D3.1 - Literature Review and data collection

WP 3 - Innovation and Access to Finance

Deliverable: Literature Review and data collection
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1. Introduction

Access to Finance is a key driver in the creation (Cassar, 2004; Aghion et al. 2007; Popov and Roosenboom, 2013; Kim et al. 2016), survival (Tsoukas, 2011) and growth (Aghion et al. 2007; Rahaman, 2011) process of firms, and especially for smalls (Beck and Demirguc-Kunt, 2006) and innovative firms (Lee et al., 2015). Small and innovative firms have more constraints and difficulties to access to finance, because they tend to have riskier projects and business models (Lee et al., 2015). Like access to finance is important for firms activities, it can consequently foster economic growth (Kim et al., 2016) and influence positively innovation (Wang, 2014; Brown et al., 2009).

Furthermore, it was demonstrated that innovation has a positive impact on economic growth (see e.g. Hasan and Tucci, 2010; Galindo and Méndez, 2014). The importance and linkage of this two variables (Figure 1), has placed innovation in the heart of the Europe 2020 Strategy.

Promoting Research and Development (R&D) activities is the main goal of the EU 2020 Strategy in order to achieve a level of total (public and private) R&D spending of at least 3% of GDP. Presently, the European Union Member states exhibit a lower performance than the US and Japan, mainly due to the lower levels of private R&D investment (European Commission, 2011b:1).

The Innovation Union is one of the seven flagship initiatives of the EU 2020 Strategy, which has the aims: to improve access to finance for R&D; ii. to get innovative ideas to market; iii. to ensure growth and jobs (European Commission, 2014b). This initiative is divided in 34 commitments and the present report focusses on commitments 10 to 13 (see Figure 2), with the aims to identify and explain the main mechanisms related to them. To this purpose we present a review of the literature on the different commitments’ thematics.

**Figure 1. Impact of access to finance on economic growth**
*Source: Authors own elaborations based on Brown et al. (2009); Hasan and Tucci (2010); Frontiers Economics (2013); Galindo and Méndez (2014); Kim et al. (2016).*

**Figure 2. Purpose of commitment 10 to 13 of Innovation Union**
*Source: Authors own elaboration based on European Commission (2014b).*

<table>
<thead>
<tr>
<th>Commitment #</th>
<th>Purpose (Progress so far)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commitment 10</td>
<td>Put in place EU level financial instruments to attract private finance</td>
</tr>
<tr>
<td>Commitment 11</td>
<td>Ensure cross-border operation of venture capital funds</td>
</tr>
<tr>
<td>Commitment 12</td>
<td>Strengthen cross-border matching of innovative firms with Investors</td>
</tr>
<tr>
<td>Commitment 13</td>
<td>Review State Aid Framework for Research, Development and Innovation</td>
</tr>
</tbody>
</table>
More than 80 scientific articles related to the present working package thematics, i.e. innovation and access to finance, were retrieved from several electronic platforms, such as, ScienceDirect, SpringerLink, Taylor & Francis, Wiley Online Library, JSTOR, EconLit and Google Scholar. We have selected a range of papers based on keywords such as “innovation”, “finance”, “R&D”, “SMEs”, “venture capital”, “business angels”, “matching”, “cross-border” and “state aid”. Despite, priority have been give to studies focusing on Europe, research based on other regions and countries in the world have been also assessed.

The present report is divided in four main sections. The first section aims at presenting a brief overview of the main issues at stake: SMEs and access to finance. The second section focuses on commitment 10 (Put in place EU level financial instruments to attract private finance) and the link between debt or equity finance and innovation and economic growth. The third section intends to explain the rational of commitment 11 and 12 based on cross-border and matching firms (demand) with investors (supply). The fourth section is dedicated to commitment 13 (Review of State Aid Framework for Research, Development and Innovation) and to assess the effectiveness of state aids in leveraging R&D investment.
2. Access to finance, SMEs and innovation: an overview of the problem

**Why do firms need finance?** Essentially, firms need finance to invest in assets or for day-to-day business operations (Figure 3). The final target is: i) to increase production, productivity and/or reduce costs, in order to be more competitive; ii) to develop new products, for maintaining or increasing market share; iii) to adapt technologies and products to new market conditions (e.g. regulations and consumer tastes); iv) to start a business; v) to pay daily financial commitments. The first three motivations are namely linked with the promotion of growth or expansion of established firms. The last one can be applied to both, new or existing firms.

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>PURPOSE</th>
<th>TARGET</th>
</tr>
</thead>
<tbody>
<tr>
<td>Why firms need finance?</td>
<td>In what firms use finance?</td>
<td>What's the aim of finance?</td>
</tr>
<tr>
<td>Invest in Assets</td>
<td>Tangible (e.g. buy new equipment or expand the facilities)</td>
<td>• Growth and expansion • Creation process</td>
</tr>
<tr>
<td></td>
<td>Intangible (e.g. R&amp;D activities)</td>
<td>• New products or services • New markets</td>
</tr>
<tr>
<td></td>
<td>Suppliers (stock and materials)</td>
<td></td>
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<tr>
<td></td>
<td>Employees (wages)</td>
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<tr>
<td></td>
<td>State (tax)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Banks (loans, interest and other financial services)</td>
<td>• Growth and expansion • Creation process • Survival of firms</td>
</tr>
<tr>
<td>Day-to-day business operations</td>
<td>Other financial commitments</td>
<td></td>
</tr>
</tbody>
</table>

*Figure 3. Main objective, purpose and target of firms finance*

Source: Authors own elaboration.

Liquidity for day-to-day business operations is crucial in businesses where firms need money in order to be able to produce goods (or more goods) to sell. Indeed, the time period between receiving from customers and payments to suppliers is not always the most convenient for firms. Companies have to fulfill their financial commitments with suppliers, employees, state, banks and other entities, independently of receiving promptly money from their customers. For newly established firms or in the process of being created, to start a business involves not only the initial capital expenditure for buying equipment and/or R&D investments but also liquidity to buy stock of material in order to start production and for day-to-day running business. In all these cases, internal or external sources of finance need to be used.
Where can firms get access to finance? Firms can get access to finance by internal or external ways, using equity or debt instruments. Equity finance consists in retained earnings, sale of assets (both internal sources), or when investors from outside join the company with capital (external source). “Debt refers to the funds that are borrowed from an [internal or external] creditor and which need to be repaid at a future point in time” (European Commission, 2014a:12).

According to Casson et al. (2008), in general firms tend to have some preferences for the modes of financing, with debt preferred to equity since it involves less loss of control rights. This trend is also visible in the EU small and medium enterprises, which answered in the Survey on the Access to Finance of Enterprises (SAFE) that external debt finance instruments, such as bank loan and credit line, are more relevant than internal funds (Figure 4).

