
State aid for Innovation

A London Response November 2005



State Aid Consultation

1. INTRODUCTION

1. Greater London Enterprise welcomes this consultation and recognises the need for the Commission to adopt State aid measures on innovation, particularly in the light of the relaunch of the Lisbon agenda. Despite the progressive attitude of the UK Government to State aid for innovation, there is still not enough being done to promote this issue across the EU. As such, we are happy to contribute to the debate and the improvement of the current legal framework.
- 1.1. On 17th November 2005, GLE organised a round table discussion in London to develop a response to the European Commission's 'Consultation Document on State aid for innovation'. The event brought together high-level experts in the field of State aid and innovation policy; delegates represented a cross section of London, including representatives of universities, economic development agencies, local authorities, innovation support services, community finance organisations, and a representative from the Department of Trade and Industry.
- 1.2. The discussion was based on the following **five questions**, adapted from the Commission's 'Consultation Document on State aid for Innovation':
 - **Q1:** Do you think the problems and market failures, identified by the European Commission as hampering innovation, are accurate?
 - **Q2:** Is State aid the right tool to address these market failures?
 - **Q3:** What is your opinion of the Commission's key principles governing State aid for innovation? (In particular, should State aid support only be authorised to technological innovation?)
 - **Q4:** What do you think of the Commission's proposed measures to promote experimentation and risk-taking?
 - Supporting creation and growth of innovative start-ups
 - Tackling the equity gap to increase risk capital
 - Technical experimentation and launching innovative products
 - **Q5:** What do you think of the Commission's proposed measures to encourage a supportive business environment for innovation?
 - Encouraging innovation intermediaries
 - Encouraging training and mobility
 - Supporting the development of poles of excellence through collaboration and clustering
- 1.5. Discussion focused on these five questions (rather than all 20 questions of the 'Consultation Document') in order to lend structure to the debate; the questions were general enough to stimulate a wide-ranging debate, while still addressing the core themes of the Commission's consultation. These questions were circulated to delegates before the event.

- 1.6 The five questions were discussed in relation to the main objectives of the Commission's intended actions. A briefing paper outlining these objectives was also circulated to delegates before the event, giving them the opportunity to familiarise themselves with the main themes of the consultation.
- 1.7 This submission is based on issues raised at the round table discussion and on delegates' responses to the five questions.

2. MARKET FAILURES

Do you think the problems and market failures, identified by the European Commission as hampering innovation, are accurate?

Delegates to the Greater London Enterprise roundtable on 17th November 2005:

- 2.1 generally agreed with the market failures identified by the European Commission – i.e. a lack of common rules and standards; weaknesses in financial and labour markets; non-functioning product markets; insufficient R&D policy co-ordination between countries, and; general ‘systemic’ inefficiencies, such as poor industry-academia interaction, lack of collaboration and networking, and lack of an entrepreneurship ‘culture’.
- 2.2 acknowledged that the issue of State aid for innovation is particularly challenging due to the fact that ‘innovation’ is broad concept and, therefore, is difficult to define.
- 2.3 argued that innovation tends to be a product of small businesses, rather than larger corporations. Therefore, as the small business sector faces significant market failures, the European Union is failing to fulfil its full innovation potential.
- 2.4 recognised that, given the urgency of the Lisbon Agenda, there is a political imperative to reduce the market failures hampering small businesses. Currently, the total State aid for innovation received by this sector is relatively small, and European Commission State aid rules could, therefore, be significantly modified. The European Union’s robust definition of the small and medium-sized enterprises (SME) would facilitate such modifications.
- 2.5 emphasised that innovation can be applied to three core components of enterprise success: product innovation, access to markets and management. Businesses require all these elements to succeed in the market place; a company with an innovative product, for instance, will not be successful if it does not have access to markets. As market failures can impact on small business success across all these areas, State aid should not be limited to product innovation.

3. STATE AID TO ADDRESS MARKET FAILURES

Is State aid the right tool to address these market failures?

