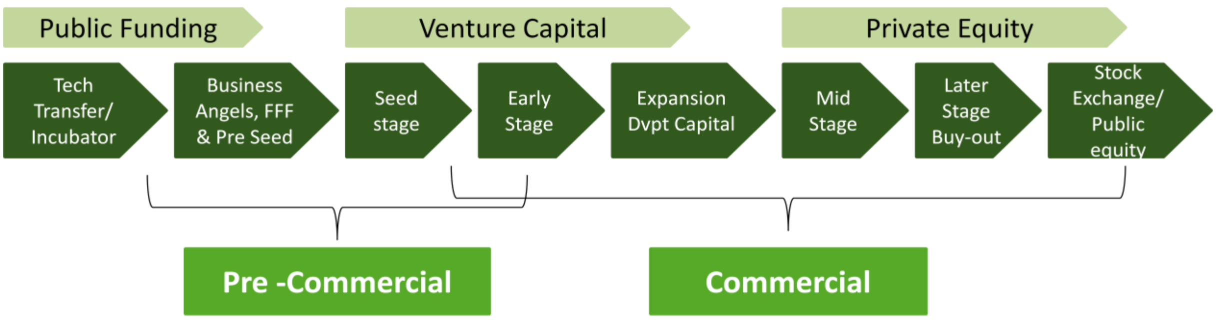
Guide to Public and Private Funding

Introduction to public and private funding

During a company's development, initial funding consists out of interplays between public and private funding in the process of technology transfer from the research institute to the market, from pre-commercial activities to commercial activities. In the pre seed an seed phase, capital comes from the university, different public subsidies and funding programs, but also friends, families, and fools (FFF). These budgets are, however, limited. Therefore from the seed stage onwards, 3rd party capital becomes necessary for most entrepreneurs to reach the proof of concept stage. Private seed capital mainly comes from Business angels (BAs) but there are also some venture capitalists (VCs) and corporate venture capitalists (CVCs) active during this stage.



These latter two investors (VCs and CVCs) become crucial during later stages of development where capital requirements are much higher than the seed capital investments (ranging from around 500,000 euro to 5 million euro and more). These investments require a proof concept and a solid business plan including clear and attractive intellectual property and a well-thought, innovative business model. The seed phase and initial venturing phase also make up the 'valley of death'. It is this phase where most SMEs already fail. Successful capital funding combined with proper management, market expertise and entrepreneurial input by the equity investors are essential to climb out of this valley of death.

This document describes the key players in public and private funding, as well as it provides a support tool in the form of a set of questions guiding you through the initial considerations you face during the search for third parties' capital injections. The funding section of the BIOCHEM ToolBox also holds additional tools with funding and investor overviews as well as more detailed information about private funding.

Key *Public* Funding Opportunities

A variety of governments and government linked agencies provide public funding (grants, subsidies, incentives) that is of interest to organisations active in the field of the biobased economy. What follows are some basic principles to help you understand this funding domain.

General principles

Governments operate under sets of evolving political objectives that determine how they wish to influence society. Grants and subsidies are one important practical mechanism by which they attempt to translate these objectives into reality. The overarching and general objectives of governments are translated into a variety of public funding programmes. Each of these programmes (grant schemes) typically has a particular government agency responsible for its execution. This government agency establishes the work programme for a particular grant scheme: what are the priority areas and activities that will be funded, who can apply under which conditions and when, what are funding rates, etc. Grant schemes typically have a limited lifetime and very often launch regular invitations (calls) to the outside world to submit proposals for projects. Proposals describe a methodological plan by which the candidate recipients of a grant will execute a project: proposed activities, expected results, timeline, budget, possibly the other partners (consortium) with which this project will be executed. Project proposals are evaluated and scored by the funding government agency and in many cases, proposals from multiple candidate grant recipients compete for the funds to be allocated. If a proposal is awarded a grant, then the applicants start executing the proposed work, justify activities towards the government, and are reimbursed for the costs made in the context of this work.

Types of funding agencies

A multitude of government agencies provide public funding for projects. These agencies can be regional, national, or European, all managing their own programmes with their own conditions and characteristics. Examples of European programmes that are of interest to the biobased economy are FP7-Cooperation, LIFE+, and Eco-Innovation.

