

EIB-OeNB Conference

Financing Investment in Innovation and Growth: Austria in Comparison with Successful Peers

On April 16, 2018, the Oesterreichische Nationalbank (OeNB) and the European Investment Bank (EIB) co-organized a conference on financing investment in innovation and growth in Austria. The conference was held at the premises of the OeNB in Vienna and it attracted almost hundred participants from both the private and public sector. High-level experts and eminent practitioners discussed the current state of investment in Austria and the existing capital structure of the Austrian economy, the effectiveness of Austria's financial system in allocating capital to its most productive use, potential bottlenecks in funding innovation and the efficiency of Austria's business ecosystem in financing start-ups and innovative SMEs. Along many other distinguished speakers, we had the pleasure to welcome Mrs Sabine Herlitscha, CEO Infineon, Bernhard Baumann, CEO of Shpock, and Stefan Dörfler from Erste Bank.

In his opening remarks, **Governor Nowotny** emphasized that for OeNB, financing investment is of a special concern. The conduct of monetary policy by setting interest rates is closely related to investment funding, as the transmission of monetary policy depends on the effects of interest rate changes on credit flows and firms' balance sheets. In addition, central banks are tasked with macroeconomic stability, with twofold impact on business investment: monetary policy aims at price stability, which makes the investment environment better foreseeable and yields better investment decisions; and financial market stability is a precondition for the efficient allocation of capital. He also pointed out that funding investment in Austria relies on banks, but new forms of funding are emerging. Supervisors and regulators must be vigilant. Alternative sources of finance like crowdfunding or venture capital play a pivotal role for a certain market segment, i.e. start-ups and innovative SMEs, but in Austria, the size of this market segment is rather small and therefore its relevance for macroeconomic stability is marginal.



Session 1: Financing business investment – sources of and limits to funding



Debora Revoltella (EIB) chaired the first session. She started by pointing out that in Austria, investment activity recovered faster after the crisis than in the EU as a whole, driven mainly by R&D investment and, most recently, by investment in machinery and equipment. Infrastructure investment has remained stable. According to the EIB Investment Survey, business investment in Austria is strong in comparison with other EU Member States, only 12% of the companies reported investing too little over the last three years. In terms of quality of capital, Austrian

firms rank among the top in the EU. Austrian firms in the construction and manufacturing sectors will likely invest in capacity expansion over the next few years. According to the survey, many firms in Austria regard lack of skilled staff or business and labor market regulations as major obstacles to their investment. Access to finance is in line with EU average; only 6% of Austrian firms feel financially constrained. R&D and innovation is high on the agenda. 12% of Austrian firms can be classified as leading innovators. These companies spend actively on R&D and develop products new to the country and to the global market. Most innovation in Austria is concentrated among medium-sized and large firms. Innovative firms face stricter credit constraints than others. Hence, more diversified sources of innovation finance would be helpful as Austria's innovators mainly rely on internal funds and retained earnings as sources of funding.

Stefan Dörfler (Erste Bank) confirmed the positive assessment of the investment environment in Austria. Erste Bank's own in-house survey shows that bank loans are the most important form of funding for SMEs. Capital market access for SMEs is difficult, and there has been little progress in Austria so far in this regard. SMEs in Austria believe in their business model, but do not see the dynamics in financing. The cost of access to capital markets could come down significantly by new technologies (digitalisation), for example the classic "Schuldscheindarlehen" (promissory note loan) can be distributed today via block chain technology.



Sabine Herlitschka (Infineon), representing one of the leading innovators in Austria with over 17% of R&D expenditures as a share of revenues, emphasized that Europe must focus more on strategic ownership, in order not to lose its key enabling technologies to foreign owners. In this respect, the EU state aid rules are a problem when it comes grants with highly competitive conditions. The EU must not be naïve, China and US play according to their own rules. The EU state aid rules were not designed to look at Europe in a global competitiveness context. She wondered how we can adapt the set of financial instruments in Europe to compete globally. Infineon does not use EIB loans at the moment, but Sabine Herlitschka would like to see EIB be more active in hi-tech innovative sectors.

