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Nordic Innovation Centre

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Challenges and Initiatives for the Nordic Seed Stage

Promoting a common Nordic seed capital market

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European Private Equity & Venture Capital Association
Nordic Venture Network

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June 4, 2009

Content

1. Executive summary

The venture capital market is an important engine for economic growth and the creation of new industries, companies and employment in the Nordic countries. Furthermore, it helps to attract international capital to the region.

This fact has been acknowledged by all the Nordic countries and efforts have been made to improve regulations pertaining to the venture capital and private equity industry in the region as well as on a European level. Academic research has also revealed that no venture capital markets have been established without public support.

A well functioning Nordic venture capital market needs, in the long term, to be attractive to the private sector and particularly to institutional investors worldwide. Since this is not yet fully the case, continued public support is neccessary.

The supply of private capital for the very early stage of venture capital – the seed stage - in the Nordic countries has been limited. Consequently, this space is today dominated by public and publicly funded players.

The resources on today's Nordic seed market are scattered. Increased Nordic cooperation is one way of reducing this problem and is expected to lead to higher critical mass and tighter networks that are vital for the success of early stage national investment programmes. Furthermore, much is to be gained by benchmarking and sharing best practices among Nordic public investors and financers. Combined, the Nordic countries could constitute a common market of a size that could have venture capital players in different stages with critical mass and global competitiveness.

Changes on a European level will take time, which presents the Nordic countries with an obvious opportunity to create a competitive advantage by acting quickly to improve regulations for the Nordic market. This would further strengthen the Nordic region as a European leader in early stage investments.

The governments have chosen different ways of supporting the seed and venture capital markets in the various Nordic countries, although today, the challenges in the early stages are similar and include lack of private financing in the seed stage, difficulties for venture capital funds to secure new funding for the expansion stage, lack of patience and focus as well as scattered resources in publicly funded investment operations.

In order for the venture capital market to be effective in promoting innovation and sustaining viable start-up companies, it must function as a coherent system for innovation finance. It is imperative that there are a sufficient number of investors in each development stage, and that these investors have adequate funds to provide the capital necessary to finance the development and growth of start-ups. Otherwise, some of those start-ups that obtained funding in the seed stage risk falling into a finance gap that impedes their development or, in a worst case scenario, force them to close down.

The members of the initiative believe that governments in the Nordic countries should aim at creating a more risk taking environment by promoting private early stage investment. Policy makers should ensure that public policy (e.g. tax and regulatory settings) is conducive to venture capital investments. Furthermore, governments should, until there is enough private capital available, invest in the seed stage as well as in funds active in the later stages of venture capital, thus creating a pool of experienced investors. These investment operations need to be executed with patience and in tune with market needs with the aim of creating internationally competitive companies.

It should be emphasized that public funding should not only go where it is apparently needed most – the seed and early stages – but where it has the highest long-term impact on creating a self-sustainable venture capital market in the Nordic countries.

If action is not taken there is a risk of a major set-back in the development of a well functioning common Nordic venture capital market as well as the loss of a substantial part of the large public capital that has been invested in the early stages.

The report contains general recommendations for the Nordic countries as well as status reports and national recommendations regarding promotion of the seed stage in each Nordic country.

2. Recommendations

2.1 General recommendations for Nordic policy makers

The members of the initiative recommend each Nordic country to:

1. Formulate policies with the aim of promoting a long-term, well functioning and self-sustainable venture capital market.
2. Create incentives to enhance the attractiveness of early stage investing, thus increasing the supply of capital for start-up companies.
3. Continue to provide equity financing for seed investments but by means of larger funds with critical mass to avoid scattered resources. Furthermore, ensure that publicly funded schemes are in tune with market needs and practice patience and consistency to enable the emergence of experienced managers.
4. Provide increased financing for venture capital funds through national or a potential Nordic fund-of-funds, to ensure stable funding for the Nordic venture capital market on its way towards a long term, self-sustainable industry.
5. Include the clear aim of generating internationally competitive new companies in publicly funded investment schemes.
6. Create an internationally competitive environment for venture capital by removing for instance legal tax barriers for cross-border investments in venture capital funds.
7. Create models for bringing management experience into start-up companies both in operative positions as well as at board level e.g. by fostering co-entrepreneurship.

2.2 Recommended Nordic initiatives

The members of the initiative further recommend the Nordic Council of Ministers and the Nordic Innovation Centre to assign the following projects:

1. Explore the possibility of a Nordic fund-of-funds for investing in venture capital funds, as a complement to national institutions, thus helping to secure stable long term financing for the Nordic venture capital market.

2. Conduct a comparative study on the status of angel investors in the Nordic countries, including an analysis of the levels of investment and benchmarking of angel investor promotion activities.
3. Continuation of the Nordic Seed Capital Initiative during 2010 to follow-up on important issues and to further promote increased Nordic dialogue around the seed stage.
4. Hold another Nordic Seed Capital Summit in 2010 to catalyze Nordic cooperation.
5. Utilize the Nordic Seed Capital Initiative for creating international contacts by, for example, execute joint presentations to relevant venture capital firms in the UK and Germany.

3. Introduction & context

The Nordic Council of Ministers has recognized the importance of seed and venture capital and has commissioned several projects aimed at promoting a highly functional common Nordic venture capital market.

Since 2004 several venture capital projects have been carried out by the Nordic Innovation Centre, an institution that reports to the Nordic Council of Ministers. The findings and recommendations have in several cases contributed to policy changes in the Nordic countries. For example, several restrictive mandates for public investors have been changed from being national to allow for Nordic investments. In addition, obstacles to investment in Nordic private equity structures have been and are in the process of being removed.

In recent decades, the earliest phase of the venture capital market – the Nordic seed stage - has become a vital part of the Nordic innovation system and contributes to the creation of new industries and employment. Due to limited private investment in the seed stage, public involvement is higher than in the later stages of venture capital.

All Nordic countries have public investment operations in the seed stage and in all countries there have been discussions on how to further promote the emergence of new companies and industries.

Academic research has revealed that no country has a well functioning venture capital market without public support. As the renowned Jacob H. Schiff Professor of Investment Banking at Harvard Business School, Josh Lerner, put it: "It is instructive to observe that all venture capital markets of which we are aware were initiated with government support".[1]

Professor Lerner concludes that the most important task for government is to ensure that public policy (e.g. tax and regulatory settings) are conducive to venture capital investments. Government can also take on the challenging role of an investor but this must be done in a careful way that is sensitive to the needs of the market.

Given the above background, a "Nordic Seed Capital Initiative" was commissioned by the Nordic Innovation Centre in the autumn of 2008.

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[1] Lerner, Moore and Shephard, *"A study of New Zealand's venture capital market and implication for public policy"*(2005)

The initiative's primary goal is to create a Nordic seed market with a sufficient critical mass to attract large non-Nordic venture capital players. It also aims to catalyze and intensify Nordic cooperation between seed stage investors and stakeholders to facilitate cross-border investments in the seed segment. Furthermore, the initiative emphasises the importance of a deeper dialogue among seed players including benchmarking and sharing of best practices.

The resources on the today's Nordic seed market are scattered and much can be gained by increasing the level of cooperation and interaction between relevant market players. By joining forces under the umbrella of the Nordic Council of Ministers, the public investors are expected to have a very positive impact on the Nordic seed segment.

The initiative includes the formation of a Nordic Seed Capital Forum, a reference group of the leading public seed investors, the writing of this joint Nordic report – "Challenges and Initiatives for the Nordic Seed Stage" - as well as the Nordic Seed Capital Summit on June 4th in Stockholm and the Nordic Public Investor Summit on September 3rd in Copenhagen 2009.

This report describes the findings and suggestions of the Nordic Seed Capital Initiative and will be presented at the Nordic Seed Capital Summit in Stockholm on June 4th 2009. The study is not an in-depth analysis but a way of presenting the status of and challenges for the seed market in each Nordic country as well as suggestions and recommendations on how to improve the market.

The members of the Nordic Seed Capital Forum have jointly written the report, and the national overviews were individually written by each member. The Swedish section was written in cooperation between the Swedish member of the Forum, Innovationsbron and the Swedish Private Equity & Venture Capital Association, SVCA.

In addition, all national venture capital associations as well as the European Private Equity & Venture Capital Association and the Nordic Venture Network have been asked to provide their views on the main challenges and most important recommendations for government.

The members of the Nordic Seed Capital Initiative have vast experience of the Nordic seed and early stage market.

Owner of the initiative:
Marcus Zackrisson, Nordic Innovation Centre

Initiative coordinators:
Erik Johansson & Carl-Peter Mattsson, Nordic Investment Solutions[2]

Members of the Nordic Seed Capital Initiative:

Nordic Seed Capital Forum	Company	Country
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Stein Jodal	Innovation Norway	Norway
Stine Kruse	Vækstfonden	Denmark
Erik Johansson & Carl-Peter Mattsson	Nordic Investment Solutions	Sweden

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European Private Equity & Venture Capital Association
Nordic Venture Network

[2] Nordic Investment Solutions is a Nordic advisory firm within private equity. (www.nordicinvestment.se)

4. The Danish seed capital market

The following text outlines the main challenges and most important issues to resolve on the Danish seed and venture capital market as seen from the perspective of the Danish member of the Nordic Seed Capital Initiative, Vækstfonden.

4.1 Present status and recommendations

In order for the venture capital market to be effective in generating innovation and sustaining viable startup companies, it must function as a coherent system for innovation finance. It is imperative that there are a sufficient number of investors in each development stage, and that these investors have sufficient funding to provide the capital needed to finance the development and growth of start-ups. Otherwise, some of those start-ups that were funded in the seed stage risk falling into a finance gap that impedes their development or, in a worst case scenario, leads to close down.

In Denmark, there are currently 45 venture funds investing in the development and growth of both Danish and international start-ups. However, not all investors are active in every stage or industry segment.