How do firms choose or can get access to a source of funding? Access to different sources of funding (Figure 5) depends on the risk level (firm or investment project), the state of firm maturity, the amount of funds needed (Manigart and Witmeur, 2009:9), the firm size, age, and information availability (Berger and Udell, 1998:623), growth goals, the nature of ownership and the activity sector (Riding et al., 2012). For example, small firms compared to larger have less access to formal sources of external finance (Beck and Demirguc-Kunt, 2006). According to Manigart and Witmeur (2009), in the early stage or seed, when the risk is higher and if the amount of investment is low, firms usually use private sources, such as, personal saving of founders, family or friends (3F). Banks usually fund companies with a low level of risk and equity financing through Venture Capitalists or Business Angels, can represent an alternative in the early stage of the company (Figure 6).
How easy is it to have access to external financing? According to the Community Innovation Survey (CIS) and Survey on the Access to Finance of Enterprises (SAFE), ‘access to finance’ is in the top 5 of the main obstacles for EU enterprises (Figure 7). This problem is even more pressing for innovative firms\(^1\) than for non-innovative ones and it is the obstacle where the difference between innovative and non-innovative firms is higher. Indeed, according to Lee et al. (2015:371) innovative SMEs have a higher probability for applying than other firms (higher demand), but they are also more likely to find it difficult to access to finance (restricted supply).

\[\text{Figure 6. Source of funding and the maturity of company}\]

\[\text{Source: Manigart and Witmeur (2009:9).}\]

**Figure 7. What is currently the most pressing problem your firm is facing?**

*Source: European Commission (2014a)*

Why innovative-firms find more difficulties to access to finance? The outcomes of an investment in innovation are often uncertain, because technological change produces uncertainty for all the economic actors involved (Mazzucato, 2013). First, there is uncertainty intrinsic to the research project - Will it be successful? Will the new product be working? A second source of uncertainty

\[\text{1 An innovative firm is one that has implemented an innovation during the period under review (OECD, 2005).}\]
rests in the product acceptance in the market - Will the innovator be able to sell its product? A third source of uncertainty concerns investment returns – how much time is needed to recover the expenses of the original investment? Finally, if innovation results are uncertain, this generates higher perceived risks both for investors and entrepreneurs. Due to uncertainty and risk, traditional financial markets and financial institutions are reluctant to invest in R&D projects compared to more traditional business projects (Mazzucato, 2013). However, when firm have difficulties to finance innovation activities, these activities also induce innovations in finance (Peneder and Resch, 2015). Firms need to find alternative channels to traditional bank loans, in order to finance their creation or expansion investments. Thus, when private sources are insufficient, banks refuse loans and governments’ grants are not suitable for a specific project, the remaining options are: i) convincing a Business Angels to invest; ii) finding an established industrial company interested in the project (corporate Venture Capitalist); or iii) going to a Venture Capitalist (Bottazzi and Da Rin, 2002:234). Indeed, according to Riding et al. (2012), firms that invest in R&D are more likely to seek equity financing. Moreover, for innovative firms, equity funding is also associated with R&D intensive innovation, while for incremental innovation, debt financing is more often used (Casson et al., 2008).

How can credits constraints affect entrepreneurship, innovation and growth? Joseph Schumpeter was the first scholar to defend the idea of the existence of “a strong connection between innovation performance of an economy and the functioning of its credit and capital market” (Mazzucato, 2013:852). According to the Schumpeterian theory, the entrepreneur through its innovation activities contribute to economic growth since when innovations are successful firms benefit from competitive advantages in markets that are detrimental to competitors. In the short-term, if competitors do not react correctly, they can lose their market position, gradually decline and even disappear. Schumpeter called this phenomenon the process of “creative destruction”, when something new (innovation) destroy something old (already in the market). However, according to Schumpeter “innovation requires a credit system and the system is a result of this necessity” (Mazzucato, 2013:852). Therefore, its theory of economic development stands on two pillars: i) innovation that increases productivity in production, trough entrepreneurship and technological advance, which allow economic development; ii) finance that supports thsz innovations (Burlamaqui and Kattel, 2014:189). The process of economic development is not restricted to technology, it is merely the result of interactions among finance (credit), entrepreneurship and competition by means of innovation (Burlamaqui and Kattel, 2014:187). For Schumpeter, “as a precondition of innovation, venture finance opens new trajectories of industrial activity” (Peneder and Resch, 2015:29).

Credit constraints can also have an effect on the cyclicality of investment (Aghion et al., 2010) and on R&D activity (Aghion et al., 2012). According to Aghion et al. (2010), long-term investment is countercyclical when financial markets are perfect, and procyclical, when firms are charactised by credit constraints. The same trend is also observed for R&D investment, however, only for firms in sectors that depend more heavily upon external finance, or that are characterized by a low degree of asset tangibility (Aghion et al., 2012).

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2 For more details see Schumpeter (1942).
3 Countercyclical phenomena happen when an expansion takes place in a recession period or vice versa, whereas, a procyclical trend relates to an evolution in the same way than the overall economy (increase in expansion period and decrease when the economy is slowing down).
Taking into account the importance of Venture Capital investors, already highlighted by Shumpeter, and Business Angels, in the present study, special attention will be given to both equity finance instruments (see definition in Figure 8). Venture Capital is effective in supporting firms to overcome credit and financial constraints (Botazzi, 2002 and 2009), but the selection process of firms backed by VC is hard, complex and slow. According to Manigart and Witmeur (2009), for each 100 applications to VC funding only 1 are accepted. This is why European Commission under Horizon 2020 includes a specific section on ‘Access to Risk Finance’. Indeed, part of the Horizon 2020 budget will not be provided through grant funding but in the form of risk-sharing (for loans and guarantees) and by providing risk finance (equity) (González, 2013). “This covers a set of debt and equity financial instrument facilities and a range of accompanying measures that scale up and refine the debt financial instruments and the early-stage equity facility” (European Commission, 2014b:35). On the debt side, two instruments need to be highlighted, namely the Risk-Sharing Facility Financing (RSFF) and the Risk-Sharing Instrument (RSI).

![Figure 8. Debt and equity finance instruments focused on the report](Source: Authors own elaboration based on [1] EC Website and [2] Metrick and Yasuda (2010:3-4).)
3. Financial instruments for growth and innovation

Under the commitment 10 of H2020, the European Commission highlights that the EU market fails in attracting private R&D investment and promoting new innovative business, because there is also a market failure in the access to finance (Figure 9). One goal of the European Commission (2014b:35) is to close the market gaps in investing in growth and innovation, namely by putting in place financial instruments to support investment in early stages of start-up development, to enhance venture capital investment for fast growing firms and to ensure access to loans for innovative fast growing SMEs. The present section focuses essentially in understanding: i) why and how putting in place new financial instrument could attract private finance; and ii) how and when Venture Capital (VC) and Business Angel (BA) can foster innovation and economic growth.

Figure 9. Commitment 10 map
Source: Authors own elaboration based on European Commission (2014b).

3.1. Debt Finance and Risk-Sharing

Bank loan is the most common example of debt finance and the selection process is essentially based on the credit risk. According to Zribi and Boujelbène (2011), Louzis et al. (2012), Chaibi and Fiti (2015), the determinants of credit risk rest both on macroeconomic and microeconomic dimensions. These authors showed that growth of GDP, inflation, exchange rate, interest rate, unemployment rate and public debt are the main macroeconomic variables that influence the level of the risk. At the micro-level, they highlight firms’ financial performance (such as, return on equity, solvency ratio and leverage), firm size and ownership structure as main factors. Inevitably, as the size of the firm matter, SMEs have more constraints in accessing the credit market (Beck and Demirgürç-Kunt, 2006) and the obstacles are still higher for innovative firms (Lee et al., 2015). However, according to Angilella and Mazzù (2015), when banks are faced to an innovative SMEs, the assessment of credit risk and
the linked uncertainty can be improved by experts’ judgments, because in these cases evaluation based on business plans, market trends and the managerial capacity of a team are not enough. On the other hand, is also important to highlight that firms’ risks over the innovation cycle are non-linear and are distinct across the different phases (Docknet and Siyahhan, 2015). The R&D phase corresponds to the phase where the risks are higher compared to the other next steps of the innovation cycle (Figure 10) and where firms needs for funding are the highest.