Ulrich Schuh (Federal Ministry for Digital and Economic Affairs) highlighted the progress made in innovation, but pointing out that SMEs are not scaling up enough. The government recognizes the need to strengthen capital market financing in Austria, and therefore, its focus would be on the following areas: (i) to improve the functioning of the capital market in Austria, while reducing market frictions and respecting specific needs of different types of companies including SMEs; (ii) to make regulations of capital markets more effective, and to reduce the administrative burden for companies. More emphasis on venture capital is needed. The government wants to mobilize capital for innovation, e.g. by improving the attractiveness of capital funded pension funds. Among other initiatives, one could mention new crowd-funding instruments and extending the volume of guarantees.



Ewald Nowotny (OeNB) added that the crisis years produced a corporate investment backlog in Austria and elsewhere, but when the outlook improved in late 2015, investment in Austria picked up, too. The current cycle of investment in plant and equipment is exceptionally long and strong. The long-lasting effect of the crisis is a wider use of more prudent financing of investment, i.e. more use of own resources, which, however is not bad by itself. Most recent forecast by OeNB sees strong investment growth in the first half of 2018, given the currently high degree of capacity utilization. In the first quarter of 2018, the European Commission reported for Austria the highest degree of capacity utilization in the whole EU.

The strong rebound of investment bears witness that the financial sector has played its role well and has allocated capital efficiently. Still, collateral is a restricting factor. Interest rates are no restricting factor at the moment, but risk taking is. Today, we face global competition in risk taking. The EU's investment policy is too static and needs to reconsider state aid rules. In US and Israel, the state pays for much innovation via the defence budget, so questions of state aid are not raised. The EU should create a peaceful equivalent to military spending in US (mission-oriented innovation policy). To allow for risk taking from the private sector, the consumer protection rules should be reconsidered, too; financial literacy must be raised to do so.



Andrew McDowell (EIB) opened up by stating that the EU investment policy has been focused too much on inward perspective for the last 10 years, and we need to look more outwards again. We should protect our interests without being protectionist. The EU has been spending less on R&D and innovation over the last 10 years than its global competitors (e.g. US, Asia). The EIB Investment Survey helps to shed light of the structural bottlenecks of investment in Europe. And there are some serious issues. First, in the EU, we have under-invested in infrastructure. Second, the lack of skilled staff mentioned by firms as a major investment obstacle shows that there are weaknesses in our system of education and training. The message for the EIB is clear, we need to provide additionality to address structural issues in areas where market cannot do it on its own. EIB has raised its stake in scope and scale. EIB's balance sheet doubled since 2009, and its funding of non-investment grade projects

rose from 5% to 35%, it has also increased the risk sharing with commercial banks. EIB has been able to move towards riskier investment thanks to its mandates from the European Commission. EFSI was a big success and should be extended beyond 2020 to leverage the EU budget further. In the MFF post-2020 discussion, we need to remember that we should not cut funding for basic research in Europe, as basic research needs grants and subsidies and it would be a mistake to completely shift from grants to debt. In addition, a new focus of EIB is decarbonisation, and we need to increase infrastructure investment to deal with climate change.

Debora Revoltella summarized the first session as follows. There is a need to have a stronger focus on competitiveness on the EU level. Efficiency of capital markets regulation warrants further improvement. More EU thinking and coordination is required to address the issue of the lack of skilled staff faced around Europe. Better public-private complementarity is required in R&D funding in EU, grants should remain to play an important role in R&D. Finally, the question of who will take the risk is an important one to address. Making equity financing more attractive for SMEs is key.