At present, the Danish venture capital market is facing a number of challenges:

- Diminishing seed funding
- Fundraising and investment capacity under pressure in market overall
- Strained interaction between the seed segment and the rest of the market

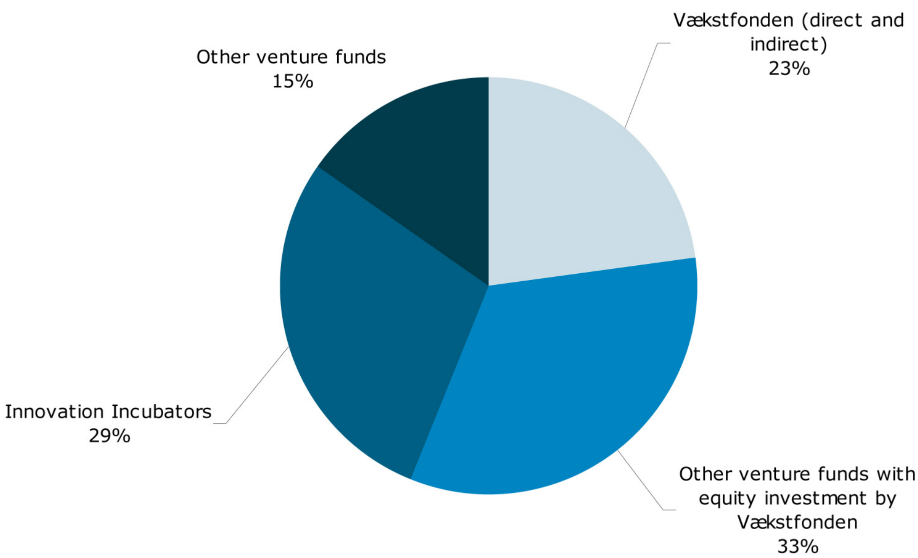
Recommendations for political action to support the continued development of the Nordic venture capital market:

- Nordic Investment Bank to function as an active investor in Nordic venture capital through a fund-of-funds activity.
- Increased investment capacity of publicly funded seed stage investors
- Initiatives to increase the capital base for fundraising

4.2 Overview

In Denmark, the seed capital market is dominated by publicly funded investors – the Innovation Incubators, Vækstfonden and funds that have received substantial equity funding from Vækstfonden along with funding from private investors. Due to the high risk profile of this type of investment, the private investors have been hesitant to engage in seed stage companies. In total, the Innovation Incubators together with Vækstfonden invest 52 % of the seed capital. And if the private investors, who have received equity investment from Vækstfonden, are added to this number, up to 85 % of the capital in seed stage companies is invested by funds that are backed entirely, or to a large extent, by public funding, cf. Figure 1.

Figure 1. Danish Seed Investors by Share of Amount Invested

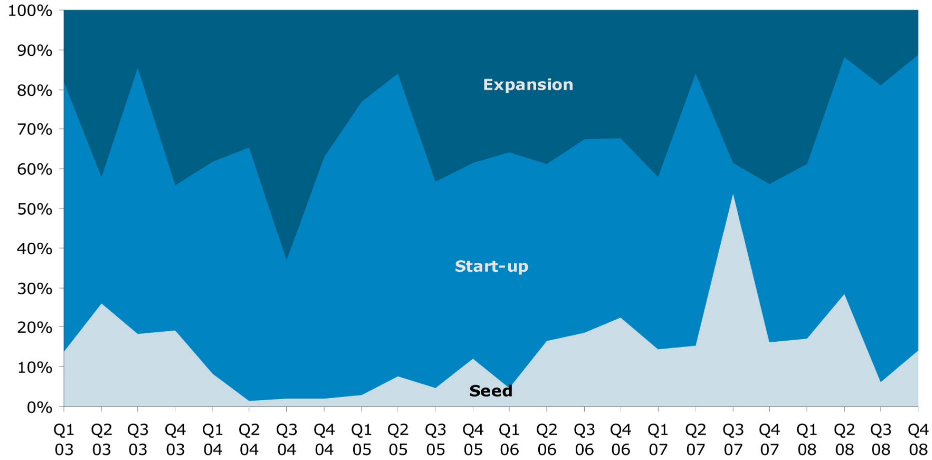


Source: *Vækstfonden*

Fully private funds, which make up 15 % of the seed investments, are for instance NOVO A/S, Via Venture Partners and Vecata.

Investments in the seed segment in Denmark fluctuate, but currently make up about 15 % of total investments in 2008, down from 24 % in 2007, cf. Figure 2.

Figure 2. Quarterly investment activity in Denmark by stage



***Source**: Vækstfonden and DVCA*

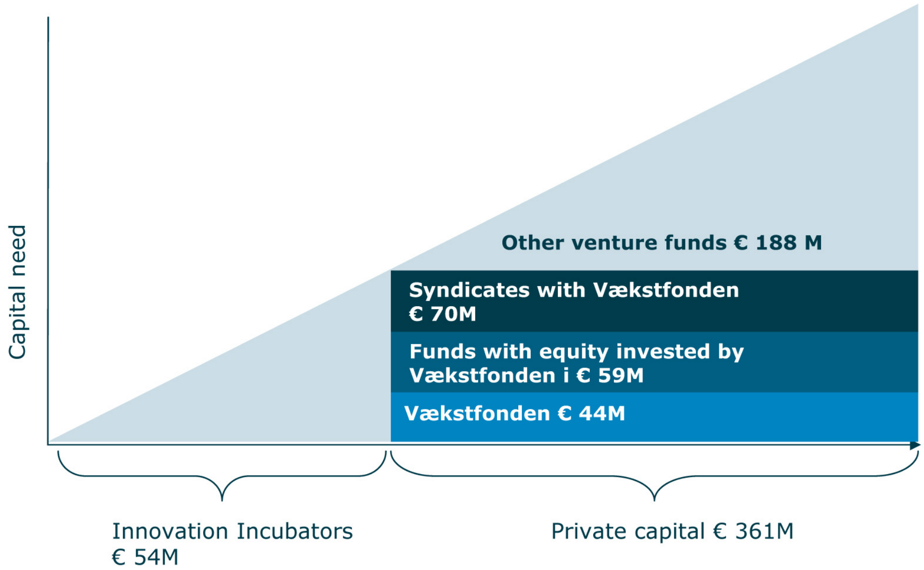
4.2.1 Seed stage investing

The initial capital raised by start-ups has to be followed by further investments as the companies develop and start to scale their businesses. Consequently, each new investment in the seed stage creates a demand on available capital in the other segments of the venture capital market. Thus, seed investors have to either increase their own investment in the company as its development progresses, or seek to syndicate investments with other investors in the market who have the investment capacity to provide the necessary follow-on funding.

As the portfolios of investors primarily operating in the later stages of the venture market encompass a growing number of companies from the Innovation Incubators and other seed investors, an increasing share of capital is allocated to follow-on investments in these companies. As a result, it is both relevant and useful to think of the venture capital market as a food chain, where seed investors should be able to find other investors willing to invest in the further development of their portfolio companies.

As mentioned above, one of the most active investor segments in the seed stage is the Innovation Incubators (Innovationsmiljøer), funded by the Ministry of Science and Technology. The Innovation Incubators may invest in companies within the limits of the EU de minimis regulation. When the companies need more funding, private investors and Vækstfonden usually take over, as illustrated below. According to FOIN, The Science Park Association in Denmark, upon receiving capital from the Innovation Incubators, companies have raised about € 360M from private investors in the period 2003-2007, cf. Figure 3.

Figure 3. Sources of Capital for Companies Started by the Innovation Incubators



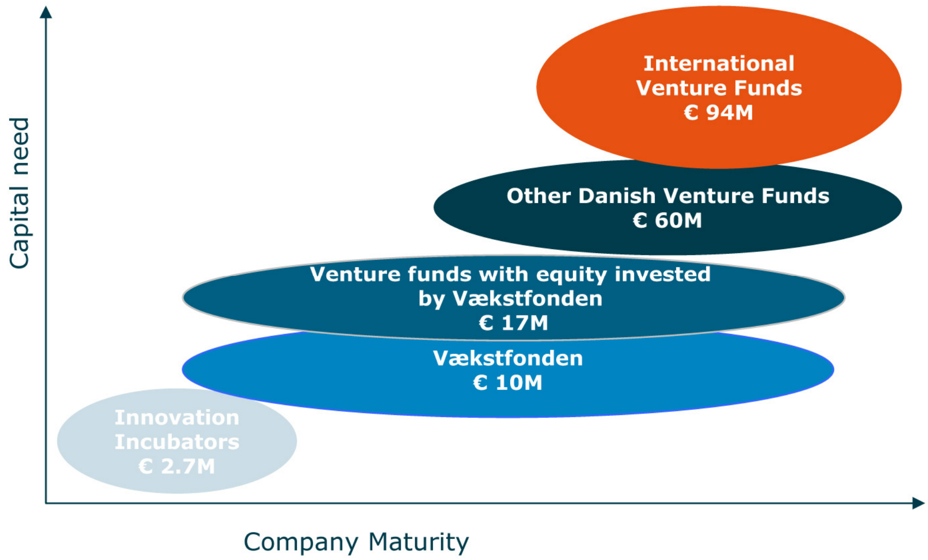
Source: *Vækstfonden*

Vækstfonden is a very important investor for the companies that originate in the Innovation Incubators. One in two of Vækstfonden's investments and 1/3 of the amount invested by Vækstfonden is allocated to these companies.

In research conducted by Vækstfonden on the total funding demand of companies in the Innovation Incubators, an estimate was made of how much capital the current investment activity in the Innovation Incubators would require from the rest of the Danish venture capital market. Every year about 10 companies from the Innovation Incubators attract venture capital from other venture investors in Denmark. Experience of the American venture market indicates that on average, while in the venture capital investors' portfolios, a company's cumulative demand for capital from the initial seed round through to exit is in the vicinity of € 54 M.

Assuming that Danish companies have a funding demand equal to that of their American counterparts in a steady state situation, companies from the Innovation Incubators will require a total of € 185M from other venture investors on an annual basis, cf. Figure 4.

Figure 4. Annual Investment Demand from Ten Companies in Innovation Incubators



***Source**: Vækstfonden*

In recent years, Danish venture backed companies have attracted venture capital from international investors corresponding to half of the annual amount invested. With this trend as a prerequisite, € 93M of the annual investment capacity in the Danish venture capital market will need to be allocated to funding the most promising companies emerging from the Innovation Incubators. Consequently, companies started in the Innovation Incubators will require investments corresponding to 1/3 of the annual Danish venture capital investment capacity.