<table>
<thead>
<tr>
<th>Innovation phase</th>
<th>R&amp;D</th>
<th>Trial</th>
<th>Market Introduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk level</td>
<td>Risk is high as the firm faces high operating leverage originating from R&amp;D fixed costs together with technological uncertainty.</td>
<td>Risk is significantly lower and dominated by option risk to launch the product in the market.</td>
<td>Risk is equivalent to the asset risk of the company.</td>
</tr>
</tbody>
</table>

*Figure 10. Risk level over the innovation cycle*  
*Source: Docknet and Siyahhan (2015).*

When financial markets don’t work properly, government intervention is needed in order to close the market gaps in investing in innovation. Under the seventh Framework Program (FP7), the European Commission launched two financial debt instruments, i.e. the Risk-Sharing Facility Financing (RSFF) and Risk Sharing Instrument (RSI) in order to help firms with a highly risky project to have access to bank loan.

Risk-Sharing Facility Financing (RSFF) is an instrument launched in 2007 through a partnership between the European Investment Bank (EIB) and the European Commission. It is expected that every euro provided by the partners will be translated into five euros of Research, Development and Innovation (RDI) investment (see appendix 1). RSFF “will cover, through capital allocation and provision, the risks borne by the EIB when lending directly to the promoter, or when guaranteeing loans made by financial intermediaries, e.g. banks in Member States and Associated Countries”⁴. This debt-based financial instrument promotes investments in RDI projects with high innovation potential that might otherwise not occur, due to the high risk⁵ and uncertainty (European Commission, 2011a:6). Private investment and finance are also encouraged because the beneficiary must provide a share of investment from its own resources or from other investors as well (European Commission, 2011a:7). On the other hand, once a project is selected by the EIB, it becomes more attractive and confident for other private investors, thanks to the EIB’s expertise in evaluating complex and high-risk projects (European Commission, 2011a:7).

Risk Sharing Instrument⁶ (RSI) is a facility under RSFF to support innovative SMEs and Smaller Mid-caps managed by the EIB and the EC through the European Investment Fund (EIF). Under RSI scheme,  


⁵ RSFF coverage project which risk is comparable with the following categories used by global ratings agencies for sovereign and corporate debt: from ‘BBB−’ to ‘B−’ of S&P and Fitch and from ‘Baa3’ to ‘B2’ of Moody’s (European Commission, 2011a:7).

the EIF is providing guarantees to banks and leasing companies, which supports SMEs and Small Mid-caps with innovation potential or with a focus on R&D and innovation. Reducing credit risks and lower capital consumption achieved through the guarantee, the EIF encourages financial intermediaries to extend new loans and leases to innovative enterprises on more attractive terms.

3.2. Equity Finance

The European Private Equity & Venture Capital Association (EVCA), recently re-named “Invest Europe”, defines Private Equity (PE) such as, a form of medium to long-term equity investment into private companies not listed on the stock exchange. According to this association, “Private equity builds better businesses by strengthening management expertise, delivering operational improvements and helping companies to access new markets”.

Studies have demonstrated that Private Equity can improve performance of PE-Backed firms (Frontier Economics, 2013), increase innovation, measured by patent applications, (Popov and Roosenboom, 2009b) and help new business creation (Popov and Roosenboom, 2009b; Samila and Sorenson, 2011). On the other hand, according to Gemson et al. (2012), PE can leverage the investment amount and even to share the risk of a project. These authors showed that: i) projects with PE investment were larger than when compared to project with no PE funding; and ii) in developing countries, PE investment in infrastructure have a higher number of sponsors, without any corresponding increase in the project size, which means that PE investors can help to share the project risk. With all these interactions between inputs, outcomes and impacts, it is expected that Private Equity activity leads, at the end, to economic growth (Figure 11).

![PE Activity diagram](image-url)

Economic Growth

**Figure 11. Private Equity activities and economic growth**

**Source:** Frontier Economics (2013:15).

There are many types of private equity investors and funds, however, in the present study we only focus on Venture Capital and Business Angels, since Venture Capital is more dedicated to start-up companies with innovative ideas and Business Angels to the seed investment.

### 3.2.1 Venture Capital

The concept of Venture Capital was born in 1946 in the USA and “has become the form of financial intermediation most closely associated with dynamic entrepreneurial start-ups\(^8\), especially in high-tech industries like biotechnology, information technology (IT) and e-commerce” (Bottazzi and Da Rin, 2002:233).

Venture Capitalists provide financial, managerial and monitoring support, however, the role of this entity depends on the firm stage in which the support is offered (see Figure 12). According to Hellmann and Puri (2000:980), VC provides different contributions for different types of companies: “for imitators, venture capital matters in terms of providing financial resources, and for innovators, it matters in other dimensions, such as for instance product market aspects”.

<table>
<thead>
<tr>
<th>STAGE OF FIRM</th>
<th>ROLE OF VENTURE CAPITALIST</th>
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<tbody>
<tr>
<td>Seed finance</td>
<td>Help to explore the viability of a project, financing small investment, which allows entrepreneur to verify whether the project is feasible and economically attractive.</td>
</tr>
<tr>
<td>Start-up finance</td>
<td>Support the company organization and corporate strategy. Investment is aimed to start and operationalize the firm: contracting employee, developing prototype, implementing marketing test, etc.</td>
</tr>
<tr>
<td>Expansion finance</td>
<td>Help to find additional clients and suppliers, recruit marketing and other non-technical executives. Financial support is needed in order to reach industrial-scale production, upgrade the production facilities and attract further employees.</td>
</tr>
<tr>
<td>Later stage finance</td>
<td>Financial assistance to become market leader and support company in the VC exit stage for trade sale or Initial Public Offering (IPO).</td>
</tr>
</tbody>
</table>

*Figure 12. The stage and roles of venture capital financing
Source: Authors own elaboration based on Bottazzi and Da Rin (2002:237).*

The selection process of VC funded firms is essentially based on firms’ characteristics and performance. In general, innovating firms are more likely to obtain venture capital investment and faster compared to imitator firms (Hellman and Puri, 2000). VC tends to select firms with a higher number of patent applications (Engel and Keilbach, 2007), profitability, labor productivity, sales growth and R&D activities (Guo and Jiang, 2013). However, what is motivating firms to use venture

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\(^8\) Start-up is defined as “a new company created by an entrepreneur in a high-tech industry” (Bottazzi and Da Rin, 2002:235).
financing or choosing another source of finance? According to Peneder (2010), who conducted a survey among Austrian VC-backed firms and non-VC-backed, VC-financed firms prefer VC not only because other sources of finance are less easily available but also because taking into account the amount of investment they are often inappropriate.

The studies assessing the impact of Venture Capital (see appendix 2) can be divided in four different levels:

- Firm-level (e.g. Hellmann and Puri, 2000; Bottazzi and Da Rin, 2002; Davila, Foster and Gupta, 2003; Engel and Keilbach, 2007; Capizzi et al. 2011; Croce et al., 2013; Guo and Jiang, 2013; Paglia and Harjoto, 2014; Colombo et al., 2016);
- Country-level (e.g. Groh, von Liechtenstein and Lieser, 2010; Geronikolaou, and Papachristou, 2012; Prohorovs and Pavlyuk, 2013; Faria and Barbosa, 2014);
- Industry-level (e.g. Kortum and Lerner, 2000; Sahaym et al., 2010; Hirukawa and Ueda, 2011);
- Regional-level (e.g. PISTORESI and Venturelli, 2015).

