

RISK CAPITAL POLICIES AND DATA

Project Proposal

To be discussed at the ICE meeting, 12-13 October 2006

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Background

Sufficient supply of risk capital is absolutely fundamental for the development of vibrant entrepreneurial climates, particularly for fostering early-stage innovative firms. But in some market segments, limited private investment calls for public sector involvement.

While governments have introduced a variety of public funded initiatives, the question is whether they address the market failures effectively. In response to this, FORA has prepared a framework paper "*Capital Markets and Informal Equity Investments*". This framework paper argues that there is a knowledge gap on risk capital. Moreover, it states that better access to international risk capital data and policy comparisons would assist governments in better focusing their risk capital policies.

Enhanced access to international data could strengthen risk capital market development and comparisons. For countries with well-developed capital markets, more advanced statistics and clear definitions could contribute to better understanding of the unique challenges in those markets. Also, a more systematic and comprehensive exchange of policy experience would shape our understanding and stimulate better policy development.

In collaboration with the members of the International Consortium on Entrepreneurship (ICE), FORA has prepared this project proposal in order to suggest international collaboration in the field of risk capital.

Purpose and objectives

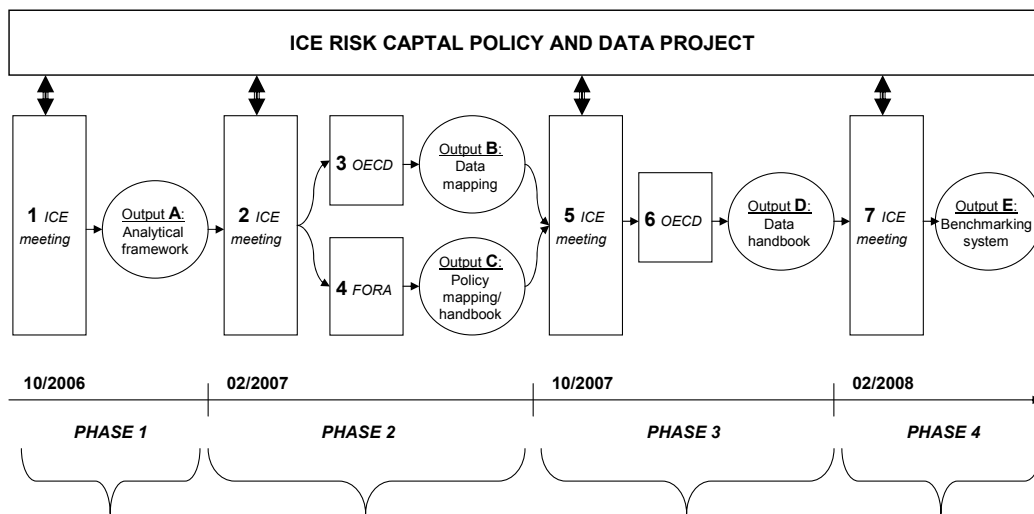
The purpose of this paper is to provide members of the International Consortium on Entrepreneurship Benchmarking (ICE) with a concrete project proposal on risk capital. The proposal is based on the analytical framework (the supply and demand side model and the investment policy model) introduced in the framework paper. The project process and concrete activities are outlined below. Finally, the proposal lists options for future work. Members are asked to consider which option(s) they think would be most useful, from their perspectives.

Process

The risk capital project could possibly be structured as two closely related and parallel tracks. The first track (policy track) aims at improving our knowledge about policies by mapping existing public policies affecting the risk capital market, while the second track (data track) aims at improving access to risk capital data by mapping risk capital data and definitions. Both tracks are structured within the same analytical framework.

The project can also be divided into four phases, where each phase has a well-specified output from both tracks (policy and data). The full project will – if initiated – run from October 2006 until February 2008 (Figure 1). Each phase and timeline is described in more detail below.

Figure 1: Process and timeline for ICE risk capital project



Source: FORA

Phase 1: Preparations

In the first phase, ICE members meet and discuss the current project proposal (13 October 2006). If members decide to pursue to the second phase of the suggested project, the project’s analytical framework is finalised within phase 1.

This phase includes establishing an international advisory group and finalising the framework paper in collaboration with the experts. In addition, a draft questionnaire for policy mapping will be prepared by FORA. The policy questionnaire will be structured according to the theoretical framework described in the framework paper.

Phase 2: Data Mapping, Policy Mapping and Handbook

At the beginning of the second phase, the final analytical framework is presented and discussed at the ICE spring meeting 2007. Against this backdrop, ICE members should decide whether to pursue the project on only one track (either policy or data track) or on both tracks.

In phase 2, *the parallel policy track* aims at providing an overview of the policies affecting supply or demand of risk capital that have been implemented in participating countries. The result can be presented in a policy handbook. To have a better picture of the various policy instruments available for different market failures, the handbook will group risk capital policies according to investment stages, informal and formal markets, investor types, industries etc., following the theoretical

framework presented in the framework paper. The overview will be based on a policy questionnaire, which will be discussed among ICE members before it is launched. The policy mapping will also investigate and compare the regulatory investment framework in the countries and map the various institutional ways of structuring capital markets. In addition, it will look into the effectiveness of various policies by including excerpts of policy evaluations, where available.