Funded domains and activities

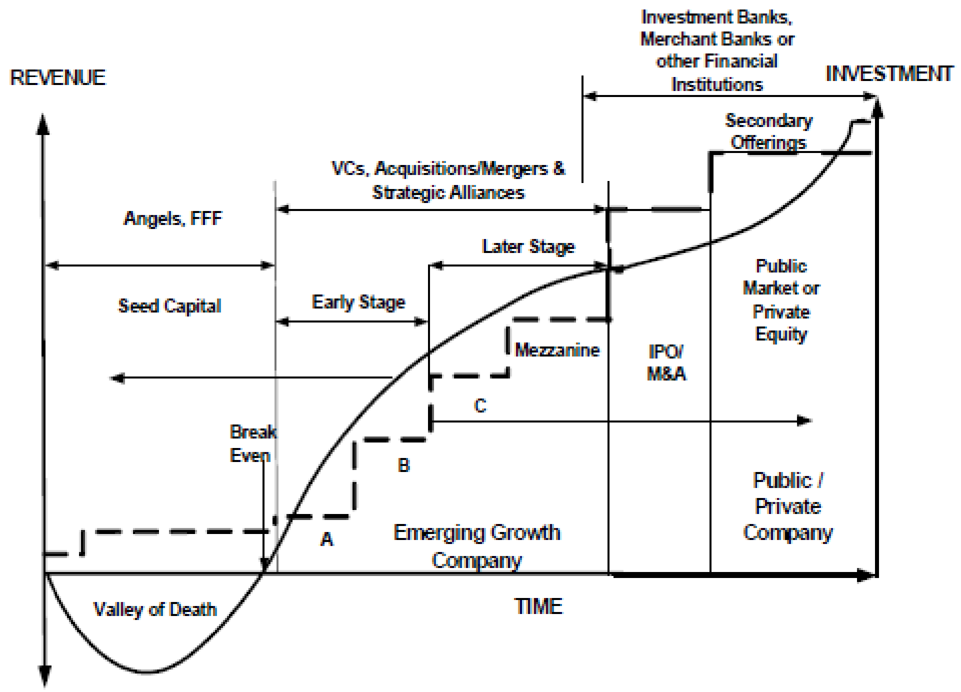
Many different domains are the object of grant programmes, but major ones are research and development, the environment, education and training, and investments. Important activities eligible for grants include R&D and demonstration work. In certain cases, desirable project activities are already requested by the funding agency in a top-down fashion. In other cases, the applicants have more freedom to fill in the technical scope of their projects (bottom-up). In all cases, the proposed activities need to align optimally with the overarching government and funding programme objectives.

An optimal match for your company

In conclusion, a very wide variety of public funding programmes is available, with different managing government agencies, different geographical linkages (regional, national, European), and different suitable domains and activities. This certainly opens up a lot of opportunities, but applicants should always consider very carefully which funding programmes can optimally be used to advance planned activities and company objectives.

Key *Private* Funding Opportunities

Several private investors can be approached by the entrepreneur that is looking for capital funding. Experience learns that most successful investor approaches are mediated by investor consultants due to the complexity of the process. All investors have different requirements for their portfolio of investments, requirements ranging from stage of development and size of the investment to geographical preferences, products and experience of management team. But all investor approaches start from the same principal; the need for a 'winner' business plan (see the business plan section of the BIOCHEM ToolBox).



Business Angels (informal venture capital)

A private investor or group of private investors that is willing to invest in business ventures in various stages of maturity. Generally, this definition signifies individuals investing their personal funds and often syndicating the remaining financing amount with other private investors. Business angels also contribute their personal managerial expertise in the invested companies. In Europe individual Business Angels on average invest between € 80,000 and € 250,000, up to € 500,000.