From a methodical point of view, as we can see in Appendix 2, the Venture Capital impact assessment is essentially divided in two approaches: counterfactual analysis, when the study is carried out at the micro-level, and panel data regression models for assessment studies at country, industry and regional-levels. The counterfactual analysis helps to understand what would happen to a firm if it is not VC-backed, whereas, macro or meso analysis allows one to estimate the impact of VC investment in the economy, region or sector, taking into account also the spillovers or externality effects arising from others firms and sectors. The choice between both approaches depends on the objectives of the study, but more importantly on data availability.

At the firm-level, several authors (Davila, Foster and Gupta, 2003; Colombo and Grilli, 2005; Engel and Keilbach, 2007; Guo and Jiang, 2013; Paglia and Harjoto, 2014) found that on average VC backed firms outperform non-VC backed firms. From a subjective entrepreneurial point of view, the results of a survey conducted among Austrian firms indicates that, to be VC-backed improves financial management and leads to higher diversification of products and internationalization (Peneder, 2010).

The presence of VC firms has also a positive impact on growth (Davila, Foster and Gupta, 2003; Paglia and Harjoto, 2014) and in company’ size (Colombo and Grilli, 2005), measured by the number of employees (increase of jobs). However, according to Paglia and Harjoto (2014) the durability of this impact is shorter. This conclusion is in line with the results of Capizzi et al. (2011:224) who found that the presence of VC or PE seems to enhance productivity (value added per employee) but only in the short term (year of VC entry). However, these authors also report that after VC or PE entry, funded firms gain greater access to bank credit at better terms (certification effect). This conclusion converges to the findings of Davila, Foster and Gupta (2003), which defend that Venture Capital funding is an important signal about the quality of the start-up project/investment.

Other interesting conclusions were also emphasized by Engel and Keilbach (2007), Capizzi et al. (2011) and Guo and Jiang (2013), which focus on German, Italian and Chinese firms respectively. These authors showed some evidence that VC does not improve innovation. According to Engel and Keilbach (2007), after a VC investment, the difference between venture-funded and non-venture-
funded firms in the probability to apply for at least one patent is insignificant. Capizzi et al. (2011) demonstrated that after VC and PE entry the growth and investment in fixed assets slowdown. Guo and Jiang (2013) found no evidence of improvement in sales growth or R&D investment of the VC-backed firms after the VC entry. Some explanations highlighted by the authors are that VC seems to focus rather on commercialization of existing innovations and growth of the firm (Engel and Keilbach, 2007) or in the implicit aim to consolidate firms’ result (Capizzi et al., 2011). Peneder (2010) also added, in a study on Austrian firms, that the higher innovation performance of VC-financed firms is the result of a VC selection process and not the direct causal effect of VC financing on innovation. According to the author, this implies that Venture Capitalist tend to finance and select firms that already have an above average level of innovative activity rather than rendering firms more innovative.

At country and industry level analysis, Geronikolaou and Papachristou (2012), Faria and Barbosa (2014) and Hirukawa and Ueda (2011) also report similar conclusions for the European countries and US industry than Engel and Keilbach (2007) and Capizzi et al. (2011). When innovation is measured by patent applications, Hirukawa and Ueda (2011) econometric results suggest that patenting activities slowdown in the US industry, once firms obtain VC funding. At European level, Geronikolaou and Papachristou (2012) demonstrated that VC investments do not cause patents but patents cause VC investment, which suggest that innovation precedes VC investment. However, Faria and Barbosa (2014), found that VC financing in the later stage of the firm’s creation has a positive impact on innovation, which suggests that VC is more helpful in the commercialization of innovation results rather than to foster its creation.

Certainly, if the main goal of VC is the maximization of financial return (Metrick and Yasuda, 2010:3), it can be expected that this source of funding focuses more on the profitability of investments already carried out and with a market potential rather than on more uncertain projects’ investments.

In general, venture capitalists invest in firms with the aim to exit after 4 - 7 years and to realize a positive return on investment (Schwienbacher, 2008:1888). According to Prohorovs and Pavlyuk (2013), the level of the country economic development and the level of the Initial Public Offering are important determinants of VC investment. Exit conditions for VC are also important in the selection process of firms to be funded. Schwienbacher (2008) found that start-up financed by VC choose their innovation strategy (innovative or imitative) based on the investors’ exit preferences (see exit route option in Figure 13). For example, “more innovative and profitable ventures are more likely to go to an IPO than ventures with more imitative or derivative projects” (Schwienbacher, 2008:1911).

<table>
<thead>
<tr>
<th>EXIT ROUTE</th>
<th>DESCRIPTION</th>
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<tbody>
<tr>
<td>Initial Public Offering (IPO)</td>
<td>The company is listed on stock market and the VC share is sold to one or different investors</td>
</tr>
<tr>
<td>Trade Sale (TS)</td>
<td>The venture is sold to another company which acquires the innovative technology, if the entrepreneur does not find the funds required to buy out the VC</td>
</tr>
<tr>
<td>Liquidation</td>
<td>The entrepreneur is unsuccessful in developing the new product and the venture is liquidated</td>
</tr>
</tbody>
</table>

Figure 13. Description of main Venture Capitalist exist route
Source: Authors own elaboration based on Schwienbacher (2008:1895).
What about country attractiveness for Venture Capital and Private Equity (VCPE)? According to the VCPE country index, developed by Groh, Liechtenstein, Lieser and Biesinger (2010), United States is the country enjoying the better conditions to attract VC and Private Equity in 2016, regarding to the six key dimension underlying the index: i) Economic Activity; ii) Depth of Capital Market; iii) Taxation; iv) Investor Protection & Corporate Governance; v) Human & Social Environment, vi) Entrepreneurial Culture & Deal Opportunities. United Kingdom and Germany are the only two EU countries in the TOP 10 (Table 1). Luxembourg is the last country in the TOP 30, Poland and Spain exhibit a similar scores and are also ranked at the end of the TOP 30 (Table 1).

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Rank</th>
<th>Country</th>
<th>Score</th>
<th>Rank</th>
<th>Country</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United States</td>
<td>100</td>
<td>Malaysia</td>
<td>85.6</td>
<td>21</td>
<td>France</td>
<td>80.3</td>
</tr>
<tr>
<td>2</td>
<td>United Kingdom</td>
<td>95.5</td>
<td>12 Denmark</td>
<td>85.4</td>
<td>22</td>
<td>Taiwan</td>
<td>79.4</td>
</tr>
<tr>
<td>3</td>
<td>Canada</td>
<td>94.3</td>
<td>13 Norway</td>
<td>85.2</td>
<td>23</td>
<td>Austria</td>
<td>78.5</td>
</tr>
<tr>
<td>4</td>
<td>Singapore</td>
<td>93.3</td>
<td>14 Finland</td>
<td>85.2</td>
<td>24</td>
<td>China</td>
<td>77.1</td>
</tr>
<tr>
<td>5</td>
<td>Hong Kong</td>
<td>92.7</td>
<td>15 Sweden</td>
<td>84.6</td>
<td>25</td>
<td>Poland</td>
<td>73.7</td>
</tr>
<tr>
<td>6</td>
<td>Australia</td>
<td>91.9</td>
<td>16 Netherlands</td>
<td>84.4</td>
<td>26</td>
<td>Spain</td>
<td>73.7</td>
</tr>
<tr>
<td>7</td>
<td>Japan</td>
<td>91.8</td>
<td>17 Ireland</td>
<td>82.2</td>
<td>27</td>
<td>Chile</td>
<td>73</td>
</tr>
<tr>
<td>8</td>
<td>New Zealand</td>
<td>88.7</td>
<td>18 Belgium</td>
<td>81.6</td>
<td>28</td>
<td>Thailand</td>
<td>71.5</td>
</tr>
<tr>
<td>9</td>
<td>Germany</td>
<td>88.6</td>
<td>19 Israel</td>
<td>81.3</td>
<td>29</td>
<td>India</td>
<td>69.9</td>
</tr>
<tr>
<td>10</td>
<td>Switzerland</td>
<td>85.7</td>
<td>20 Korea, South</td>
<td>80.8</td>
<td>30</td>
<td>Luxembourg</td>
<td>68.9</td>
</tr>
</tbody>
</table>

