compared to Europe (1,110 compounds versus 450 compounds). Furthermore, it is obvious that only those companies that have significant, late stage (e.g. clinical) development programs will finally create real value, both in terms of revenue generation, as well as in terms of job creation and economic growth.

2.3. Recommendations: YIC status

Given the young and underdeveloped nature of the European biotech industry, EuropaBio asks the Commission **i)** to propose and implemented more advanced measures reflecting the prolonged product development time frames in innovative, R&D-driven industries and **ii)** to expand the proposed fiscal measures for innovative start-up companies towards emerging

and more established high-tech companies, including companies listed on the stock exchange.

With respect to **Question 9**, whether or not different criteria for high-tech sectors like biotech and pharmaceuticals should be established, **EuropaBio considers a simple, unified and transparent regulation applicable across all high-tech sectors to be more feasible from a practical and political perspective**. Furthermore, EuropaBio suggests changing the proposed rules in **Paragraphs 38** and **39** as follows (changes to original text indicated in bold green or italic comments):

----------start of proposal for change----------

(38) Proposed rules: the proposed definition of **young** innovative **companies** *(replace 'start-up' by 'companies')* is that they should meet both of the following criteria:

- **Young innovative company criterion**: must have less than **15** years of existence *(remove reference to SME-definition)*
- Innovation criterion: either i) proof that the beneficiary will produce products and processes which are technologically new or substantially improved compared to the state of the art in its industry in the Community, and which carry a risk of technological or industrial failure or ii) R&D expenses represent minimum 15% of the beneficiary's overall expenditure.

(39) The following rules could apply for granting State aid:

1. exemption of **100%** on social contributions and other local/regional taxes (i.e. not linked to profits) **for the first 15 years** provided the benefits are reinvested in the company or repayable advances.
2. **exemption of 100% on tax on revenues for the first 3 profitable years, of 50% over the next 5 years and of 35% over the next 7 years.**
3. **exemption of 100% on tax on capital gains on shares or stock options that have been held for a minimum of 3 years**
4. in addition, the possibility to grant aid of up to EUR **3** million over a 3 year period to a **young** innovative **company**, without specific restrictions on eligible costs and provided that i) it is not cumulated with any other State aid, ii) the beneficiary is not a firm in difficulty and iii) the company receives the aid only once.

----------end of proposal for change----------

2.4. Recommendations: YLC status

While the above rules will favor emerging, young innovative companies, EuropaBio also urges the Commission to expand the proposed rules in **Paragraphs 38** and **39** to the more developed high-tech companies listed on the stock exchange. The introduction of a Young Innovative Company status across Europe would certainly have great benefits, but this only takes young companies so far. To maximise their chances of becoming successful,

competitive, public companies, the so-called Young Listed Company (YLC) status is equally important. The YLC status would be aimed at re-attracting the interest of institutional investors and stock-market investors in growing young technological companies by offering tax benefits to investors.

Comparing the EU 'listed' biotech industry versus its US counterpart, we can observe i) that in Europe we have more than 3 times fewer biotech companies listed on a stock exchange than in the US (106 versus 344) and ii) that the associated market capitalizations is almost 10 times less in Europe than in the US (EUR 19 billion versus EUR 175 billion). Given the fact that companies listed on a stock exchange are generally those companies that will create real value, both in terms of revenue generation, as well as in terms of job creation and economic growth; EuropaBio urges the Commission to foster IPOs (Initial Public Offering) of young emerging companies, which is a key factor for their growth and international development; thereby preventing 'listed' European biotech companies from becoming cheap targets for hostile/not-friendly acquisitions by US companies. In this respect, EuropaBio proposes to complement the proposed rules in **Paragraphs 38** and **39** with the following criteria and benefits:

----------start of proposal for change----------

Proposed rules: the proposed definition of **young listed companies** is that they should meet the following criteria:

- have a headcount of fewer than 500 employees
- have R&D expenses representing minimum 15% of the beneficiary's overall expenditure
- be listed on a stock exchange on a controlled or supervised European market

The following rules apply for granting State aid for an 15-year period following IPO:

1. exemption of 100% on capital gain tax for shareholders (whether direct or through any investment company), whenever the securities have been acquired or are held at the time of IP or in the 15 years following IPO
2. exemption of 100% on wealth tax for directly or indirectly held securities, whenever these have been acquired or held at the time of IPO or within 15 years following IPO and have been kept for at least 1 year following IPO
3. exemption of 100% on inheritance tax on directly or indirectly held securities, whenever these have been acquired or held at the time of IPO or in the 15 years following IPO
4. exemption of social costs on the salaries of personnel linked to R&D activities at a rate of:
    - 100% exemption for the first 3 years following IPO
    - 50% exemption for the next 5 years
    - 25% exemption for the next 7 years

----------end of proposal for change----------