Unlike venture capitalists, business angels are often invisible for the entrepreneurs as they prefer to remain unidentifiable. Estimations say business angels are responsible for significantly more investments than venture capital funds. Business angel invest most of their capital in lower risk projects compared to venture capitalists, and invest in only few high risk projects (even higher risk profile investments than venture capitalists). Industry specialization is often also less obvious. Although it's not strictly defined, business angels invest also in seed stage companies, unlike most venture capitalists. Business angel investments require considering the following aspects:

Venture Capital

The process by which investors fund early stage, more risk oriented business endeavors. A venture capital funding arrangement will typically entail relinquishing a sizeable percentage ownership and control of the business (so also bringing in managerial and market expertise), offsetting the high risk the investor takes is the promise of high return on the investment. The investment is usually in the form of stock or a convertible debenture. As the business matures, an initial public offering may take place, or the business merged or sold, or other sources of capital found. Any of these would occur with the intention of buying out the venture capitalists. Venture capitalists typically expect a high percentage annual return on their investment at the time they invest in the private company. Venture capitalists typically invest in high growth companies with the potential to generate revenues of €20 million in any one company, but typical investments range from between € 500,000 and € 5 million. Management experience is a major consideration in evaluating financing prospects.

Corporate Venturing

Venture capital invested by existing firms for the purpose of funding innovative businesses set up by their own staff or active in industries considered of strategic importance.

The existing firms taking equity stake of small innovative firms by providing capital, and sometimes also management and marketing expertise with the objective of the large firm to gain a competitive advantage for their own business. Besides this strategic objective, there is also off course the financial objective, similar to the objectives of other private equity investors.

Investing Incubator

Incubators nurture young firms, helping them to survive and grow during the start-up period when they are most vulnerable. Incubators provide hands-on management assistance, access to financing and orchestrated exposure to critical business or technical support services. They also offer entrepreneurial firms shared office services, access to equipment, flexible leases and expandable space-all under one roof. Investing incubators mostly provide proof-of-concept financing or seed-financing which is capital contributed at a very early stage of a new venture, usually in relatively small amounts. It comes even before what they call "first round" venture capital.