Table 1. TOP 30 Venture Capital and Private Equity country attractiveness index, 2016
Source: Venture Capital & Private Equity Country Attractiveness Index website
Note: TOP 30 in 125 countries.

3.2.2. Business Angels

Another equity financing instrument, which shares some similarities with Venture Capital, is represented by Business Angels. The EBAN (European Trade Association for Business Angels, Seed Funds and Early Stage Market Players) Glossary\(^9\) defines a business angel as "an individual investor (qualified as defined by some national regulations) that invests directly (or through their personal holding) their own money predominantly in seed or start-up companies with no family relationships". Business Angels provide not only financial support for high-risk projects and start-ups, but also assistance in the management and strategy development (Dibrova, 2015:286). The main differences between a Venture Capital and a Business Angels are that: i) Business Angels focus more in the seed and early stage than Venture Capitalists (Dutta and Folta, 2016) and consequently in firms or projects with a higher risk (Manigart and Witmeur, 2009:9); ii) Business Angels have a more limited capacity of funding than Venture Capitalist (Hellman and Thiele, 2015:640). Nevertheless, like for Venture Capitalists, the potentially high return on investment (ROI) and the exit strategy are also two important criteria for investors and entrepreneurs (Dibrova, 2015:283), which influence the selection process.

Despite the critical importance of Business Angels for an entrepreneurial economy (Mason and Harrison, 2015), the majority of impact assessment of private equity are more focused on venture capitalist (Dutta and Folta, 2016). However, in the last years some studies have been carried out such as Mason and Harrison (2015), Hellman and Thiele (2015) and Dutta and Folta (2016).

Mason and Harrison (2015) shown that, during the 2008 financial crisis, business angels played an important role in the UK economy, through financing entrepreneurial businesses when banks and venture capitalists reduced their levels of investments.

Regarding to this last conclusions, how could Business Angels and Venture Capitalist interact in the market? Are these entities complementary? Hellman and Thiele (2015) studied the interrelationship between both types of investors and found that, on the one side, they are complementary, because Business Angels have limited funds and need VCs for providing the follow-on funding of their company, and VC also needs Business Angels for their own deal flow. However, on the other side, they are also competitors, when at the later stage the venture capitalists no longer need the Business Angels to make the investment funding (Hellman and Thiele, 2015:640).

In the light of these findings, what can be said about the performance of Business Angels and Venture Capitalist? Dutta and Folta (2016) compare Business Angels and Venture Capitalist on the basis of a sample of made North American firms. They found that group composed of Business Angels and early stage VCs have a similar impact on the innovation rate, measured by patent applications. However, the findings also conclude that there are no marginal benefit of receiving VC investment if a firms had already received funding form Business Angels (or vice versa), because the effects are non-additive (Dutta and Folta, 2016:41). Regarding to the success in the commercialization phase, the authors found that the impact of VC is higher compared to the Business Angels’ one.
4. Cross-border and matching innovative firms with investors

4.1. Cross-border venture capital investment

With the aim to promote better access to finance for SMEs, the European Commission introduced in 2011 a new regulation, entered into force in 2013 and with the goal to make it easier for venture capitalists to raise funds across Europe for the benefit of start-ups (European Commission, 2014b:36). By removing the obstacles and improving the fiscal environment of VC, the European Commission seeks a more efficient European venture capital market, able to enhance innovation, competitiveness and growth. The goal of commitment 11 of Horizon 2020 (Figure 14) is precisely to ensure cross-border operation of venture capital funds.

The literature about the geography of venture capital investment (see e.g. Mason and Harrison, 2002; Guo and Jiang, 2013; Jääskeläinen and Maula, 2014; Espenlaub et al., 2015) converge about the importance and added value of cross-border venture capital. On the one hand, the supply of venture capital is not equally distributed across regions and in order to close the gap in the most disadvantaged areas, firms need to attract VC from elsewhere (Mason and Harrison, 2002). Actually, VC is even more effective in the poorest regions in promoting regional economic growth (Pistoresi and Venturelli, 2015). On the other side, foreign VC compared to domestic VC appear to add more value to firm after the investment, as demonstrated Guo and Jiang (2013). These authors, which compared the effect of foreign and domestic VC investment on Chinese firms’ performance, explain their results by highlighting that foreign VCs have more expertise in monitoring and providing support to their portfolio companies compared to domestic VCs. Another interesting conclusion of the study is that, conversely to domestic VC, foreign VC backed firms intensify their R&D investment after the original investment is made. This finding is very relevant if we compare with the results of other studies which do not make a distinction about the location of the portfolio of VC companies.
and the location of private equity firms. Espenlaub et al. (2015) also found that cross-border VC investment could speed up VC backed firms’ performance in North America, because the time to exit through IPO (initial public offering) or an M&A (merger and acquisition) is shorter than for domestic VC investments. However, the exit performance is also linked with the degree of economic freedom in the domestic country (Wang and Wang, 2012) and could be improved through partnerships between foreign and local VC (Dai et al., 2012).

4.2. Matching innovative firms with investors

The commitment 11 previously cited is also linked with the commitment 12 (Figure 15) whose target is to strengthen cross-border matching of innovative firms with investors. Indeed, it is important not only to improve the financial ecosystem, but also to develop instruments focused on: i) Matching the supply and demand sides for innovative projects and ideas, through intermediaries’ organizations; ii) Developing a new ‘financial culture’ among entrepreneurs, improving their knowledge in finance and in different forms of support; and iii) Promoting the cooperation among Business Angels and Venture Capitalists.

![Figure 15. Commitment 12 map](image)

*Source: Authors own elaboration based on European Commission (2014b).*

‘Enterprise Europe Network’ is an example of an interactive platform, created by the European Commission with the aim to connect SMEs and match business opportunities. Services are offered to SMEs by its member, such as chambers of commerce and industry, technology centers, universities and development agencies.

Networking, partnership and cooperation are keywords in fostering access to finance (Dai et al., 2012; Jääskeläinen and Maula, 2014) and in making the innovation ecosystem more efficient (Samila and Sorenson, 2010; Colombo et al., 2016).

Network in financial intermediaries could mitigate the effects of distance in cross-border venture capital, because it facilitates the identification of investment opportunities among partners and have
also a certification effects about the project quality (Jääskeläinen and Maula, 2014). Partnership between a foreign and local venture capitalist could also improve the VC backed firms’ performance, measured by the success of VC exit (Dai et al., 2012).