This example illustrates that in order for seed capital funding to generate sufficient and significant returns, a broad-based, vibrant venture capital market is necessary. Thus, seed funding has to be viewed in the context of the investment capacity of the venture capital market as a whole. In Denmark, the food chain seems to function well with the current investment activity in the seed stage. However, it is a delicate balance and seed investors should be careful not to meddle with it by overextending investment activity. In addition, the impact of the current economic downturn has made it more difficult for venture funds to attract capital for additional investment.

4.2.2 Business angels

Business angels are organized within the DVCA, which took over responsibility for the national Business Angel Network initiated by Vækstfonden a few years ago.

Furthermore, in 2006 Vækstfonden set up "Partnerkapital", a business angel matching fund to co-invest with business angels. The purpose of this fund is to increase the investment capacity of business angels and to improve access to the competencies of experienced business professionals who are dedicated to investing in innovative and growth oriented companies. To date, Partnerkapital has made seven investments.

There has been no recent research on the business angel community in Denmark, but according to a report from 2002, there were 150 business angels in Denmark with total assets of approximately € 805M at that time. Together, this group of business angels had contributed to the creation of about 200 start-ups and had invested in more than 500 companies, of which 243 were still in their portfolios at the time of the analysis in 2002.

4.3 Looking ahead

The Gazelle Growth Program is one recent initiative intended to boost go-to-market strategies for Danish start-ups aspiring to penetrate the US market. As part of this program, selected technology start-ups, many of which are VC-funded, are paired with a mentor, who has hands-on experience of setting up business in the U.S. and is able to help with the design of an effective roll-out plan to attack the market. Moreover, the selected start-ups participate in a series of workshops and targeted pre-marketing trips to the U.S.

On the funding side, there have been no significant new policy initiatives to inject capital into the venture capital market since 2006 – neither in the seed nor later stages.

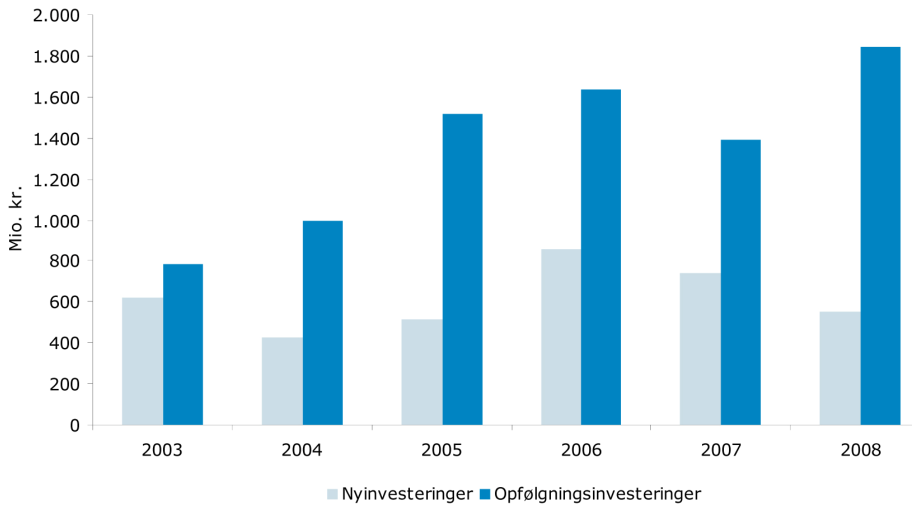
Issues being discussed at present primarily relate to fundraising for funds operating in the start-up and expansion stages as well as the performance of the venture segment as a whole. With a mature venture market and a large number of the portfolio companies approaching exit, follow-on investments make up the lion's share of the annual investments, to the detriment of new entrepreneurs looking for early stage capital. The annual number of investments is expected to decrease in the coming years, if venture capital funds are unable to raise new capital.

As part of the challenging climate in the Danish venture capital market, venture funds are facing increasing pressure from current and potential institutional investors to deliver results on past investments by driving through exits with high returns before they can reasonably expect to see new funds flowing into the market.

Recent data from the quarterly reports on investment activity in the Danish venture capital market contain some revealing facts. On the positive side, overall investment activity was up by 22 % in 2008, driven by a strong increase in follow-on investment. This is an important sign of vitality in that it indicates the commitment and capacity of Danish venture capital funds to continue funding their portfolio companies through the economic slump toward an exit.

However, the drying up of funds available for new investments has caused a staggering decline of 25 % in new investments, pushing the activity below the 2005 level, cf. Figure 5. This means that fewer start-ups are being funded, and as a corollary, these companies will not be available for later-stage investors to invest in further down the line. The next generation of Danish venture funded start-ups will thus be significantly smaller than in this decade.

Figure 5. Annual venture investment activity in Denmark by type of investment



Source: *Vækstfonden and DVCA*

4.3.1 Policy recommendations

The most critical issue facing the Nordic venture capital markets is the challenge to raise new funds in times of economic downturn. With the existing portfolio maturing and approaching exit, venture capitalists are looking for the exit markets to reopen in order to capitalise on their investments and demonstrate returns that will enable them to raise new funds. However, the exit routes are currently unavailable for investors, the holding period increases and no results can be demonstrated as a foundation for raising new funds. Thus, there is a need to look further into political initiatives to improve the fundraising climate:

1. Nordic Investment Bank as an active investor in Nordic venture capital through a fund-of-funds activity.

2. Increase the investment capacity of publicly funded seed stage investors such as the Danish Innovation Incubators (Innovationsmiljøer). The innovation incubators should have a larger capital base and be able to invest

more in each company. Today, companies raising capital in the early stage have to raise even more capital in order to reach a point where private venture capital investors will invest. In Denmark, the limits for publicly funded investments in early projects such as the innovation incubators have so far not been increased despite the change in the EU de minimis regulation.

3. Initiatives to increase the capital base for fundraising for venture capital funds

- Initiatives that make it attractive for institutional investors to invest in the venture segment in the Nordic countries, e.g. tax incentives and/or regulation.
- Initiatives that create tax incentives for individuals to invest in unquoted, early stage companies, as has already been implemented in e.g. France and the U.K.
- Initiatives to supply public funding to support venture capital financing for high-tech start-ups in times when venture capitalists' exit routes have diminished or closed down.

5. The view of the Danish Venture Capital & Private Equity Association

The following text briefly outlines the main challenges and most important issues to resolve on the Danish seed and venture capital market as seen from the perspective of the Danish Venture Capital & Private Equity Association.

5.1 Main challenges and recommendations for the Danish market

5.1.1 Main challenges for the Danish market

The Danish seed and venture capital markets stand before a most challenging time. Many companies will not survive if not increased levels of financing is provided. This is a serious situation for Danish business life which needs to be addressed with urgency.

The main problem is the lack of risk willing capital. The venture capital firms have limited funds and have to prioritize among their existing investments. The limited supply of growth capital could mean that a generation of growth companies could be lost and that the government's goal for 2015 that Denmark should be among the top countries in the world regarding the amount of entrepreneurs could become unreachable.

The main challenges for the Danish seed and venture capital markets are:

- Mature companies are not being exited due to the financial crisis.
- Hence companies need financing for a longer period.
- Financing from banks is not possible. Hence all financing needs to come from venture funds.
- Today funds available are limited among the venture firms and it's
- currently most difficult to raise new funds.

5.1.2 Main recommendations for the Danish market

The main solution for the financing challenge is more public capital to secure the supply of growth capital. It is also important to promote start-up companies by providing them the same tax benefits as large companies enjoy for research and development.

Main recommendations:

- More capital for the "proof of concept" stage and for the public seed investors "Innovationsmiljøerne".
- 3 times DKK 500M over three years in funding for start-ups through the venture capital funds
- Equal tax status for start ups and large companies

As stated above the Danish seed and venture capital market are hit hard by the financial crisis. In this situation we believe it's vital to get more risk willing capital into young Danish entrepreneurial companies to ensure the emergence and growth of new successful companies in Denmark.

6. The Finnish seed capital market

The following text outlines the main challenges and most important issues to resolve on the Finnish seed and venture capital market as seen from the perspective of the Finnish member of the Nordic Seed Capital Initiative, Veraventure.

6.1 Present status and recommendations

Finland is one of the most R&D intensive countries in the world with a spending target of 4.0% of GDP in R&D. As a result of this commitment, Finland has led competitiveness tables for several years running. While these achievements are exceptional, without an equally impressive commercialization path and sufficient investment infrastructure, the goal is unachievable.

In contrast to R&D, early stage venture capital provision compares favourably with EU averages and appears better than the most. Such comfortable acceptance of “above average” commitment remains inconsistent with Finland’s world class R&D performance. This contradiction between R&D achievements and the investment eco-system is striking. One of the clearest signals emerging from the market is a need to catalyze higher amounts of value-adding early stage VC equity in conjunction with business angel investments in early stage companies.

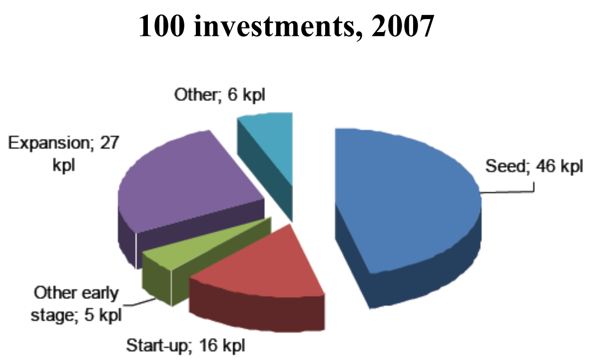
The status of the Finnish early stage investment industry is critical; there are a mere 5 early-stage funds actively investing, for which there are two main reasons. Firstly, institutional investors lack the appetite to invest in this space, conversely, new funds have difficulties fund raising. Secondly, existing funds have moved from early stage to more mature stages or Buy-out/MBO/LBO –investments pushed by higher return requirements.

Few funds have above € 50M under management, which is reflected in the limited ability of the respective funds to rapidly scale early stage companies to international growth. Furthermore, only a small number of funds with over € 50M under management have made initial investments in early stage companies. This reflects the need for funds to reserve sufficient capital for follow-on investments or a change in investment strategy.