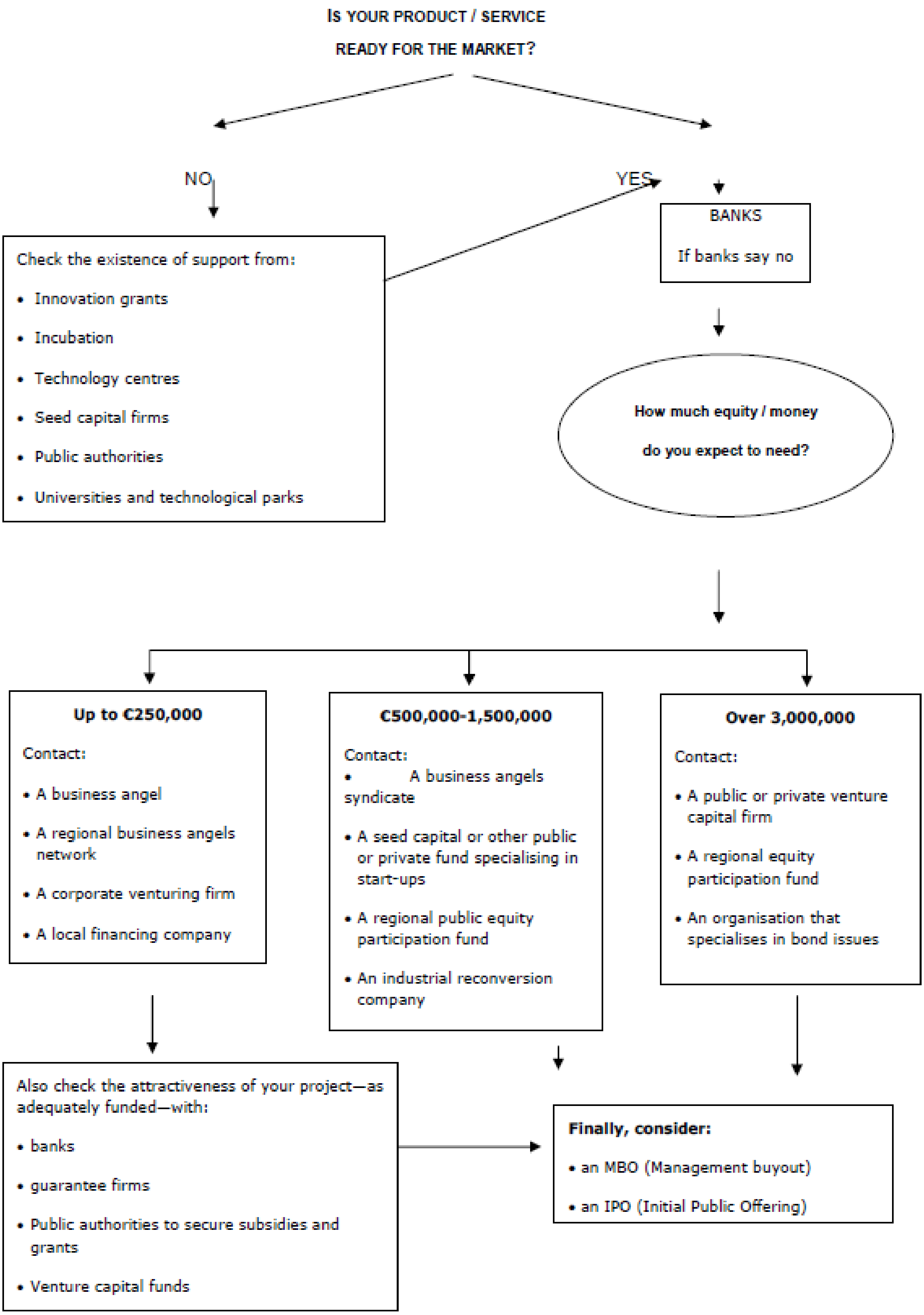
Public Equity Provider

Public finance mostly comes in grants, which are subsidies paid without an obligation to refund by public authorities to companies investing in a region for the purpose of facilitating their establishment or expansion. Public equity providers can operate on a European level (EIF), national level or even regional level.

Bank

It is a financial institution that is licensed to deal with money and its substitutes by accepting time and demand deposits, making loans, and investing in securities. The bank generates profits from the difference in the interest rates charged and paid. Banks are often the first organizations that entrepreneurs looking for funding to develop their projects turn to. However, bankers more often than never limit their analysis to a credit solution. Banks provide loans and debt to SME, which are the most common sources of funding for SME’s.

Which funding opportunity is right for my business?



Do I want *private* capital investments for my business?

Private equity is right for your business if your answers to below questions are predominantly yes.

- Are you prepared to take on the responsibility of being an entrepreneur, i.e. to run a business with a method and structures, to delegate responsibilities to a team and know how to motivate them, to develop your knowledge outside the business and this knowledge into your company, to take on the legal responsibilities – in a word, to take the plunge?
- Are you prepared to give up part of your company's capital to a private investor?
- Does your business operate in a growth market?
- Are your company's development prospects sufficiently ambitious?
- Is your team prepared to follow you? Does it have the necessary experience?
- Does your company have a certain technological or competitive advantage that can be developed or exploited?
- Are you prepared to share certain strategic decisions with shareholders outside your "inner" circle?
- Is there a realistic exit strategy for all shareholders?

Private equity is an option worth exploring once you want to:

- Create a business;
- Improve and develop your export performance;
- Exploit the creativity and innovation of your team;
- Recruit highly qualified personnel;
- Sell part or all of your company;
- Change the size of your business and take over one of your competitors;
- Launch a new product;
- Improve your management capacity;
- Liquidize some of your assets.

What does a private equity form bring to you?

- Long-term capital, solidly underpinning your company's growth;
- Increased visibility with bankers, suppliers and clients;
- A partnership, sharing the risks and the rewards;
- An investment fixed within the framework of a negotiated contract;
- The adoption of high-performance management standards;
- Strategic and operational support along with financial advice in times of crisis;
- Assistance with subsequent financing operations;
- Alliances due to the investor's network of contacts and portfolio of investments;
- A partial or total exit strategy.

What is a private equity firm looking for?

- High growth, competitive products or services;
- In the case of disposal or transfer, a loan capacity and recurring profits;
- A quality and stable management team, capable of turning the negotiated goals into reality;
- Solid management procedures, either already in place or able to be quickly put in place;
- A transparent legal structure where personal and professional assets are not entangled;
- An agreement on the investor's exit, with or without the head of the company.