The strong interaction between private financial intermediation and public research funding appears to bring positive effects on promoting entrepreneurship (creation of new firms) and innovation (rates of patenting) (Salima and Sorenson, 2010). The study of Salima and Sorenson (2010) show that US regions which receive high levels of public funding to R&D (innovation and firm creation stimulus) are also those who benefit from an influx of venture capital. On the other side, according to Colombo et al. (2016), VC has a positive impact on EU-funded R&D partnerships for new technology-based firms. Both studies highlight the importance of an effective innovation ecosystem as a whole, where different players interact together.
5. State Aid Framework for RDI

In order to assess the effectiveness of the legal framework for RDI State aids revised in 2008, the European Commission conducted in 2011 a Mid-Term Review of the Community Framework for State Aids (European Commission, 2014b:38). The study concluded “that the current Framework has so far constituted a useful instrument for well-targeted public support (…), [however,] the possibilities offered by the R&RD&I Framework and the GBER (General Block Exemption Regulation) have not been utilized by the Member States to their full extent” (European Commission, 2011b:7).

The European Commission launched in 2012 the State Aid Modernization (SAM) and, in order to simplify the granting of RDI aids, a new General Block Exemption Regulation (GBER) was developed (European Commission, 2014b:38).

Commitment 13 focuses on a Review of State Aids Framework for RDI, aims at: i) providing a clearer information about R&D State Aid possibilities and limits; and ii) checking for its contribution to the EU innovation goals (Figure 16). This section will focus on: i) understanding the threshold to incompatibility of state aids with internal market rules; and ii) how and when State Aids can enhance RDI.

**Figure 16. Commitment 13 map**
Source: Authors own elaboration based on European Commission (2014b).

5.1. State Aid and Competition Policy

The focus of industrial policy is on industrial sectors and firms, with the aim to regulate activities, to support innovation and to promote competitiveness and sustainability. For example, state aids that support the manufacturing sector have a positive impact on export performance (Holzner and Stöllinger, 2013) and consequently on the economic growth (Dritsaki and Stiakakis, 2014; Szkorupová, 2014) of Member States. However, in the EU, state aids are also restricted and regulated by the EU competition policy in order to contain their potential negative economic impact.
"The aim of the EU competition policy is to safeguard the correct functioning of the Single Market, [ensuring] that enterprises have the possibility to compete on equal terms on the markets of all member states" (Szczepański, 2014:1).

State aids support can be considered as creating a distortion of competition within the Internal Market of the EU to the extent that it provides an economic advantage to particular entities or sectors, which in turns affects trade between EU Member States (Sciskalová and Münster, 2014:224). The distortion of potential competition only exists "if the aid is considered to hinder the entry of new competitors into the market" (Wishlade, 2003:10) or leads the undertakings to leave the market. On the other hand, state aids also have the function to alleviate market failures. Yet, when the public support is excessive it can represent a barrier to entry for new firms and decrease the real level of competition (Figure 17).

![Diagram](image)

**Figure 17. Functions and potential impact of state aid**
Source: Authors own elaboration based on Sciskalová and Münster (2014), Spector (2009) and Szczepański (2014).

"The EU prohibits in principle any public measure that constitutes a state aid" (Nicolaides, 2013:2), since it is considered incompatible with the definition and purpose of the Internal Market (Szczepański, 2014:12). Nevertheless, some exceptions exist, such as for instance regional aids specifically designed to certain disadvantaged areas, sectorial aids for structural problems in specific sectors and horizontal aids targeting all economic sectors, e.g. R&D activities (Szczepański,

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10 The European Commission defines the internal market as a “single market in which the free movement of goods, services, capital and persons is ensured and in which European citizens are free to live, work, study and do business. Since it was created in 1993, the single market has opened more to competition, created new jobs, defined more affordable prices for consumers and enabled businesses and citizens to benefit from a wide choice of goods and services” (EC Website).
Public funding to support private R&D is an example of state aid allowed, under certain conditions, by the EU law.

5.2. State Aid, Innovation and Effectiveness

When countries or regions are faced with market failures, such as, the difficulty to access to finance, public support can foster innovation (Falk, 2007; Un and Montoro-Sanchez, 2010; Afcha and López, 2014; Radas et al., 2015) and this effect is even higher during crisis periods (Paunov, 2012; Moșteanu and Romano, 2013). According to Paunov (2012), the recent economic and financial crisis led many firms to stop ongoing innovation projects, but firms with access to public funding were less likely to abandon innovation investments. On the other hand, Moșteanu and Romano (2013), who assessed the effectiveness of the EU Competition Policy, also found a positive impact of this instrument on economic development, especially during the crisis period, given its effect on reviving the EU economy.

The main public policies to support R&D activities are: i) grants and direct funding; ii) tax incentives; iii) public-private partnerships; iv) loans and guarantees; v) market regulation; vi) knowledge-based environments (e.g. science parks).

The effectiveness of the public intervention to support R&D was assessed by several authors, such as, Hyytinen and Toivanen (2005); Muscio et al. (2013); Takalo et al. (2013); Antolin-López et al. (2015); Radas et al. (2015). The effect of public instruments on leveraging private R&D or innovation have nevertheless some restrictions.

Hyytinen and Toivanen (2005) found that in the presence of capital market imperfections, public policy can complement capital markets. These authors demonstrated that “firms in industries that are more dependent on external financing invest relatively more in R&D and are relatively more growth-oriented when they can benefit from more government funding (potentially) available” (Hyytinen and Toivanen, 2005:1402). However, when the cost of external finance taken into account, Takato et al. (2013) showed that a higher cost will lead to a lower optimal subsidy amount at the intensive margin.

Radas et al. (2015) found that direct subsidies used alone or with tax incentives enhance R&D activities of the Croatian SMEs compared to firms that did not use any of the two instruments, although the effects of policy measures are not much different when users of direct grants are compared with those who used both the grants and the tax incentives. When the distinction is made between new and established firms, Antolin-López et al. (2015) found that some instruments are more effective than others in fostering product innovation, in function of the firm’s maturity state. These authors conclude that for new ventures the participation in trade fairs and networking with other companies are the most effective support, whereas, for established firms the most effective policies consisted in tax incentives and subsidies to R&D activities.

At last, if we focus on the effectiveness of public R&D spending in leveraging private R&D, Bogliacino and Lucchese (2011) highlighted that investment in public research can also promote private participation in innovation financing and this instrument of the innovation system could be
an alternative when financial market fail, e.g. downturn phases of VC investment. Muscio et al. (2013:63) provide “evidence that government funding to universities complements funding from research contracts and consulting, contributing to increasing universities’ collaboration with industry and activating knowledge transfer processes”.

6. Conclusion

The report has reviewed the main findings and conclusions of studies published in peer-reviewed journals, working papers and in the grey literature, in order to assess the theoretical mechanisms related to the commitments 10 to 13 of the Innovation Union and understand how they can be empirically assessed.

According to the Survey on the Access to Finance of Enterprises (SAFE), access to finance is in the top 5 of the main obstacles for EU enterprises and even this problem is more pressing for innovative firms, because inherent risks associated with their projects. In order to fill the market gap, new debt financing instruments were created by the European Commission in partnership with the European Investment Bank, such as, the Risk-Sharing Facility Financing and the Risk Sharing Instrument. These two tools aim at enhancing the access to finance and leverage private investment, by covering and sharing the risk of a project.