There remain substantial entry barriers to the Finnish venture capital market given the reluctance of institutional investors to back first-time funds. Many of the key institutional investors currently consider that Finnish VC funds do not offer sufficiently attractive returns. Therefore, many of the private venture capital firms have been established as spin-offs/MBOs from public investors.[3]

This vacuum has led to a situation where the public sector has been forced to invest more resources into the early stage space. Consequently, the early stage market is today dominated by public entities, namely Veraventure, which commands over 80% of the early stage market in Finland (based on FVCA 2007) figures. The graph below depicts the distribution of early stage investments by stages.

The distribution of the number of initial venture capital investments between investing stages



There are divergent opinions on whether the early stage venture capital funds lack good quality investment offers or whether there are sufficient good quality investment offers but not enough funds. There is also an active ongoing debate about the amount and quality of deal flow.

6.1.1 Main recommendations for the Finnish market

Key recommendations for political action to support the continued development of the Finnish and the Nordic early stage venture capital market:

- Active support for initiatives that increase access of the start-up companies to managerial skills and experience, e.g. in form of co-entrepreneurs and experienced board members, especially issues relating to taxation of compensation paid by issuing shares.
- Support for cross-border investments by (semi)public operators where national and Nordic interest is shared even tough one or several investors might be investing outside the own domicile

[3] Ministry of Trade and Industry, "Financing of Young Innovative companies"

- Evaluation of whether the Nordic Investment Bank can enter the venture capital market.

6.2 Overview

The Finnish early stage venture capital market is thin and lacks institutional investors with an adequate appetite for seed/start-up risk. Moreover, the current funding mentality fails to address the issue of continuation. Substantial efforts have been directed to funding several seed stage companies without paying enough attention to what these companies require to become attractive investment targets for the next stage, international A/B round funds and industrial partners. One of the guiding principles, market rate returns on investments, is not the primary driver for public market players, creating some slack in the process. This is reflected in risk tolerance, which is low and exacerbated by the fact that, by definition, Finnish investors seek compromises instead of going for a winner and concentrating resources on developing those winners.

Finland has invested substantial amounts to build an innovation eco-system. The early stage funding space used to be filled by State controlled entities without a coherent structure for cooperation or division of responsibilities. In response to this challenge, the State reorganised the public sector related venture capital universe. Based on a new division of labour, the responsibilities of the public sector funds were reallocated:

- SITRA to concentrate solely on venture capital investments within its specific programmes;
- Finnish Industry Investments to concentrate solely on growth stage investments;
- Veraventure to concentrate solely on investments in the seed and start-up stages.

The low growth ambitions of a large share of entrepreneurs is reflected in the insufficient investment amounts sought and obtained, which appears to create a "chicken and egg" dilemma that is an obstacle for Finnish growth companies. Introduction of new investors to the market would stimulate entrepreneurial activity by increasing the "size of the pie". The more unique the fund's focus and the greater the expected value-added support for the growth and internationalization of the new fund's portfolio companies, the greater the new deal flow generated.

In addition to State controlled entities, there are only a handful of private sector players who are also characterised by a heavy State presence through Finnish Industry Investment, a State controlled fund-of-funds acting as a limited partner in the majority of existing early stage players. The most notable private early stage players are Open Ocean, Conor Venture Partners, Iveni Capital, Inventure. Innofinance and Tutor Partners.

6.2.1 Seed stage investing

Finland has a strong research, technology development and IPR foundation but has failed to develop growth companies out of seed investments. Despite the fact that the overall financing situation of early stage companies is relatively good, there is a challenge involved in catalyzing the finance of early stage companies that aim to capture global markets. There are currently few sources of sufficient value-adding risk capital for these growth oriented and internationally focused ventures, particularly in the first rounds of external finance. This is a fundamental growth entrepreneurship challenge, where the ability to tolerate risk is the ultimate building block for developing the companies to the next stage. This risk aversion is further exacerbated by public venture capital funding, where selection criteria are not always geared towards the best returns, but instead support policy objectives. This has led to a situation where the focus is on the survival instead of the success rate. Consequently, public funds have ended up supporting a large number of companies with insufficient resources for growth.

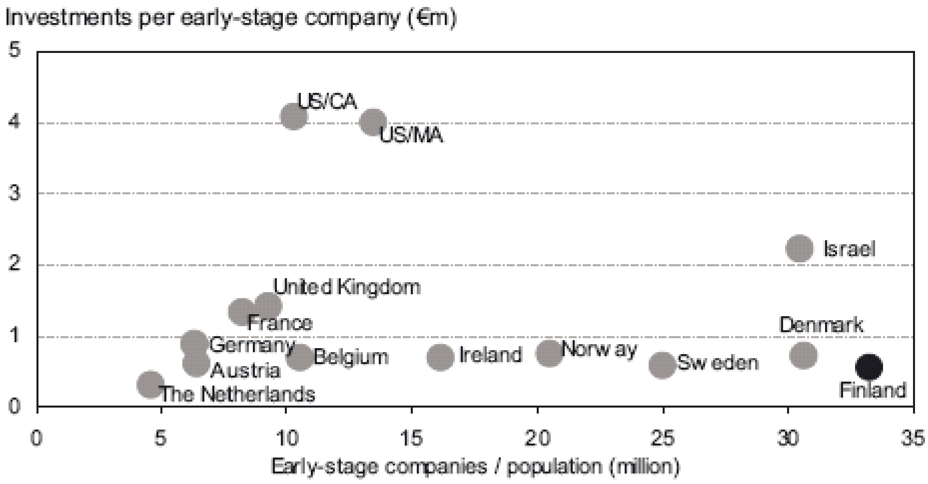
One constraining factor in developing innovative early stage companies is the difficulty in attracting institutional investors. Large pension funds remain the core source of funds and it is still somewhat of a new asset class for investors. Institutional investors suffered huge losses following the dotcom crash and since then, little new investments have been made in early stage funds. Only a few “trusted” early stage VCs have attracted sufficient funding, while those with no prior track record have been ignored.

Although a majority of early-stage companies recognize the necessity of international operations, investors and venture capital firms are only slowly waking up to this reality. Finnish venture firms have only recently expanded their operations beyond an exclusively domestic or, at best, Nordic focus. Very few have been able to recruit foreign expertise to their boards or top management. Such a predominantly domestic focus has not made it easier to attract talented and experienced foreigners to come and build growth companies in Finland.

6.2.2 Challenges

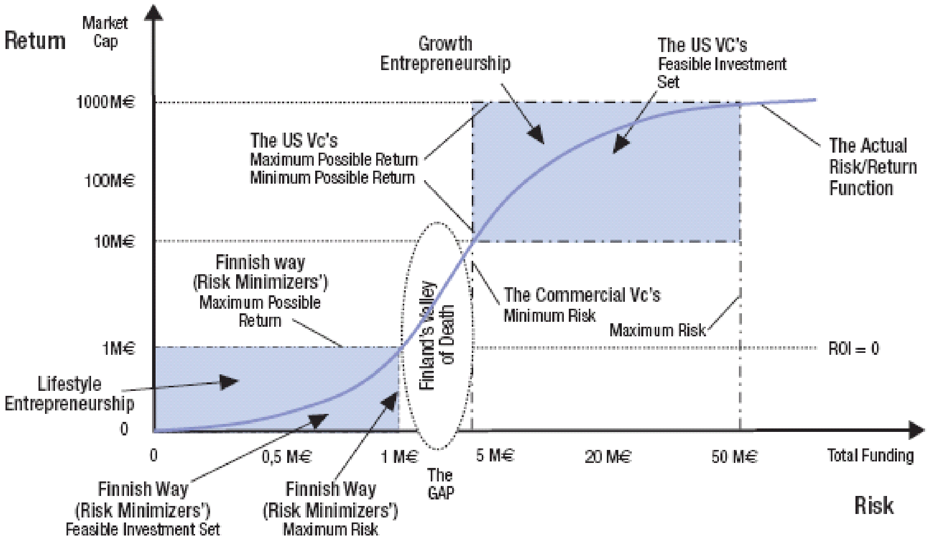
The primary challenge in the market is the lack of success stories, which are necessary in order to attract foreign investors to invest in Finnish early stage space. This would not only provide depth in venture capital firms operating in the market, but also valuable international experience.

Another challenge is the risk aversive nature of the existing players. There seems to be a tendency to spread available, scarce resources too widely by funding too many companies without adequate follow-on investment strategies. Furthermore, the current innovation eco-system supports a large number of "lifestyle entrepreneurs" lacking the drive and ambition to take their companies to the next level. This is mainly reflected in the general attitude of giving everybody a fair chance of making it instead of concentrating funds, time and effort in developing the fittest. The eco-system also lacks serial entrepreneurs who have been there and seen that, and thus have the ability to help seed companies to thrive and reach the next stage. The risk aversive nature of early stage investing is depicted in the table below.



Note: it is worthwhile to bear in mind that in addition to venture capital investments, TEKES (Finnish Funding Agency for Technology and Innovation) has a budget of some € 500M for grants and soft loans for innovative early stage companies.

There is a sufficient amount of seed/start-up capital as far as the expansion stage but that is followed by a "valley of death" until the growth stage, which paralyzes the development of the companies. There are few serious players in the early stage space and the further the companies progress in their respective evolution, the thinner the market becomes. The graph below depicts the Finnish challenge in terms of adequate funding.



***Source**: TEKES*

Another major challenge is the short time horizon and lack of international experience in terms of developing the companies to their fullest potential. The lack of international scope and experience has led to a general inability to expand operations beyond the Finnish borders and therefore failure to attract international investors. The early stage companies remain reluctant to take the quantum leap of canvassing for international opportunities. When they finally decide to do so, they often underestimate the challenges and overestimate their resources. This partly applies to venture capital players as well.

An even more serious challenge is the lack of global business competence. The number of serial entrepreneurs is very low and most of the talented business professionals choose to work for the large corporations. This can also be seen in the low number of corporate spin-offs or spin-outs entering the Finnish early-stage, high-growth ecosystem.

As indicated above, the biggest challenge is to create an innovation eco-system, which would produce high-growth success stories on a regular basis. Although there have been some random success stories, the market lacks a clear and structured system of developing winners from growth companies.

6.2.3 Solutions

Based on the deal flow analysis, it can be concluded that there is more deal flow in Finland than was previously thought to be the case and that the deal flow volume is likely to increase further if new specialized investors enter the market. The performance analysis suggests that although past returns on early stage investments have not been satisfactory, there is no reason why that should be the case in the future.

