

August 2022

ITRE DRAFT REPORT ON THE IMPLEMENTATION OF THE EIC

INPUT TO MEMBERS OF THE ITRE COMMITTEE OF THE EUROPEAN PARLIAMENT FROM THE EIC BOARD



Summary of key points

The EIC Board welcomes the engagement of the ITRE Committee of the European Parliament in the critical issues for the successful implementation of the European Innovation Council. Many aspects of the EIC are advancing well (e.g. the EIC Pathfinder and Transition instruments) and the EIC Accelerator which provides a unique combination of grant and equity funding to early stage startups has seen a huge demand and the rapid selection of several hundred high potential startups and SMEs for support. However, the changes being introduced by the Commission on the EIC Fund have resulted in major delays in funding and investment decisions to these companies, and undermine the critical contribution the EIC can make to improve Europe's innovation performance, deliver on the EU's policy ambitions for the twin green and digital transition, and achieve future strategic autonomy.

In support of the ITRE Committee's considerations, we recommend the following improvements and actions in the short term (to be completed by December 2022) which are particularly critical in the more adverse current funding environment for new deep tech companies

- 1. Implement the full transition solution for the EIC Fund immediately** to clear the backlog of companies awaiting financing, building on the success of the EIC pilot phase.
- 2. Remove immediately the requirement for single award decisions** involving the College of Commissioners for each investment and grant decision, as it slows down the process and contradicts the rationale for indirect management (designed to protect the Commission against liabilities).
- 3. Continue with the successful model from the EIC pilot of co-investing where possible with other investors** in order to leverage larger financing rounds to Europe's most promising companies with high risk but potentially ground breaking innovations.

¹The EIC Board is established by the Council Decision (EU) 2021/764 to provide advice on the strategy and implementation of the EIC. Its 20 members were appointed by the Commission in November 2021, see https://eic.ec.europa.eu/eic-communities/eic-board_en

4. To ensure that EIC support and funding flows rapidly to new applicant companies and therefore **avoid the proposed freeze on the 2023 EIC budget on condition that the EIC Fund is operational** and able to make timely investment decisions.
5. Let the transition solution operate until the midterm review and use this time to conduct a **proper assessment of the performance of the transition solution as well as the institutional options for the EIC including the option of a Union agency. Current decisions on the EIC Fund should avoid pre-empting the outcome** of this assessment.

Original Idea

The European Innovation Council (EIC) was established to be a one-stop shop that would identify and provide scale up support for breakthrough technologies and game changing innovations. It was expected to take risks that the market would not take alone, and bridge a critical early-stage financing gap for deep tech companies looking to bring forward disruptive innovations, where the EU lacks funds of necessary scale when compared to the US and China, through flexible instrumentation and agile policy making.

A new and unprecedented form of “blended finance”, which combined grant and equity investment in a single aggregated support, was envisaged to catalyse and crowd in private investment into scalable deep tech companies in Europe. Such crowding in, or syndication, was inspired by common practice in venture capital, and designed to leverage the domain knowledge and expertise of more specialised funds, and in turn ensure that EIC beneficiaries would be viewed as credible propositions by the market when seeking additional follow-on funding.

Further, by incorporating support for the development and commercialisation of emerging science and technologies at earlier stages of development, the EIC was positioned to draw on and maximise the impact of Europe’s world leading research base.

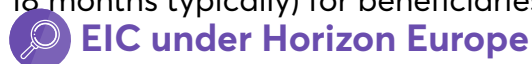
EIC Pilot

During the EIC pilot phase under the Horizon 2020 programme (2018-20), the EIC brought together several pre-existing Horizon 2020 instruments, including in particular Future and Emerging Technologies (FET), which evolved into the EIC Pathfinder and the SME Instrument (SMEi), which evolved into the EIC Accelerator.

A new legal entity, the EIC Fund, was also established with the agreement of all concerned Commission services as a legal entity owned and directly managed by the Commission to deliver equity investments under the EIC Accelerator.

The Fund was incorporated in June 2020, became operational in September 2020, and made rapid progress to conclude investment decisions from preceding rounds with significant learning. The time to investment approached market norms towards the end of the pilot, and by the end of the pilot phase, the EIC Fund had made over 140 investment decisions with approved investments worth over €600 million, making it the largest deep tech investor in Europe. Importantly, and in keeping with its founding mission, it was successful in attracting private investors to co-invest in early stage deep-tech start-ups, leveraging 2.7 Euro of additional equity for every Euro of EIC investment. In addition, over 50% of the investment agreements signed by the Fund under the pilot took the form of convertible loans, to act as a bridge to the next fundraising round (12-

18 months typically) for beneficiaries.



+ [Pathfinder](#)

The EIC Pathfinder has built on its strong foundations, and attracted over 1,000 proposals under its Open and Challenge led calls. Its potential impact has also been strengthened through the introduction of Programme Managers, a novelty, to pro-actively identify and target support for key emerging technologies. Demand has outstripped available funding with a success rate of ca. 7.5% in 2021.