However, not all firms are eligible to RSFF or RSI. Faced with financial constraints, firms need to find alternative solutions for funding their projects or business creations. Venture Capital and Business Angels are two equity financing instruments dedicated to start-up companies with innovative ideas or in the seed stage. Despite VC-backed firms show a higher growth (Davila et al., 2003; Paglia and Harjoto, 2014), financial and innovation performance compared to non VC-backed firms (Engel and Keilbach, 2007; Guo and Jiang, 2013), some studies (e. g. Capizzi et al., 2011; Hirukawa and Ueda, 2011) also showed some limits of these impacts, in particular a slowdown in the innovation performance after the VC investment or the firm entry in the market. Peneder (2010) even found that the higher innovation performance of VC-backed firms is in part the result of a VC selection process (and not only the result of a direct VC intervention in firms) since the innovation efforts of these financed firms are higher before the VC intervention.

To enhance access to finance, matching both the demand (entrepreneurs) and the supply (investors) sides is also very important, because entities such as venture capitalists are not equally distributed around European regions. Networking of financial intermediaries could mitigate the effects of distance in cross-border venture capital (Jääskeläinen and Maula, 2014). In addition, foreign VC compared to domestic VC, appeare to add more value to firms after the initial investment (Guo and Jiang, 2013).

Another way to enhance access to finance and fostering innovation is through public support to R&D activities (see e.g. Falk, 2007; Un and Montoro-Sanchez, 2010; Afcha and López, 2014; Radas et al., 2015). However, Antolin-López et al. (2015) found that some instruments are more effective than others in fostering product innovation, in function of the firm’s maturity state.

Based on to the conclusions of this review of the literature on financing innovation, it could be interesting in the next steps of the I3U project, in order to better assess the impact and limitations of different financial instrument, to include in a single macro-econometric model Venture Capital, Business Angel and Risk-Sharing investments.
7. References


D3.1.1 Literature Review WP3
Innovation and Access to Finance


European Trade Association for Business Angels, Seed Funds and Early Stage Market Players website: http://www.eban.org.


D3.1.1 Literature Review WP3
Innovation and Access to Finance


Invest Europe Website: http://www.investeurope.eu


This project has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 645884.
D3.1. I Literature Review WP3
Innovation and Access to Finance


Venture Capital & Private Equity Country Attractiveness Index website: [http://blog.iese.edu/vcpeindex/](http://blog.iese.edu/vcpeindex/)


8. Appendix

Appendix 1. RSFF Approach

<table>
<thead>
<tr>
<th>Fundamental Research</th>
<th>Applied/Industrial Research</th>
<th>Technological development Prototypes/Pilot projects/IPR</th>
<th>Commercialization</th>
</tr>
</thead>
<tbody>
<tr>
<td>time:</td>
<td>Own funds</td>
<td>Own funds</td>
<td>Own funds</td>
</tr>
<tr>
<td></td>
<td>Grants</td>
<td>Grants + Loans</td>
<td>Equity</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Grants + Loans</td>
</tr>
<tr>
<td></td>
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<td></td>
<td>Loans</td>
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</tbody>
</table>

**Framework Programme (FP) 7**

RSFF loans by EIB and its partner banks

Figure 18. RSFF approach – Loans for R&D

Source: RSFF presentation\(^{11}\).

**FP 7 Contribution:**
Up to € 1 billion

**EIB Contribution:**
Up to € 1 billion

Up to € 2 billion for **Risk coverage** for potential losses (non-repayment of RSFF loans by borrower/beneficiary)

EIB sets aside, on average, 20% of the volume of each individual loan for **risk coverage** (provisions & capital allocations)

Allows EIB to provide **RSFF loans and guarantees** of up to € 10 billion

Figure 19. RSFF approach – Risk-sharing EC/EIB and mobilization of RSFF finance

Source: RSFF presentation.


This project has received funding from the European Union’s Horizon 2020 research and innovation programme under grant agreement No 645884.
## Appendix 2. Venture Capital: Benchmark main studies conclusions’

<table>
<thead>
<tr>
<th>Author</th>
<th>Country (or region) and period</th>
<th>Methodology</th>
<th>Variables</th>
<th>Conclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hellmann and Puri (2000)</td>
<td>US firms (Silicon Valley high-tech start-up)</td>
<td>Counterfactual analysis (VC backed and non-VC backed firms)</td>
<td>Dependent variable: • VC backed or not (probit model) • Time to obtaining VC financing (cox regression) • Amount of funds (OLS regression) Independent variables: • Firm characteristics: age, activity sector, innovator or imitator firm. • VC backed or not</td>
<td>• Innovator firms are more likely to obtain venture capital investment and more quickly than imitator firms. • VC is associated with a reduction in the time to bring a product to market. • The presence of VC increases the amount of funds raised by imitators firms, but not by innovators. • VC provides different contribution to different type of companies: for imitators, venture capital matters in terms of providing financial resources, and for innovators, it matters in other dimensions, such as product market aspects.</td>
</tr>
<tr>
<td>Bottazzi and Da Rin (2002)</td>
<td>European innovative firms</td>
<td>Counterfactual analysis (VC backed and non-VC backed firms)</td>
<td>Dependent variable: • Employment and sales growth Independent variables: • Venture capital financing. • Firm characteristics: age, foreign sales, ROA (return on assets), leverage experience and activity sectors.</td>
<td>• VC is growing fast in Europe, but less than in the US. • VC is effective in helping European innovative firms’ to overcome credit constraints, but still confined to the earlier stages of firm’s life. Venture-backed companies do not generate more sales, create more new jobs and grow faster than non-backed, either before or after the IPO. • European venture capital lacks more human than financial resources.</td>
</tr>
<tr>
<td>Davila, Foster and Gupta (2003)</td>
<td>USA</td>
<td>Mostly firms from Silicon Valley-based companies and primarily technology industries.</td>
<td>Propensity score matching</td>
<td>Presence of Venture Capital Firms has a positive impact on growth, measured by the number of employees. Venture Capital funding is an important signal about the quality of the start-up project/investment.</td>
</tr>
<tr>
<td>Engel and Keilbach (2007)</td>
<td>Germany</td>
<td>Young firms</td>
<td>Counterfactual analysis (VC backed and non-VC backed firms)</td>
<td>Dependent variable: • To be VC funded or not • Firms performance: employment growth or patent application Independent variables: • Firm characteristics: size (number of employees), age and industries sectors. • Time dummies for months: [Month 1, Month 3]</td>
</tr>
<tr>
<td>Capizzi et al. (2011)</td>
<td>Italy</td>
<td>SMEs</td>
<td>Counterfactual analysis</td>
<td>Dependent variable: • To be VC and PE funded or not • Effects on backed firms on firms’ financial indicators Independent variables: • Firm characteristics: size and age; activity (high-tech or not) and location; • Firms’ financial indicators: Intangibles assets; EBITDA; ROE; Capes; Leverage, Growth; Debt.</td>
</tr>
</tbody>
</table>

Table A. Firm level analysis: main characteristics and conclusions (continued on next page)
**Table A. Firm level analysis: main characteristics and conclusions**

Source: Authors own elaboration based on Hellmann and Puri (2000); Bottazzi and Da Rin (2002); Davila, Foster and Gupta (2003); Engel and Keilbach (2007); Guo and Jiang (2013); Paglia and Harjoto (2014).