A possible solution is to focus on creating winners and concentrating efforts and resources on developing success stories, which would act as an example for other seed/start-up stage ventures. However, that would require the creation of a risk taking environment that would facilitate serial entrepreneurs to invest funds and knowledge in early stage ventures.

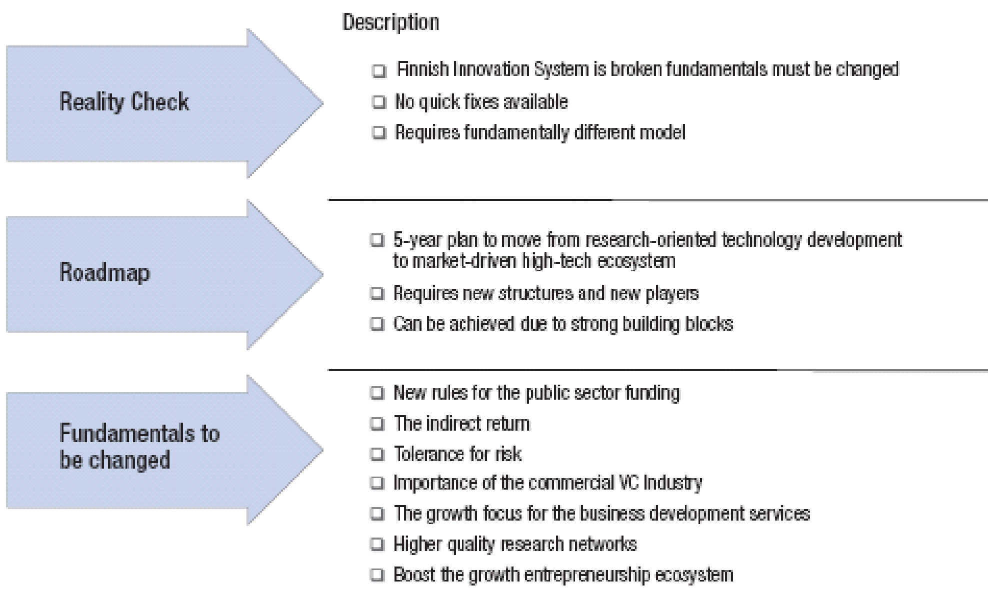
It is also necessary to focus on ensuring venture capital firms ability to generate and sustain a unique deal flow. In high technology venture capital, good deal flow often emerges from serial entrepreneurs and as spin-offs from leading research institutions and corporations. Both public and private venture capital firms should have access to superior deal sources, which can help to put together dream teams to commercialize these new technologies.

Another aspect is the inability of venture capital firms to support portfolio companies' internationalization. Venture firms should have a very wide and strong contact network that includes leading global corporations and international investors in order to enable the portfolio companies to reach the next level. The contact network is critical in all stages of the investment process from origination and due diligence to identifying industrial partners and/or additional exit avenues.

The supply and the demand sides should be addressed simultaneously in order to solve the chicken and egg problem in the early stage venture capital. According to Gilson (2003), "replicating the U.S. venture capital contracting structure confronts a daunting simultaneity problem. Three central inputs are necessary to the engineering process: capital, specialized financial intermediaries, and entrepreneurs. The problem is that each of these inputs will emerge if the other two are present, but none will emerge in isolation of the others."[4]

The graph below provides a snapshot of measures suggested by a recent study conducted by TEKES[5].

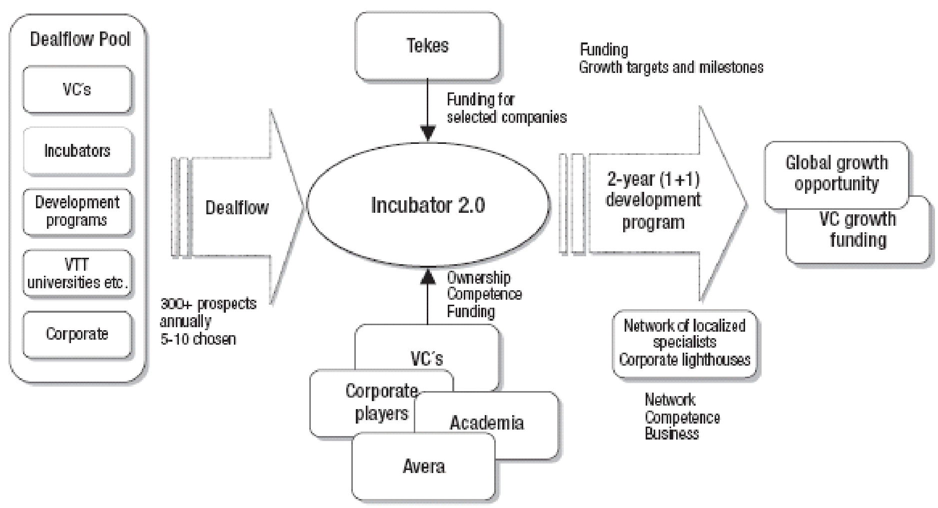
[4] Gilson (2003)
[5] VICTA - Virtual ICT accelerator / TEKES technology review



Source: *TEKES*

6.2.4 Incubators

The Finnish incubator programme "Vigo" (www.vigo.fi) was launched in March 2009. The programme's tenure is 3+3 years and started immediately with the aim of establishing 3-5 sector specific incubators managing up to 10 companies at any given moment. The central government is committed to investing up to € 45M in the programme during the first 3 years. The graph below depicts the anticipated incubator system operating model.



In addition to financial sources, the secondary aim is to engage serial entrepreneurs with substantial international experience to develop the incubator companies to their full potential.

6.2.5 Business Angels

There is an active angel community. Until the beginning of 2008 SITRA was responsible for developing the Finnish business angel community and had a pool of 460 names. At the beginning of 2008, Veraventure started building their Angel Pool, which has 110 potential angel investors today. Veraventure estimates that the number of active Angel investors in Finland is 150. For Veraventure, this active Angel Investor pool represents a critical resource for managing its portfolio companies and taking them to the next level.

During the 2008 fiscal year, Veraventure made a total of 17 syndications with Business Angels. However, a vast number of investments made directly by the Angels are not in official statistics.

Given that venture capital firms alone are unable to resolve the funding and development challenges of early stage companies in Finland, Angels have a potentially significant role as one of the most appropriate forms of early stage capital. As a funding mechanism, they not only bring risk capital but are also experienced, entrepreneurial individuals with the relevant skills to take the early stage companies to the nest level. Therefore, incentives offered to Business Angels should remain at the heart of supportive measures to catalyze Angel investments.

6.3 Looking ahead

Finland is increasingly open to leveraging international financial and human resources in order to support early stage innovative companies. Cross-border venture capital would play a very significant role in developing these companies into attractive investments. The ability to attract foreign investors is of critical importance for the success for the developing Finnish innovation eco-system. Such investors would materially assist early stage companies to internationalize, thus facilitating additional funding. However, a necessary precondition is a strong and respected local investor base with an adequate international contact network demonstrating the ability to create quality deal flow.

Furthermore, given the risk aversion combined with the relatively low entrepreneurial interest of Finnish early stage companies, international investors would certainly alleviate the problem.

There have been numerous initiatives to support Finnish early stage companies to identify international investors and create an international network. The most notable are the FinnNode innovation centre and the International Business Accelerator Centre in Silicon Valley, as well as the FinnCh innovation centre in Shanghai. Veraventure's participation in the

EU Early Stage Investor project promoting cross-border investments within Europe is another encouraging example of the growing internationalisation of early stage investments. Pan-Nordic initiatives such as the Nordic fund-of-funds can also be seen as an important step in the right direction, provided that this initiative actually materialises. Nevertheless, the international scope and orientation of Finnish early stage companies is still based exclusively on a few enlightened individuals and fragmented project type initiatives. An international perspective and ambition should become a core competence of Finnish early stage innovation eco-system.

There remains a clear need for industry focused General Partners with sufficient resources, world-class competencies and a wide international contact network. Venture Capital managers should be able to invest in the early stage and have the ability to aggressively follow on and invest in order to support their portfolio companies to build an international presence, thus filling the preconditions for commercially attractive exits.

7. The Norwegian seed capital market

The following text outlines the main challenges and most important issues to resolve on the Norwegian seed and venture capital market as seen from the perspective of the Norwegian member of the Nordic Seed Capital Initiative, Innovation Norway.

7.1 Present status and recommendations

The seed capital segment is an important piece of the creation of new companies and industries in Norway. Together with research facilities, incubators, science parks and later stage investors they make up an eco-system that can produce young growing companies.

The supply of seed capital financing in the Norwegian market has been low. Today, most capital in the seed segment is provided by public schemes. Outside of the public operations the supply of seed capital is very limited, despite the fact that there is an emerging trend of private investments in the early phases.

The overall Norwegian private equity market has had strong growth over the last decade. In Norway, private equity financing has traditionally been practised by family-owned companies carrying out investment activities, generally as a sideline to their primary business. It is only in the past 10–15 years that we have seen the emergence of a professional fund management industry based on institutional capital. Historically, the private equity market has been organised around industrial clusters such as oil and gas, marine and maritime, technology, media and telecoms.

In terms of activity, the Norwegian private equity sector has previously been more orientated towards venture capital than is usually the case internationally. However, during the last few years several new mid-buyout funds have been established, which have raised substantial amounts of capital.

Some of the major challenges for today’s Norwegian seed market are:

- Relatively low overall supply of seed capital. There are too few experienced investors.
- The supply of private capital in the seed stage is still too limited.

- Fundraising for venture capital funds has become more difficult and the venture capital firms still need to prove their long-term competitiveness. These firms are important follow-on investors with which the seed investors can cooperate.

Recommendations for politicians:

- "Public seed" funds should have enough critical mass in terms of capital and personnel to be successful investors and attractive partners for private investors.
- Private investment in the early phases should be stimulated.
- Long-term financing should be provided for venture capital funds to ensure the evolution of experienced Norwegian venture capital firms.