+ [Transition](#)

A new initiative under Horizon Europe, the EIC Transition scheme looks to support the commercialisation of groundbreaking ideas previously supported through Pathfinder/ FET or ERC Proof of Concept (PoC). The Open and Challenge led calls of 2021 attracted just under 300 applications and resulted in 42 funded projects of which 60% originated from the ERC PoC with nearly 40% of all projects coordinated by start-ups/spin-outs.

+ [Accelerator](#)

Demand for support and "blended finance" in particular has continued to be strong with each call (two calls in 2021 and two completed to date in 2022) attracting over 1,000 proposals, with an increased share requesting the equity component.

In implementing Horizon Europe, the Commission has decided – contrary to the successful pilot phase - to make use of indirect management for the purposes of managing the EIC Fund. The aim was to reduce risks and potential liabilities for the Commission and accommodates operational constraints namely, the requirement for additional staff to manage the growing portfolio of investments and appoint company board members or observers where required.

In the suggested transition phase, the EIC Fund remains under direct management (i.e. is a Commission owned entity) but an independent Fund manager is being appointed to take investment decisions and management. In the longer term (expected by the end of 2022), the aim is to transfer ownership of the EIC Fund to an external body, e.g. the EIB, to complete the move to indirect management.

Furthermore, a "Single Award Decision" for each selected company to cover both the grant and maximum equity investment was introduced. Here, we understand that the Commission decided that this should not follow the normal practice of delegating such decisions to the operational level, and required instead a decision at the level of the College of Commissioners, at least for the duration of the current and planned transition period.

In combination with other factors, these changes have:

- + Significantly already increased and may further increase complexity in the decision-making process causing confusion for applicants, and resulting in long and unacceptable delays in equity financing for companies (currently approximately 1 year since the close of the first competition, and ca. 9 months since the companies were aware of the final outcome).

- + Led to significant delays to grant funding where companies seek blended finance as both the grant and equity components must be approved through a “Single Award Decision” by the College, which handicaps the key novelty of blended finance;
- + Raised the risk of a loss of critical coordination between the grant (EISMEA administered), the Business Acceleration Services (BAS - also EISMEA administered) and delegated equity (EIB/ Alternative Investment Fund Manager, AIFM, administered) components, endangering the blended finance approach; and caused significant reputational damage to the EIC reversing the progress and strong profile built up during the pilot.

In our statement of 9 February 2022, the EIC Board urged the Commission to implement a “speedy completion of a minor restructuring of the EIC Fund while maintaining continuity from the successful pilot, so that it can recommence investments in the coming weeks” and emphasised that this should “build on the success of the pilot with fast decision making by a team independent of sectoral or political interests, and with clear responsibilities and a mandate for high-risk investments”. We regret that 6 months later, the EIC Fund is still not operational and able to take investment decisions. The EIC Board has engaged regularly with the Commission. We established a small Board working group on the EIC Fund, which met regularly and provided written and verbal advice to the Commission. Furthermore, the EIC Fund has been a discussion item on the agenda of every Board meeting. In particular, we welcome that following our advice, the Commission has moved away from a fragmented structure involving multiple investment partners and we understand is now focused on a long term solution based on a single EIC Fund. However, despite our efforts the progress on implementation of the EIC Fund has been too slow.

We therefore welcome the engagement of the European Parliament and its ITRE Committee as we consider the decisions on the EIC Fund to have political implications including for the Union’s objectives on open strategic autonomy on emerging technologies and the importance of breakthrough innovations for climate, energy, food security, health and many other policy goals.



Recommendations

It is clear that the changes introduced by the Commission have resulted in major delays in funding and investment decisions under the Accelerator, and undermine the critical contribution the EIC can make to improve Europe’s innovation performance, deliver on the EU’s policy ambitions for the twin green and digital transition, and achieve future strategic autonomy.

Recent developments in the VC market add to the frustration as the EIC is ideally positioned as a critical counter-cyclical initiative: evidence from previous economic downturns for example show that VCs move away from first investments in early-stage, pre-revenue startups and especially capital-intensive companies with longer time horizons to revenue and profitability (e.g. semiconductors), and reserve more capital for their existing portfolio companies. Such startups will in turn be pushed to slow growth and investment in exchange for extending cash runways and if seeking more capital, faced with valuations that will flatten or more likely go down.

Nonetheless, early indications suggest that European VC fundraising remains robust and VC fund managers across different financing stages have continued to attract capital in recent months. As valuations reduce and improved deal terms become available, there is a clear opportunity for the EIC to take the lead, identify credible propositions and catalyse private investments in deep tech startups bringing forward innovative solutions that address key policy challenges.

To achieve this however, **the Commission must immediately complete the restructuring of the EIC Fund to make it fully operational and enable fast decision making in line with market needs**. Further, given trends in the VC market, the current uncertainty surrounding the EIC's budget and the implementation of its programme must be removed, albeit recognising that the transition arrangements and the proposed long-term solution for the EIC Fund necessitated by the decision of the Commission to opt for indirect management, still need to demonstrate that they are workable and fulfil the EIC objectives.