Delegates to the Greater London Enterprise roundtable on 17th November 2005:

- 3.1 agreed that State aid is the right tool to address many of the market failures affecting SMEs. It was acknowledged, however, that in the UK State aid is often viewed rather pejoratively; delegates preferred to talk about 'public policy intervention'.
- 3.2.1 recognised, however, that not all market failures can be resolved by State aids. For example, intellectual property is a key issue for all innovative SMEs. Delegates encouraged the European Commission to put in place a simple, affordable and time efficient patenting process which can allow Europe to compete with the US system.
- 3.2.2 emphasised that, similarly, innovation is dependent on the presence of entrepreneurs with the technical qualifications to start businesses. This issue relates more to immigration policy than to State aids; the US, for example, have a very liberal immigration policy, linked with universities, which has brought innovative individuals into the country – in Silicon Valley, for instance, a significant percentage of entrepreneurs were born in India or China.
- 3.2.3 Innovation is also closely linked to university funding. This is another area where the US is superior to the European Union – indeed, spin-out companies are much encouraged in the US. As well as promoting State aids for innovation, the European Union should support measures to make universities a more integrated part of the businesses environment.
- 3.2.4 Finally, there is no single financial services market in the EU; this constitutes a major barrier to SME growth and development.
- 3.2 Delegates considered that the European Commission should draw a distinction between direct (i.e. government 'hand-outs') and indirect government intervention (e.g. tax incentives etc.). In the field of innovation, direct aid may be useful in some sectors (e.g. environmental technology, rapid prototyping products and the building of pre-production products) but this should be the exception, not the rule. Generally, it was felt that governments should not put money directly into companies.
- 3.3 Any grants for innovation, for example, should be highly competitive and designed to incentivise businesses, rather than substitute what they would have done anyway (for example, the UK Department of Trade and Industry's Research and Development grant programme).

(NB: The 'Incentive effect' is one of the key principles put forward by the Commission's consultation document: "State aid for innovation must have an incentive effect and result in the beneficiaries changing their behaviour in the desired way. Aid should be granted only if it can be shown that, without it, the proposed innovation activities would not have been undertaken.")

4. KEY PRINCIPLES

*What is your opinion of the Commission's key principles governing State aid for innovation?
(In particular, should State aid support only be authorised to technological innovation?)*

Delegates to the Greater London Enterprise roundtable on 17th November 2005:

- 4.1 generally welcomed any public intervention that can contribute to the objectives of the Lisbon agenda. As recommended by the Commission, government interventions should take place when market failures occur and should vary according to the type of activities concerned. Importantly, State aid must support SMEs without impeding the growth of other businesses that are also contributing to the Lisbon objectives.
- 4.2.1 emphasised – in relation to the European Commission's key principle governing State aid for innovation, "At this stage, it is proposed that ex-ante rules for State aid for innovation be restricted to those activities that relate to technological innovation" – that State aid can not be limited to technological innovation.
- 4.2.2 underlined the broad definition of 'innovation'. Indeed, the concept of innovation can be applied to a range of contexts, such as management methods and sales and marketing and procedures, as well as technological innovation. State aid for technological products only is too limited.

5. PROMOTING EXPERIMENTATION AND RISK-TAKING

What do you think of the Commission's proposed measures to promote experimentation and risk-taking?

Delegates to the Greater London Enterprise roundtable on 17th November 2005 supported State aid initiatives to promote experimentation and risk-taking in the following areas:

- 5.1 *Tackling the equity gap:* Innovative small businesses from across Europe must be able to access appropriate finance in order to grow. Many small businesses have a clear knowledge gap when it comes to accessing early stage equity finance and loans. 'Investment readiness' programmes can be highly effective in addressing this issue.
- 5.2 *Experimental state of research:* State aid should support innovative SMEs in the experimental stage of research, not just in the development of prototypes. Moreover, State aid rules should be more generous when a company's profit is going to be reinvested back into the research process.
- 5.3 *Mentoring initiatives:* Mentoring support is crucial for high-growth SMEs and can be even more valuable than financial support. In particular, delegates felt that businesses benefit greatly from being able to tap into investors during the early stages of their development in order to assess the business opportunity behind the technical idea.
- 5.4 *Market development support:* Similarly, as innovators are not necessarily sales people, market development support can be extremely beneficial – for example, helping to present ideas effectively to the market, to brand products and to identify cheap manufacturing opportunities.

6. ENCOURAGING A SUPPORTIVE BUSINESS ENVIRONMENT

What do you think of the Commission's proposed measures to encourage a supportive business environment for innovation?

Delegates to the Greater London Enterprise roundtable on 17th November 2005:

- 6.1 welcomed the Commission proposals to encourage a supportive business environment for innovation.
- 6.2 emphasised that the provision of short term workspace can be particularly useful in encouraging a supportive business environment for innovation. Currently, many opportunities to provide such workspace are lost due to complex State aid procedures.
- 6.3 felt that, if the goals of the Lisbon Agenda's goals in the field of competitiveness are to be met, State aid must go beyond helping small businesses in Assisted Areas only.