7.2 Overview

Most of the public financing facilities for SMEs in Norway are gathered in one organization, Innovation Norway. The concentration came about after a merger of a number of functions and organizations in 2004. The task of Innovation Norway is to contribute to the development of Norwegian business life, both nationally and internationally, with focus on renewal and innovation. Innovation Norway provides services and programs aimed at developing the regions, increasing the level of innovation in business all over the country and promoting Norwegian business life and tourism.

During 2008 Innovation Norway contributed about NOK 4.1 billion in grants and loans to development projects. 85% of this financing was directed towards companies with less than 20 employees.

As stated above, most capital in the seed stage is provided by public schemes. The supply of competent and active seed capital outside of the public schemes is very limited. There are incubators, TTOs and science parks, but these are mainly oriented at pre-seed and have limited amounts of capital to invest in each company. There is however, as mentioned earlier, an emerging trend of private investors in the early stages. Organizations such as Kistefos, Scatek, Höegh Capital Partners, Statkraft and Statoil New Energy are included here and have all increased their activity. However, this has not changed the overall picture.

Innovation Norway has organised seed capital funds since 1998. Today there are 15 separate funds, of which 5 cover the whole country while the others are regional. All of the funds comprise substantial public financing, part of which is defined as a loss fund that can be used when holdings are fully written down.

The funds and the fund managers are privately owned but 50 – 70 % of the funds are financed by public means. The funds in turn invest in portfolio companies. The seed capital funds were established in two waves, 1998-2000 and 2006-2008. These funds have a total capital of NOK 3.1 billion.

An analysis of the first wave of publicly financed funds shows, that so far these funds have had lower returns than expected. The regulations were set up with the aim of ensuring that the funds should have reasonable returns in comparison to other asset classes. Evaluations reveal that all but one fund have had negative returns. The main reason for this is the lack of high return exits. A mere two out of 175 investments were sold at a high profit.

Later funds have a higher capital base, larger management teams and invest greater amounts in each company. It is still too early to judge how these funds are performing.

It has been suggested that a potential wave of new funds should be made up of larger funds. A size of NOK 500M per fund has been recommended. The idea of setting up larger funds is in line with academic research findings and OECD studies showing that funds with sufficient critical mass in capital and organization tend to perform better.

7.2.1 Business angels

Over the years several projects have been executed to promote business angel investment as well to create a national network of business angels in Norway. So far these attempts have been unsuccessful and there is today a lack of a professionally organized structure for angel investors in Norway.

7.2.2 The Norwegian venture capital market

The venture capital market in Norway has grown rapidly in recent years and the leading firms have been successful in raising Norwegian and international capital. The Norwegian Venture Capital Association lists 23 venture capital firms. The larger firms today include names such as Northzone Ventures, Verdane Capital and Viking Venture.

The recent economic downturn will, however, make it more difficult for venture capital firms to raise capital. The venture capital firms are important for the so-called food chain of capital and thus also for the seed investors. These firms provide capital for the expansion of successful companies from the earlier phases. If capital becomes scarce in the venture capital phase it also constitutes a problem for the early stage investors.

7.2.3 Argentum - the public fund- of- funds

Argentum Fondsinvesteringer AS was founded in 2001 and is a public investment company investing in Nordic venture capital and buyout funds. Argentum does not focus on seed funds but as stated above, the venture capital funds they invest in are vital for early stage investors.

Argentum's mission statement is: "Argentum aims, by means of professional investment management, to make the Norwegian private equity environment internationally competitive and thus better capable of developing good ideas and businesses into profitable growth companies. We aim to have a return on investments comparable to that of the best fund-of-fund investors in Europe".

Argentum today is an important investor for many Norwegian venture funds and has produced high returns since its inception.

7.2.4 Recent developments

In 2009 Argentum's equity capital was increased by NOK 2.25 billion from the Norwegian government, which further ensures Argentum's ability to invest in the market.

In 2008 a new public investor, Investinor AS was established in Trondheim. Investinor invests in Norwegian based, high potential companies that are internationally oriented and in the phases ranging from early growth to expansion. The company has NOK 2.2 billion under management and focuses on companies within the energy, cleantech, maritime, marine and travel sectors. The cleantech and marine sectors are of particular interest, with MNOK 500 earmarked for the latter.

Investinor AS has a co-investment strategy and can take up to 49 % equity ownership of a portfolio company. They co-invest with private players.

Investinor is not a seed investor since its focus is on early growth to expansion, but it will be an important complement to the existing public funds. The organization was built up during the first part of 2009 and is now up and running.

7.3 Looking ahead

Going forward there will be a continued need for high public activity in the seed phase to create experienced seed investors and contribute to a well functioning eco-system. Public funds will probably be set up with a larger capital base ensuring critical mass regarding capital resources as well as organization. It takes time to build a well functioning seed market and it is important for policy makers to be patient.

It is essential that the venture capital market continues to develop in order to create a sustainable market in the long term. It is also vital that more private capital is attracted to invest in the early stages.

In the Norwegian innovation system the combination of research, science parks, incubators, private investors, publicly funded seed capital funds and venture capital firms are all important factors in the creation of viable new companies.

8. The view of the Norwegian Venture Capital & Private Equity Association

The following text briefly outlines the main challenges and most important issues on the Norwegian seed market as seen from the perspective of the Norwegian Venture Capital & Private Equity Association. Relevant statistics pertaining to the Norwegian seed and venture capital markets are also included.

8.1 Main challenges and recommendations for the Norwegian market

8.1.1 Main challenges for the Norwegian market

The Norwegian venture capital market is relatively mature with competent management companies that have been operating for 15-20 years.

The Norwegian private market for seed capital is relatively weak compared with the need for early stage financing. Hence, the lion's share of Norwegian seed investments is made by funds supported by public loan capital.

As a result of the financial crisis it has been particularly hard for some early stage/seed funds to find co-investors for their investments.

8.1.2 Most important issues to be resolved and recommendations

Some of the above mentioned challenges are likely to be of a temporary character, while others are more systemic. One of the more permanent challenges is the need for more capital in the seed capital market. An important arrangement in solving this problem is the seed funds which have been raised in private/public cooperation. In these funds, one unit of private investor capital is backed by one unit of public loan capital. NVCA also believe that the new governmental "co-investor fund", Investinor, will make an important contribution to financing early stage companies in companionship with other investors.

NVCA believe that in order to achieve an efficient market for seed investments it is necessary with continuity and predictability in the already existing arrangements. An important next step would therefore be to arrange a new round of seed funds in private/public cooperation similar to the abovementioned existing arrangements. With continuity in the private/public capital seed funds, it will be possible to build management competency in this segment over time, which in turn may improve returns and attract more private capital.

The government should also look further into and consider tax schemes which encourage private investors to invest in early stage companies. In many countries such schemes have been very successful, and made additional funding available for a large number of start-up companies.

Recommendations:

- A new round of private seed funds backed with public loan capital should be established with the aim to, in the long term, building management capacity in the seed segment.
- Governmental tax schemes which encourage private investors to invest in early stage companies should be implemented.

8.2 Statistics of the Norwegian markets

Below are relevant statistics for the Norwegian seed and venture capital markets.

In 2008 3 seed, 2 venture and 4 buyout funds were established in Norway. According to the latest statistics, 51 management companies now manage 107 funds with € 7.2 billion. As can be seen below, about € 390M of this is seed capital.

Capital under management by phase (31 December 2008, € millions)

	2008
Seed	389
Start-up / Venture	2827
Expansion / Internationalization	693

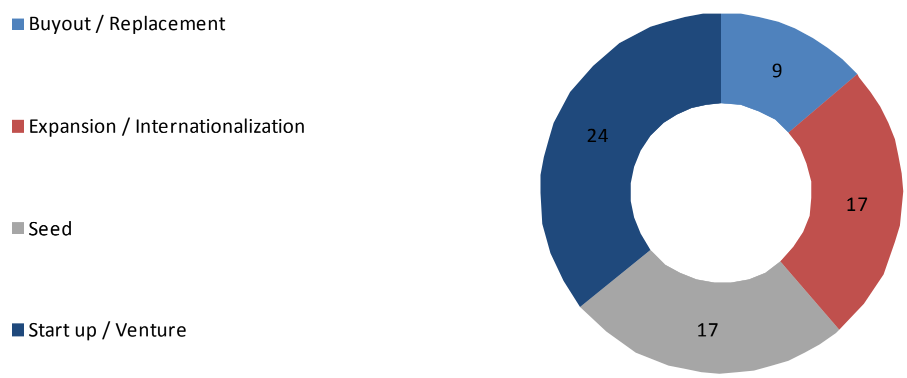
In the seed phase about half of the capital is public, while in the start-up/venture segment nearly 10% percent of the capital is public and represented by the public management company Investinor. In addition, there is a Norwegian public private equity fund-in-fund (Argentum) of more than € 600M, which invests in all Nordic private equity segments from start-up / venture to buyout.

Number of deals 2008 (seed-start up –expansion[6]

	Initial investments	Follow-on investments
Expansion / Internationalization	17	47
Seed	17	6
Start up / Venture	24	77
Total	58	130

The charts below show the number of new portfolio companies in existing funds during 2008.

Number of initial investments by segment (2008)

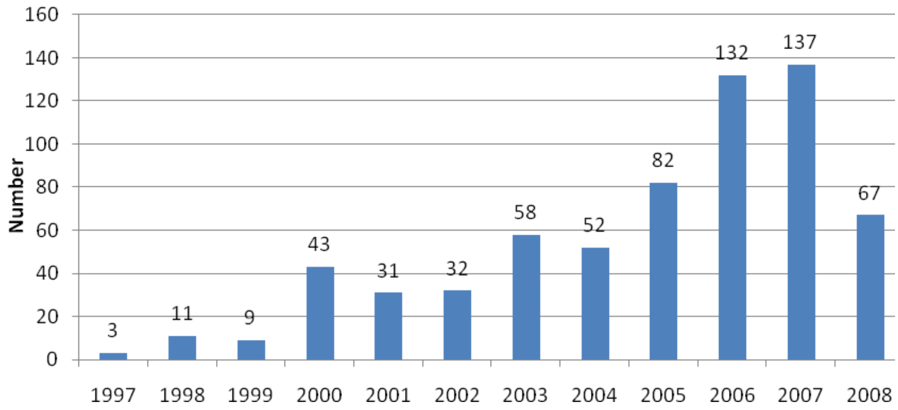


In 2008 only 58 initial investments were made in the seed, start up/venture and expansion/internationalization segment in comparison to 121 investments in 2007. The slowdown relates to early stage investments (both seed and venture).