Immediate attention should instead be focused on restoring operational excellence, at least to the level achieved by the end of the pilot phase, and the performance of the EIC including that of the EIC Fund should be closely monitored against the Key Performance Indicators (KPIs) developed and published recently by the EIC Board, including on speed of time to grant (4-5 months) and investment decisions (8 weeks²)³.

This monitoring will provide a clear evidence base on the impacts of the EIC organisational set up, including the proposed solution for the EIC Fund. Therefore, we recommend that a full assessment of the EIC institutional set up, and in particular for the EIC Fund, is conducted in time to inform the mid-term review of Horizon Europe (in 2024) and subsequent budget discussions. This should include an assessment of the merits of establishing the EIC as a Union Agency or other institutional form, to enable the EIC to better fulfill its objectives in supporting and scaling up high-risk technologies and startups, ensure fast and integrated delivery of a range of innovation actions (one stop shop), crowd in other investors, and enable effective collaboration with other initiatives and Member State actions. Such work should start immediately in order to be ready for the mid-term review to take appropriate decisions if need be. In addition, any decisions taken now on the EIC Fund by the Commission should include review clauses and flexibility to move to another structure as needed following the mid-term review. In particular, if the Commission decides to proceed with the proposed long term solution of transferring ownership of the EIC Fund from the Commission to the European Investment Bank, clauses should be included in the agreement to enable the transfer of ownership back to the Commission or another Union entity if this is the outcome of the mid-term review. In addition, it should be ensured that returns to the EIC Fund remain within the EIC Fund.

We recommend the following improvements and actions in the short term (to be completed by December 2022):

- + Implement the full transition solution immediately** to clear the backlog of companies awaiting financing and building to the extent possible on the pilot phase.
- + Let the transition solution operate until the midterm review and use this time to conduct a proper assessment of the performance of the transition solution as well as the institutional options for the EIC including the option of a Union agency. Current decisions on the EIC Fund should avoid pre-empting the outcome** of this assessment.
- + Remove immediately the requirement for single award decisions** involving the College of Commissioners for each investment and grant decision, as it contradicts the rationale for indirect management, designed to protect the Commission against liabilities and address the day-to-day issues of managing the growing equity portfolio of the EIC Fund.

²Date of investment decision from the start of the due diligence exercise.

³<https://eic.ec.europa.eu/system/files/2022-06/KPI%20EIC-1.pdf>

- + Establish an Advisory Committee to the AIFM's Investment Committee with members who understand the specificities of the EIC and whose membership is endorsed by the EIC Board.
- + Ensure full involvement of the Commission and EISMEA in the Advisory Committee (or any other relevant structured coordination mechanism) to enable essential coordination with policy objectives and between the operational components of blended finance (grant, equity and BAS).
- + Ensure that any members or observers appointed to the Boards of investee companies by the EIC Fund have the right expertise to add value (e.g. in venture building, market/business acumen)
- + Ensure that the aggregate fees paid to bodies external to the Commission are in line with market norms, represent good value for money, and that the fees (both management and success) are not multiplied because of a multi-party approach.
- + Maintain a proactive funding stream and investment approach to achieve key strategic priorities such as with respect to promoting women and widening country success, and retain agility to keep pace with and/or react to market conditions.
- + Maintain flexible instrumentation and agile policy making through institutional learning. The EIC is the testbed for innovation policy approaches, as was evident already in the response to the Covid pandemic and Ukrainian war.

Finally, whilst the EIC Board understands and shares the ITRE Committee's frustration at the delays, increased bureaucracy, and uncertainty introduced by the Commission's decision to move to indirect management, **we do not support the proposal to withhold part of the EIC's budget for 2023 (i.e. EIC Accelerator budget) as the focus should be getting funding to flow immediately.** With the more adverse current funding environment for new deep tech companies, the growing importance of addressing European challenges: green transition, renewable energies and storage to replace fossil fuels, technological sovereignty in for example semiconductors and quantum computing, the significant new investment from competitor countries e.g. the US Chips and Science Acts, the large number of funding applications received by the EIC (and subsequent low success rate), and the original rationale for establishing the EIC to address the European innovation funding gap, **it is more important than ever to have a properly functioning EIC** and an efficient market facing flow of investments to the companies that need them.

The EIC Board advocates that there are no further delays and that the management procedures put in place for the EIC Fund are compatible with the market norms, entrepreneur friendly, proactive for example in increasing success from companies based in widening countries and companies with female leadership, and catalytic in attracting and crowding in additional investment and expertise. To this end the EIC Board has established and published a set of Key Performance Indicators (KPIs) – including operational excellence – by which the management procedures established by the Commission and the EISMEA Agency should be judged and if appropriate amended. The EIC Board has taken a constructive approach to help solve the current challenges and remains at the service of the EU institutions to help and advise going forward.

⁵From the start (i.e. investment round) or after a convertible loan (possibly completed/matched by other investors) for a maximum period of 18 months allowing for a subsequent investment round.