Statement by NEFI on the Consultation Document of the EU Commission on State Aid for Innovation

1. General remarks:

No new State Aid Regime for Innovation

We approve the intention of the Commission not to create a separate State aid regime for innovation but to integrate specific regulations for innovation in the existing legal framework, for instance the SME Block exemption regulation, the Commission Communication on State aid and Risk Capital ("Risk capital guidelines") or the R&D Community Framework. (Question 1) A new regime for innovation would counteract the objective of simplifying the EU State aid law.

Block exemption for State Aid for Innovation to SMEs

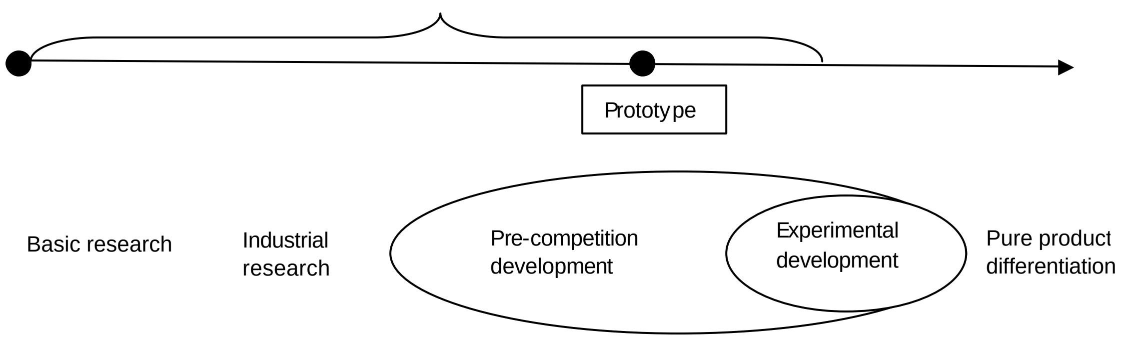
We support the intention of the Commission to simplify the procedural regulations for innovative SMEs as per EU definition and for activities at a distance from the market. We share the opinion of the Commission that the danger of sustained distortions to competition is lower for such enterprises and activities than for larger enterprises and activities close to the market.

Innovation includes Experimental Development

We welcome the intention of the Commission to support State aid for innovation in the EU in the future on a larger scale. The Commission proposes to introduce new regulations for innovations that relate to technological innovation as defined in the Oslo Manual (see item 25). We support this, since the definition of the Oslo Manual takes account of the increasing importance of services in the modern technological and knowledge society.

In this sense innovation is a continuous process which starts at one end with the different stages of research and development activities (R&D) and leads at the other end to measures that serve the introduction of the innovation in the market. The Commission describes this last phase of technological innovation as experimental development. This stage includes, besides the purchase of licences and machinery required for production, also measures such as staff retraining and marketing. However, product differentiation that aims at modifications of a purely aesthetic nature, is not included in experimental development.

Technological Innovation Activity



An expansion of support for innovation to cover all innovation stages will ensure a "one-stop-shop" support and might contribute to sustainable activity in innovation.

Market Failure is better described as Market Inefficiency

The term 'market failure' can be misinterpreted. Market failure does not mean that a market for specific services / a specific product does not exist (complete discrepancy of supply and demand). Thus, market failure should rather be interpreted as market inefficiency. Market inefficiency is the result of a situation where the markets do in practice not fulfil the theoretical, ideal preconditions, for instance complete information, negligible transaction costs, no external effects, financing restrictions due to less developed capital markets. If markets are inefficient, individual (private) and macroeconomic (social) costs and returns diverge. This implies that the return for the individual enterprise, for instance from R&D activities, is lower than the macroeconomic return (compare Question 2).

This leads to an investment activity in the area of R&D that is too low from a macroeconomic perspective. Looking at private costs and returns this is rational, however from a macroeconomic perspective this is inefficient because the social optimum will not be achieved. State support for R&D may help to overcome this market inefficiency by reducing the gap between private and social costs and returns. This must not be a loss-making business for the State since the State will participate in the positive external effects by obtaining higher revenues from taxes and social insurance.

The specific degree of market inefficiency in a given situation cannot be identified precisely because the deficits in comparison with a theoretical perfect market cannot be quantified. Thus, the degree of market inefficiency can only be estimated or determined by approximation through the examination of indices/studies.

In the area of R&D/innovation finance SMEs as per EU definition and newly-established enterprises are particularly affected by the phenomenon of market inefficiency (see item 15). However, market failure does not only refer to the above-mentioned groups. Larger enterprises active in R&D are also affected by market failure when seeking finance and for this reason they also need State incentives in order to carry out innovation. Innovation by this group of enterprises should be eligible for support over the entire innovation cycle described above.

For the reasons stated above, market inefficiency is all the more pronounced the earlier the state of the technological investment activity (basic research, industrial research) is, which means the more distant it is from the market. Thus, the admissible maximum State aid intensities should be higher for earlier innovation stages than for later stages.

Making Incentive Effects plausible

We agree with the Commission that State aid for innovation must have an incentive effect on the respective company to carry out the innovation planned (see item 19). If the company would make the investment also without State aid such State support would exclusively result in windfall effects. In practice, however, it is difficult to provide precise evidence for the incentive effects since many factors (not only the granting of State aid) play a role in companies taking their investment decisions. For this reason it must be sufficient to make the incentive effect plausible by a standardised set of questions (see Question 3).