[6] In addition, there are 43 investments, 21 in seed, 21 in start-up/venture and 1 in expansion /internationalization, which are not split between initial and follow-on investment.

The figure below shows the number of new portfolio companies by year, including new buyout companies.

Number of initial investments by year



Source: *Menon Business Economics and NVCA*

Lists of the present management companies in Norway in the seed and start up / venture capital segments are presented below.

Norwegian seed capital managers:
Bølgen
Campus Kjeller
Fjord Invest
IT Fornebu Inkubator
KapNord
Kongsberg innovasjon
Leiv Eiriksson Nyskaping
Midvestor
Norinnova
Proventure Seed
SåkorninVest
Sarsia Seed
Sinas
Sinvent / SINTEF
Spring-fondet
Sydvestor

Norwegian Venture Capital managers:
Alliance Venture
BTV Invest
Convexa
Creo Capital
Energy Capital Management
Energy Future Invest

Energy Ventures
Ferd Venture
Hafslund Venture
ICON capital group
Incitia
Investinor
Kistefos Venture
Mallin Venture AS
Neomed
Northzone
O. N. Sunde Venture AS
Procom Venture
Sarsia Life Science
Skagerak Venture
Teknoinvest
Telenor / Televentures
Venturos
Verdane Capital
Viking Venture

9. The Swedish seed capital market

The following text outlines the main challenges and most important issues to resolve on the Swedish seed and venture capital market as seen from the perspective of the Swedish member of the Nordic Seed Capital Initiative, Innovationsbron and the Swedish Private Equity & Venture Capital Association.

9.1 Present status and recommendations

The venture capital market is vital for financing innovative start-up companies in order for them to grow into larger enterprises. As many studies have proven, venture-backed companies grow faster and in a more sustainable manner than their non-backed peers. Therefore, the sustentation of a strong and robust venture capital market is imperative for the growth of small and medium sized companies. Moreover, sufficient, adequate financing in all venture stages is of great importance in order for start-up companies to develop into growing and expanding enterprises.

There is quite a large amount of capital available for seed companies through various financing options such as conditional loans and grants from government agencies. However, in the case of equity capital, the situation is quite different.

The Swedish venture capital market is currently under a great deal of pressure considering the number of investments in new portfolio companies. The venture market has undergone major changes within the past year which have seriously affected the number of new companies receiving finance from venture capital firms.

- The risk aversion towards investing in the early stages has increased due to the financial crisis. More and more capital is being deployed in the latter stages of venture.
- This is particularly apparent in the seed stages, where there has been a dramatic decrease in the number of investments and very few new investments. A distinct majority of all the investments made in the last half of 2008 were follow-on investments.

- During 2008, there was an inflow of capital from foreign investors, which could impact on the future location of companies started in Sweden. There is a risk that some of these foreign-funded companies might move the holding company's headquarters to a foreign location.
- The governmental response to the financial gap in the early stages has been to increase the funding of later early stages and expansion through the launch of ALMI Invest, which has received funding from the EU structural funds, governmental agencies and regional players. However, these regional funds need to be invested together with private capital on at least a 50/50 basis, which can lead to a problematic situation due to the lack of private capital for new early stage investments.

9.1.1 Recommendations

In order to increase the availability of venture capital in the market, we recommend that politicians and the public sector focus on three specific areas:

- The creation of a fund-of-fund similar to the Norwegian Argentum model, which invests in venture capital funds and can function as a cornerstone investor in order to help new management teams in their fundraising activity.
- The implementation of the Tax Incentives Investigation (Skatterabatt på aktieförvärv och vinstutdelningar- SOU 2009:33), which would increase private capital by creating incentives for private investments in unquoted companies.
- Facilitating an environment in Sweden where new venture capital and private equity funds can be set up without creating a double taxation situation for international investors.

9.2 Overview

The venture market in Sweden has, historically, been dominated by venture capital funds at least partly funded by the government. At the seed stage, many of the investments were made by venture firms with a clear connection to either university holding companies or incubators. Some of the more active publically funded firms investing in seed companies are Chalmers Innovation, Teknoseed, AB Chalmersinvest and Sting Capital.

When looking at the trends of 2008, the number of investments decreased substantially. New investments in particular experienced a sharp drop from the annual figures for 2007.

Number of venture investments by stage in Swedish portfolio companies during 2007 and 2008

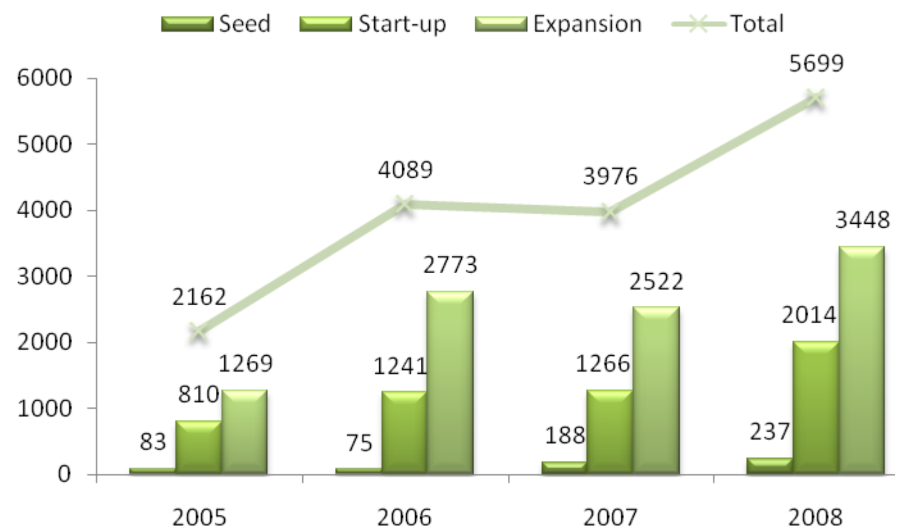
Stage	Number 2008			Number 2007		
	Initial	Follow-on	Total	Initial	Follow-on	Total
Seed	18	23	41	60	47	107
Start-up	66	196	262	90	205	295
Expansion	43	159	202	61	150	211
Total	**127**	**378**	**505**	**211**	**402**	**613**

The trend for the amounts invested in venture during 2008 was a substantial increase in all stages.

Amounts invested in venture by stage in Swedish portfolio companies during 2007 and 2008

Stage	Amount 2008 (MSEK)			Amount 2007 (MSEK)		
	Initial	Follow-on	Total	Initial	Follow-on	Total
Seed	126	111	237	74	114	188
Start-up	863	1 150	2 013	583	683	1 266
Expansion	1 313	2 136	3 449	1 527	995	2 522
Total	**2 302**	**3 397**	**5 699**	**2 184**	**1 792**	**3 976**

Amounts invested in Swedish portfolio companies within venture 2005-2008 (MSEK)



However, when looking at the current trends, during 2008 less capital came from government funded venture capital firms compared to previous years. Instead, more capital was invested by private and foreign venture firms. Moreover, Swedish Venture capital firms dramatically decreased their investment in seed companies, while foreign venture capital firms increased their investments substantially during 2008, which in total led to an increase of capital to seed companies during 2008. In fact, over 60 % of the amount invested in seed companies came from foreign venture capital funds.

9.2.1 Incubators

Innovationsbron is a governmental agency that focuses on commercializing research and innovation to create successful businesses. One of its tasks is the running of a national incubator program, IBIP that enables participating incubators to strengthen the flow of business ideas into the incubator environments, while creating more innovative new enterprises that generate growth at regional and national level. The vision for IBIP is that "Swedish Incubators are the most efficient in creating new business based on R&D and Innovations"

The program also includes a company and business development process, as well as activities related to benchmarking and the exchange of experience between incubators at national and regional level. These activities are open to all incubators. In addition to IBIP, Innovationsbron invests in regional projects and processes as well as promotes development in special sectors in order to further strengthen the incubators.

9.2.2 Business Angels

Business Angels have also been a major source of funding for early stage companies. The financial crisis has had an impact on this, as the amount of capital per business angel has decreased due to the recession. The current lack of incentives for private capital investments in unquoted companies has also had an impact on the private investors' willingness to invest.

9.3. Looking ahead

The Swedish venture market as a whole faces many challenges. One example is the non-existent exit market, which will lead to more follow-on and even fewer new investments. Furthermore, the poor performance of many early stage funds will reduce the possibility to raise future funds, thus affecting new investments in early stage companies.

The lack of funds raised with an expected allocation to early stage investments is a concern. Only 21 % of the funds raised within venture, which totaled SEK1 577M, is expected to be invested in either seed or start-up companies.

The inflow of capital from foreign investors is expected to increase due to Sweden's strong R&D position.

Sweden always has a high ranking on Innovation and R&D in various benchmarking reports and is also among the highest when ranking the percentage of venture capital in comparison to a country's GDP. Despite these facts, Sweden is considered to have a less favorable environment for entrepreneurs and business enterprises in terms of regulations and tax structures. Therefore, simplification of the regulatory framework and benchmarking with countries that have more encouraging business environments could lead to an increased possibility to commercialize more innovations and stimulate the growth of early stage companies.