<table>
<thead>
<tr>
<th>Author</th>
<th>Country (or region) and period</th>
<th>Methodology</th>
<th>Variables</th>
<th>Conclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guo and Jiang (2013)</td>
<td>China</td>
<td>Counterfactual analysis (VC backed and non-VC backed firms)</td>
<td>Dependent variable: Firms’ performance: Return On Sales (ROS); Return On Equity (ROE); Labor Productivity; R&amp;D; Sales growth.</td>
<td>VC-backed firms outperform non-VC-backed firms in terms of profitability, labor productivity, sales growth, and R&amp;D investment.</td>
</tr>
<tr>
<td></td>
<td>Manufacturing industry</td>
<td>OLS panel data</td>
<td>To be VC funded or not Independent variables: VC backed or not (dummy variable); Firm characteristics: Firm size and age; Leverage (total debts over total assets); State ownership; Employee treatment</td>
<td>VCs select firms with higher profitability, labor productivity, sales growth and R&amp;D activities.</td>
</tr>
<tr>
<td></td>
<td>Period: 1998 - 2007</td>
<td>Logit regression model</td>
<td>Firms’ performance: Return On Sales (ROS); Return On Equity (ROE); Labor Productivity; R&amp;D; Sales growth.</td>
<td>After receiving VC investment, the differences in profitability (ROS and ROE) and labor productivity are magnified and higher than non-VC-backed firms.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(probability to be VC funded)</td>
<td>VC characteristics: VC entry period, Domestic VC and Syndicated VC.</td>
<td>No evidence of improvement in sales growth or R&amp;D investment of the VC-backed firms after the VC entry.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Propensity score matching</td>
<td></td>
<td>Foreign VCs add more value to the firms face to domestic VCs.</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>Firms backed by syndicated investment perform better and invest more in R&amp;D after the investment is made compared to those backed by non-syndicated investment and non-VC-backed firms.</td>
</tr>
</tbody>
</table>

| Paglia and Harjoto (2014) | USA                           | Probit regression                | Dependent variable: Sales or employment growth during the post financing period | PE or VC financing positively affect the establishments’ net sales and employment growth rates. |
|                          | Small and medium firms.        | (first stage).                   | Independent variables: Modes of financing: Private equity (PE) or Venture Capital (VC) financing. | The impact of VC financing on establishments’ growth is immediate and larger than PE financing, however, the durability of VC financing impact is shorter than the impact of PE financing. |

**Table B. Sector level analysis: main characteristics and conclusions**

Source: Authors own elaboration based on Kortum and Lerner (2000); Hirukawa and Ueda (2011).

<table>
<thead>
<tr>
<th>Author</th>
<th>Country (or region) and period</th>
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<th>Variables</th>
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<td></td>
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<td>Non-linear least-squares regression</td>
<td>Independent: Venture capital funding</td>
<td>R&amp;D and VC are perfect substitutes.</td>
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<td>Private fund to R&amp;D</td>
<td>Venture firms are more likely to patent and have previous patents cited.</td>
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<td>Public fund to R&amp;D</td>
<td>VC could be responsible for 8% of industrial innovation between 1983 and 1992.</td>
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<td>Dummy for sectors and year</td>
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<td>Hirukawa and Ueda (2011)</td>
<td>US 1968 – 2001 19 industry sectors</td>
<td>Panel Autoregressive model (Patent model)</td>
<td>8 models were estimated, with innovation or VC investment as dependent variable.</td>
<td>The relationship between innovation and VC investment is not in one sense. VC investments can stimulate innovation but also innovation can induce VC investment.</td>
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<td>Dynamic regression models (TFP model): GMM first differences and OLS estimator</td>
<td>Dependent: Innovation (Patent or Total Factor Productivity growth) or VC investment per R&amp;D activity (first round – early stage; follow-on round – later stage; total).</td>
<td>Econometric analysis showed that innovation (measured by Total Factor Productivity Growth) is more likely to induce future VC investment, than VC support innovation.</td>
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<td>Independent: Independent variable lagged 4 time</td>
<td>When patent is used for measuring innovation, results suggest that patenting activities slowdown, once firms obtain VC funding.</td>
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<td>Innovation variable (lagged 4 time) for VC models</td>
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<td>VC variable (lagged 4 time) for innovation model</td>
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</table>
### Table C. Country level analysis: main characteristics and conclusions

<table>
<thead>
<tr>
<th>Author</th>
<th>Country (or region) and period</th>
<th>Methodology</th>
<th>Variables</th>
<th>Conclusions</th>
</tr>
</thead>
</table>
| Groh, von Liechtenstein and Lieser (2010) | • 27 EU countries, Switzerland and Norway  
• Period: 2000 – 2005 | • Rescaling, factor analysis and geometric aggregation. | Dependent variable:  
• Venture Capital and Private Equity (VCPE) country index  
Independent variables - 42 parameters based on the following key drivers:  
• Economic activity  
• Depth of capital market  
• Taxation.  
• Investor Protection and Corporate Governance.  
• Human and Social Environment. Entrepreneurial culture. | • The top performers are the United Kingdom, Ireland, Denmark, Sweden and Norway. Germany ranks slightly above the average. France, Italy, and Spain have rather disappointing scores. Bulgaria, Greece, Slovakia, and Romania are the least attractive European countries for VC and PE investors.  
• Investor protection and capital market are important determinants for attractiveness, but there are also other criteria to consider. Some countries also attract investors with low corporate taxes. The Nordic countries are especially strong in Entrepreneurial Culture. |
| Geronikolaou, and Papachristou (2012) | • 15 European countries  
• Period: 1995 - 2004 | • Dynamic panel data in first differences  
• Causality testing methodology | Dependent variable:  
• VC investment in t or patent applications in t  
Independent variables:  
• VC investment in t-1  
• Patent applications in t-1 | • VC investment doesn’t cause patents but patents cause VC investment > innovation precedes VC investment.  
• In Europe innovation seems to create a demand for VC and not VC a supply of innovation.  
• Innovation ideas seems to lack more than funds in Europe. |
| Prohorovs and Pavlyuk (2013) | • 22 EU countries and 2 groups of countries (Baltic States and countries of the former Yugoslavia and Slovakia)  
• Period: 2012 | • Cluster analysis, factor analysis and regressions methods. | Dependent variable:  
• Venture capital investment per capita.  
Independent variables:  
• Total amount of venture capital per capita.  
• GDP per capita.  
• R&D investments per capita.  
• Turnover of innovative enterprises per capita.  
• Volume of venture capital de-investment per capita.  
• IPO (Initial Public Offering) volume per capita.  
• Country’s attractiveness index for venture capital. | • The economic factors influencing VC investment are clustered in two groups. First group include EU15, Norway and Switzerland. The second group the rest of the sample countries.  
• The IPO and R&D investments volumes have a positive effect on VC investments, whereas, the volume of de-investment (withdrawal of capital from VC projects) has a negative impact.  
• General determinants of VC investment are the level of country economic development and the level of IPO. |
| Faria and Barbosa (2014) | • 17 European countries  
• Period: 2000 - 2009 | • Dynamic panel data estimator (GMM System) with instrumental variables | Dependent variable:  
• Ratio of patent applications at the EPO to GDP.  
Independent variables:  
• Lagged dependent variable;  
• Ratio do total venture capital investments to total investment;  
• Ratio of early stage venture capital investments to total investment;  
• Ratio of late stage venture capital investments to total investment. | • Venture capital has a positive impact on innovation but only in the later stage.  
• Venture capital is more to help the commercialization of innovation rather than to foster its creation. |

Source: Authors own elaboration based on Groh, von Liechtenstein and Lieser (2010); Geronikolaou, and Papachristou (2012); Prohorovs and Pavlyuk (2013); Faria and Barbosa (2014).