State Aid for Innovation independently of Support of regional Cohesion

State aid for innovation should not be linked with the objective of achieving regional cohesion (Question 6). Innovation finance may indeed have a regional component – for instance if a regional technology cluster is supported – but this has to be taken separately from the aspects of regional cohesion.

In order to take account of the regional dimension, however, it is useful to allow the cumulation of State aid for innovation and regional State aid. State aid for innovation should not lead to a ban on additional regional support. Excessive utilisation of State aid can be curbed through the implementation of cumulation ceilings.

2. Support for the Start-up and Expansion of new innovative Enterprises

We hold the view that limiting the eligibility for State aid to newly-established and small enterprises in accordance with the EU definition is too restrictive. We rather recommend that also larger SMEs, for instance enterprises with an annual turnover of up to EUR 500 million, should be eligible for State aid regardless of the age of the enterprise (Item 38, Question 8) since these enterprises in particular make an important contribution to innovation activity in Europe.

Furthermore we suggest to integrate private innovators being in the process of starting a company into the new rules. To help these innovators to get their plans set up, they should benefit from State aid to the same extent as newly established firms. In this context e.g. prestudy loans could be helpful to foster the pre-seed phase.

We think that the planned regulation to allow State aid to innovative start-ups up to a total amount of EUR 1 million over a period of three years (item 39 (2)) is insufficient especially for innovation-prone larger companies. Thus, we favour increasing the maximum State aid amount to EUR 2 million.

We welcome the proposal of the commission to eliminate the term of 'eligible costs' in the new State aid regulations for innovation (see Item 37, Question 8). On principle, in the context of innovation all costs related to the investment should be eligible for State support.

Especially in the event of newly-established enterprises liquidity and financing bottlenecks frequently occur during the early stages. These usually are typical start-up difficulties of such enterprises. For this reason we think that the Commission should clearly state in its planned regulations that these enterprises are not "firms in difficulty" and that in consequence the existing "Community Guidelines on State aid for rescuing and restructuring firms in difficulty" do not apply here.

3. Closing the Equity Gap through Support for Risk Capital measures in the EU

We have already made detailed statements on the revision of the "Commission communication on State aid and risk capital" ("Risk capital guidelines") in the context of the Commission consultation of Member States on this issue. On this occasion we proposed, among others, that mezzanine capital should be included in the "Risk capital guidelines" because mezzanine capital is of particular importance for the financing of innovation (see Question 10).

We welcome the intention of the Commission, contrary to the regulations in place up to now in the "Risk capital guidelines", to enable support for enterprises by providing equity/mezzanine capital also beyond the start-up phase through to the expansion stage (item 40). This takes account of the fact that, besides young enterprises, established SMEs are often also facing an equity gap.

We support the considerations of the Commission in the event of seed-stage financing to allow higher state participations in risk capital funds than was possible up to now (50% in non- assisted, 70% in assisted areas) (item 44). Especially due to the existence of market failure private capital providers are often not willing to invest in enterprises in their seed or early development stages.

However also established enterprises frequently face these problems.
Here the State has to ensure that market inefficiencies are corrected and that these enterprises will be made more attractive for private equity. Here, too, the Commission should take account of market inefficiencies by setting the minimum requirements for private equity ratios not too high.

We expressly support a block exemption regulation for private equity measures (item 43). Given the fact that since the "Risk capital guidelines" entered into effect the Commission has gained comprehensive experience in the area of support for private equity, we think that a wide-ranging need for notifying risk capital measures is no longer required. Observance of the block exemption requirements may be reviewed by the respective State aid providers in the Member States. However, the Commission might reserve control rights in order to verify in individual cases whether the block exemption requirements have been met.

4. State Aid for the technological Testing and Cushioning of Risks connected with the Marketing of innovative Products

We welcome the inclusion of experimental development in State aid for innovation as planned by the Commission. For innovative enterprises in particular it is important to receive State aid not only during the early R&D stage but also to receive "one-stop-shop" support during the entire period through to the market introduction of technologically new products and services (Question 11). As does the Commission, we regard the stage of experimental development as part of the stage of pre-competitive activities (compare 1. above). For this reason we support the view, in opposition to the proposal put forward by the Commission, that the current level of State aid intensity of 25% for pre-competition development activities in the R&D Community framework should also be applied to experimental development activities. This would simplify the shaping and design of promotional programmes and ensure appropriate and continuous support over the entire innovation process.

We welcome the intention of the Commission to include activities conducted by the eligible enterprise in the context of R&D projects even if the services are contracted out to another firm (item 50 (8)). Due to their limited personnel resources, smaller enterprises in particular frequently face problems in implementing innovative activities in-house. In order not to endanger the innovation project such enterprises should be allowed to contract out services to other firms.

5. Supporting the Development of Centres of Excellence through Collaboration and Clustering

We welcome the support proposed by the Commission to allow the emergence of centres of excellence and clusters (see item 63ff.) since regional networks (clusters) play an important catalyst role in order to harness innovation potentials in the context of the transfer of research results. Regional clusters can support innovation by lowering transaction costs (e.g. through the emergence of regional labour markets for specialised human capital) and especially by producing a local knowledge dynamics among the cluster protagonists (network externalities) that contribute to the spill-over of technological know-how.