Session 2: Funding Innovative Start-Ups and SMEs in Austria

Doris Ritzberger-Grünwald (OeNB) chaired the second session. She kicked off the discussion by pointing to the European Commission's assessment that Austria needs to create an ecosystem that fosters equity financing for SMEs, inter alia to enable fast-growing companies to scale up more successfully. The elements of such an ecosystem include a well-established business sector, entrepreneurial recycling where founders re-invest their wealth, an entrepreneurial culture, specific services like lawyers and consultants in intellectual property, universities as talent magnets, and alternative finance. Unfortunately, the venture capital and crowdfunding levels in Austria are very small.





Christian Laurer (Tecnet) as a representative of a leading venture capital firm explained that even though there are not a lot of venture capital firms based in Austria, there are a number of foreign venture capital firms active in Austria. Venture capital firms are by nature risk takers but they take calculated and well-understood risks. Tecnet differentiates between SMEs and start-ups in terms of technology. He also explained that IPOs are only a small portion of exits for seed investors, and as such they cannot be planned as much as sales of companies, which represent the majority

of exits. As a word of caution, he noted that the new trend of ultra-high net worth individuals investing in start-ups as opposite to luxury goods is a wrong trend based on wrong incentives.

Bernhard Baumann (Shpock) provided the perspective of a successful start-up. As a typical start-up, their financing went in phases, initially from the founders, then from the aws (the Austrian federal promotional bank), venture capital and business angels, followed by strategic investors and ended by a strategic take-over. In his view, the start-up financing needs improvement on multiple fronts. There is a lack of financing for seed capital (business angels), which could be improved by a different types of tax breaks. Also, in the expansion stage, there is



a lack of venture capital and private equity funding in Austria in comparison to the rest of EU, which could be improved by more funds-of-funds solutions allowing family offices in Austria with risk-averse investment policy to invest in start-ups, hence increasing the risk taking for the family offices. Finding good talent to work for start-ups is also getting more challenging, as for regulatory reasons it is difficult to offer share participation for employees on the new start-up. While contemplating how to attract more firms having their base in Austria, he saw a role for banks to play as well, for example to partner up with fintech companies in order to exploit the benefits of innovation ahead of time.



Marlis Baurecht (aws) spoke as a representative of a promotional bank in Austria with a long-standing experience with investing in start-ups ranging from seed financing, guarantees to loans for international expansion. The collateral squeeze could also be addressed by guarantees from aws. She mentioned that in Austria, the family owned SMEs that are traditionally reluctant to hand over ownership to third parties are not predominantly active in high-tech.

Sandrine Croset (EIB) spoke about EIB activity in Austria. She mentioned that when it comes to EIB lending in innovation and skills, last year in Austria this comprised about 10% of EIB's total lending, but more could be done if benchmarked to other northern European countries. Through our various instruments, we finance innovative SMEs in order to help catalyse investment. She also discussed the specificities of lending to innovative SMEs. For example, there are issues in terms of collateral for intangible investment, and classical bank lending is based on material assets. Start-ups are even more penalized since credit assessments focus mainly on past performance. In addition, valuation of technology is not systematically incorporated in credit decisions.



Reinhilde Veugelers (University of Leuven) provided an academic perspective on innovation. What is really missing in Europe are young and radically innovative firms. The EIB investment survey is showing us that we have very few young innovating firms in Europe. Young firms are less likely to be leading innovators. In terms of the share of leading innovators, Austria is close to EU average, but the EU itself



is already behind the most innovative countries. Austria is missing young innovative firms that are small but can turn to become true leading innovators. What are the investment obstacles for innovative companies? Access to finance is an obstacle for young leading innovative SMEs. Regulation and availability of skilled staff is also considered an obstacle by the innovators. In terms of sources of finance, innovative firms are more likely to use external finance, are more likely to use grants. In addition, young leading innovative SMEs are more likely to be credit constrained. What are the

solutions that EU regulators should focus on? One thing is more focus on young radical innovators, not just on SMEs per se. More integrated EU capital markets and removing barriers for risk capital to move within the EU could also be part of the solution. Lastly, grants are more important for radical innovators.