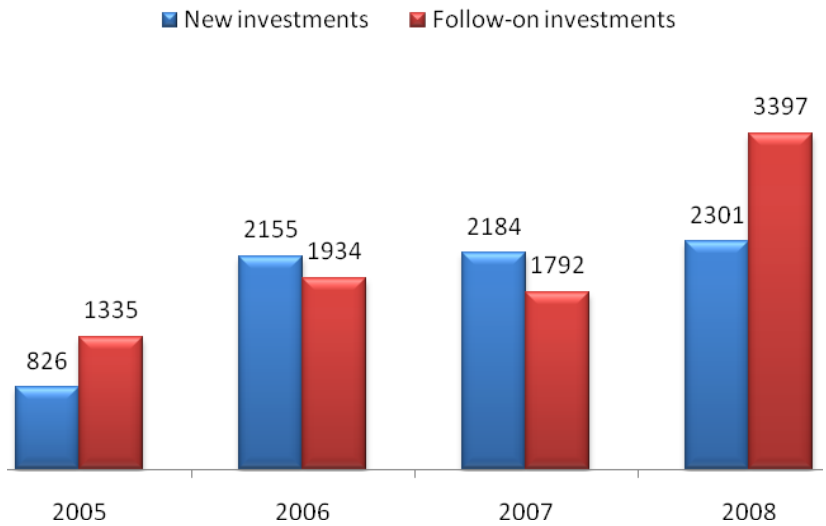
To date, the governmental focus on the lack of capital in the early stages has primarily been directed towards post-revenue companies. This has been done through the setting-up of an organization within the ALMI Företagspartner corporate group, ALMI Invest, that will focus on equity investments. The ALMI Invest initiative targets companies with a positive cash flow and a desire to expand regionally, nationally or internationally. Most of the government funded venture capital needs to be invested together with private venture capital. At present there is a shortage of private capital in the market. The government must therefore facilitate the investment of more private capital in early stage companies. This can be done by, for example, implementing the Tax Incentives Investigation (Skatterabatt på aktieförvärv och vinstutdelningar- SOU 2009:33), which would increase the amount of private capital by creating incentives for private investments in unquoted companies.

Other governmental actions could include the creation of a governmental fund-of-fund, similar to the Norwegian Argentum model. The fund-of-fund's objective would be to invest in venture capital and private equity funds, thus increasing the availability of capital in the market. This would definitely increase the number of venture funds and new management teams in Sweden, where the governmental fund-of-fund would function as a cornerstone investor in the fundraising process.

The government has launched an investigation, Innovations and Business Enterprises – Swedens' future (SOU 2008:121), to establish how the government should help to finance new SMEs in the future and which will determine future public financing. However, the result and real outcome of the investigation is yet to be seen.

As mentioned previously, there has been an inflow of foreign capital, not only in seed companies but for companies in all stages of development. However, there has been a clear shift towards more focus on follow-on investments, especially during the two last quarters of 2008.

Annual venture investment activity in Sweden, by type of investment (MSEK)



10. The view of the European Private Equity & Venture Capital Association

The following text briefly outlines the main challenges and most important issues on the European seed and venture capital market as seen from the perspective of the European Private Equity & Venture Capital Association

10.1 Main challenges and recommendations for the European market

A functioning European venture capital industry needs to be attractive to the private sector and particularly to institutional investors worldwide – this is currently not the case and necessitates continued public invention. Such funding should go where it has the highest long-term impact, i.e. where it has the potential to create a self-sustaining venture capital industry.

Attracting international institutional investors is critical for the European venture capital industry to benefit from diversified sources of funding, deep knowledge and experience and global networks. The priority of public support should be enabling the fledgling venture capital industry to develop a more convincing track record that allows it to attract private capital and where internal institutional investors even seek access to European funds. To achieve this objective, three major problem areas have to be addressed:

1. Europe lacks “patient money” with a true “venture culture”.
2. The European venture capital market is highly fragmented and does not benefit from its size. The difficulties related to the structuring of investment vehicles shifts the venture capital firms’ priorities away from building innovative SMEs.
3. Institutional investors are generally unconvinced about the return potential of the European venture capital industry and do not see a sufficiently strong supply in high quality fund proposals that would justify a significant allocation to European venture capital.

Schemes should be explicitly designed for and give the necessary priority to innovative entrepreneurship with a strong international orientation, as well as avoiding regional fragmentation and targeting the global market. EVCA has long argued that public support needs to stimulate market forces to get into action and should only be given when partnered with private money.

11. The view of the Nordic Venture Network

The following text briefly outlines the main challenges and most important issues on the Nordic seed and venture capital markets from the perspective of the Nordic Venture Network. NVN is a club made up of the leading private technology venture capital firms in the Nordic region.

11.1 Main challenges and recommendations for the Nordic market

The single most important recommendation for Nordic policy makers today is to create incentives to increase the attractiveness of entrepreneurship and investing in the seed and early stages. Making it profitable to become an entrepreneur and to invest in start-up and early stage companies without the need for government support is the most important measure that can be taken for the creation of a long term, self-sustainable venture capital market.

However, in order to achieve a self-sustaining market, public support, provided in tune with the market, is needed in the seed and early stages as well as a stabilizing force for the venture capital market during the financial crisis.

The present status of public support in the seed stage varies between the different Nordic countries. In for example Finland, public funding for the early stages seems to be available whereas in Sweden, it is difficult for entrepreneurs to obtain financing for the first 6-12 months. It is essential that public financing is provided in a careful manner and only to fill gaps where there is currently not enough private capital available. If too much soft capital is made available it can distort the market.

11.1.1 The most important challenges for the Nordic seed stage

The most important challenges for the Nordic seed stage today include:

- **Lack of private capital in the seed stage**

There is a lack of private capital for investments in the seed stage. A number of venture capital firms make a few investments each year, but many start ups need to obtain financing from business angels, or similar sources. Today it is not considered attractive to invest in the early stages.

A number of initiatives have been presented from the national venture capital associations to resolve this issue. For public policy makers, the most important issue today is the creation of incentives to increase the supply of risk willing capital in the early stages. One example could be to make losses due to investments in early stage companies tax deductible and postpone taxes on profits if intended for new investments in early stage companies.

- **The importance of managing the level of "soft capital"**

In some Nordic countries like Sweden, the supply of available soft capital has been reduced substantially in recent years. This has had a strong negative effect, as this stage is the most difficult to finance. However, in Finland there is a great deal of soft capital available. It is important for government to be cautious about the levels of soft capital, because if made available in abundance, it distorts the market and funds to many companies in the earliest phases.

11.1.2 The most important challenges for the Nordic venture capital market

The most important challenges for the Nordic venture capital market are:

- **Funding for Nordic venture capital firms**

The financial crisis has made it difficult for venture capital firms to raise new funds. In the medium term it would be of great importance for the development of the market if more public capital was made available for investments in venture capital funds. The long term goal is a well functioning venture capital market mainly financed by private institutional investors.

In order to spark private interest in early stage funds models could be tried where public investments were made with lower return expectations or higher management fees than private investments.

- **Lack of incentives for entrepreneurship**

If a chart is made with company size on one axis and tax percentage on the other axis it is evident that the larger the company, the lower the tax rate. If we want to create new large companies it must be made more attractive to run smaller companies. In Sweden, for example, the youngest large companies, H&M & IKEA, were founded in the 1940s.

One idea to promote start-ups would be employee social cost reductions for early stage companies. Another way of promoting young companies is for government to invest in new technologies and make purchases from early stage companies.

- **Possibility to recruit qualified staff with relevant incentives**

In the Nordic countries the regulations for incentive programmes such as option schemes vary. In several of the countries the regulations are unclear, which leads to uncertainty and costs for start up companies. In the longer term it makes it more difficult for start ups to hire qualified staff.

- **Tax and legal obstacles**

In several of the Nordic countries there are still legal and tax obstacles to setting up internationally competitive structures for venture capital funds. This has the effect that most funds are organized abroad, which implies unnecessary costs for the funds and their investors. Working towards the removal of these obstacles is important for the development of the market.

11.1.3 Nordic Venture Network members and sponsors

Today NVN has 11 members with about € 3.5 billion under management. Sponsors of NVN are leading Nordic public investors:

Members of the Nordic Venture Network:
Verdane Capital, Norway
InnovationsKapital, Sweden
Eqvitec, Finland
CapMan, Finland
TeleVenture, Norway
Brainheart Capital, Sweden
Northzone Ventures, Norway
Nordic Venture Partners, Denmark
Creandum, Sweden
Viking Venture, Norway
SCOPE, Sweden

Sponsors of the Nordic Venture Network
Argentum, Norway
Industrifonden, Sweden
New Business Venture Fund, Iceland
SITRA, Finland
Sjätte AP-fonden, Sweden
Vækstfonden, Denmark

Members of the Nordic Seed Capital Initiative

Innovation Norway
Innovation Norway's objective is to promote private and socio-economically profitable business development throughout the country, as well as to promote the commercial opportunities of the districts and regions by encouraging innovation, internationalisation and image-building. The state owned company employs over 800 people. Innovation Norway has offices in every Norwegian county and in more than 30 countries world wide. The head office is situated in Oslo.

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Innovationsbron
Innovationsbron is a Swedish public organization focusing on turning research and innovation into business. Innovationsbron´s vision is for Sweden to become an international leader in commercializing research-related business ideas. It supports researchers, innovators and entrepreneurs by translating their ideas into business. Innovationsbron´s role is to act market complementary and its efforts are focused on projects and companies in the very early stages of development.

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Nordic Investment Solutions

Nordic Investment Solutions (NIS) is an independent Nordic focused private equity advisory firm based in Stockholm. The services provided by NIS include; Non-discretionary advice for institutional investors, Strategic advice to institutions involved in the private equity market, Communication and Public Policy services to market players and public authorities as well as Nordic facilitation aimed at creating relevant business opportunities.

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NORDIC INVESTMENT SOLUTIONS

Veraventure

Veraventure Ltd is the largest seed fund in Finland focusing on research, development and innovation intensive companies, which address a market need or identifiable problem with substantial market potential. Target companies need to have a realistic opportunity of achieving a strong international market position while being able to build an attractive business case through strong technology, a coherent development plan and identifiable exit strategy. Veraventure has a unique position in Finland and controls 85% ('07 FVCA statistic) of the Finnish early-stage technology investment and innovation landscape.

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VERAVENTURE

Vækstfonden

Vækstfonden is a Danish State investment fund and since 1992 it has financed growth in over 3,500 Danish companies for more than DKK 6.5 billion. Vækstfonden invest directly, via other funds or with private investors, business angels, pension funds, banks, etc. The fund provides a broad spectrum of finance solutions for small as well as medium-sized companies – ranging from equity to loan guarantee.

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VÆKSTFONDEN

Nordic Innovation Centre

Nordic Innovation Centre

The Nordic Innovation Centre initiates and finances activities that enhance innovation collaboration and develop and maintain a smoothly functioning market in the Nordic region.

The Centre works primarily with small and medium-sized companies (SMEs) in the Nordic countries. Other important partners are those most closely involved with innovation and market surveillance, such as industrial organisations and interest groups, research institutions and public authorities.

The Nordic Innovation Centre is an institution under the Nordic Council of Ministers. Its secretariat is in Oslo.

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