In phase 2, *the data track of the project* would collect definitions and information about available data. The objective is to map existing definitions within the theoretical framework of investment stages in order to detect overlaps and ambiguities in the definitions. The exercise should also include definitions relating to the name/types of the investors. Based on the mapping of definitions used in different countries, new internationally-agreed definitions would be examined and discussed with key stakeholders. In addition, possible new areas of research should be investigated. The OECD would be well-placed to carry out this work. The output of this part is a paper with recommendations on which definitions are required and how they should be structured to be mutually exclusive.

All outputs from phase two will be discussed and evaluated by the ICE at the fall meeting 2007. At this meeting, the ICE will decide on future activities (phase 3 and 4) within the project.

All aspects of phase 2 will be shared with OECD Working Party on SMEs and Entrepreneurship, as the working party is planning similar work. This ICE project could potentially be a pilot study for the OECD and a test case for further work on risk capital policies.

Phase 3: Data Handbook

Based on the recommendations from the data track and the insights from the policy track, the OECD would prepare a data handbook, which would provide an overview of existing data and definitions and suggest new definitions, as required. The new definitions would correspond to existing definitions, to the degree possible, and be designed to meet the needs of policymakers. The OECD would endeavour to achieve widespread acceptance of the handbook by member countries, project partners and other relevant institutions such as the European Venture Capital Association (EVCA) and the National Venture Capital Association (NVCA).

In addition, the OECD would provide ICE members with a recommendation regarding collection of new data and the costs of such an activity. ICE members could then decide to what extent they would like to proceed with further data collection. It would also be possible to decide to proceed with data collection in only one area or a few selected areas.

Phase 4: International Benchmarking System

In the final and fourth phase, the outputs from the previous phases would be consolidated into an international benchmarking system. Such a

benchmarking system would aim at comparing risk capital performance and policy frameworks between countries.

It could also provide policymakers and practitioners with a better understanding of the market mechanisms, and more sophisticated views on where and why the markets are not performing sufficiently.

The ICE risk capital benchmarking system would be based on the definitions and indicators agreed on in the data and policy handbooks. Polices would be compared between countries with high and low risk capital performance, and framework conditions would be benchmarked based on the new indicators.

Project partners

In order to gain international recognition and consensus, the project should seek synergies with existing international initiatives in the field such as those by the EVCA, the NVCA and others. It should be coordinated by an international body and have support from national governments, regional risk capital institutions, leading international researchers and others.

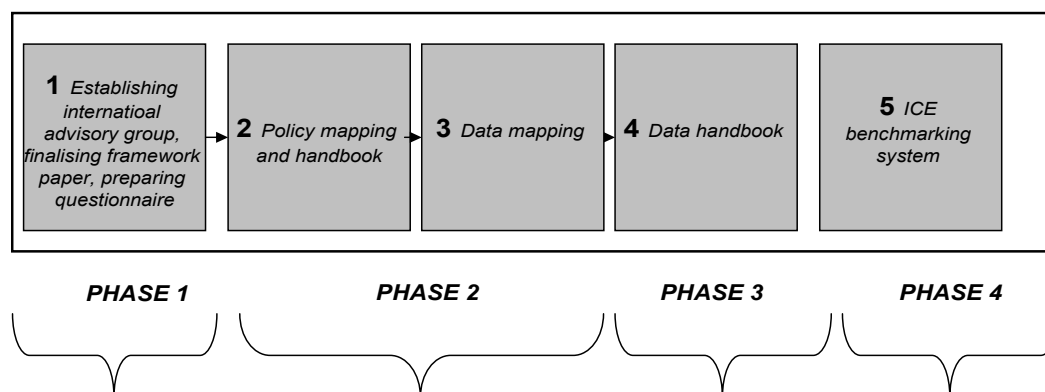
Project partners should include ICE members, though it would be possible to proceed with the project even if not all ICE members wish to participate. In addition, it could be possible to include non ICE members in the project if their participation is viewed to be valuable by the other project partners.

In close collaboration with all parties, FORA could assist in the coordination of the overall project as well as in implementation of the policy and data tracks.

Output and Milestones

In summary, as shown in Figure 2 below, the overall project has 5 milestones throughout the four phases.

Figure 2: Outcome and milestones for ICE risk capital project



Source: FORA

First, by the beginning of 2007, an international advisory group would be established, comprising researchers, experts and key stakeholders from various countries. The international advisory group would provide insights and knowledge about the market and ensure that the project properly reflects the work already undertaken by others.

Then, towards spring 2007, risk capital policies and data and definitions would be mapped in parallel. It is possible that the policy mapping could be initiated ahead of the data mapping. Both mappings will lead to handbooks with risk capital policies and data/definitions and will be circulated among ICE members for input. The Policy handbook is expected to be ready by summer 2007. The results of the data mapping and Policy Handbook would be presented at the ICE meeting in September 2007.

At the ICE meeting September 2007, a data handbook proposal would be presented by the OECD including recommendations on what areas to investigate further. This work could be initiated in autumn 2007. Temporary results could be presented at the ICE meeting February 2008.

Finally, based on the data and policy an international risk capital benchmarking system would be established. This work could be discussed at the ICE meeting February 2008.

Resources

The financial resources required in order to conduct the studies and implement the project are specified below. It is intended that the costs involved should be drawn from existing ICE annual budgets.

Phase 1:

The work could be carried out by FORA. The work should be finalised within four month at the cost of €20000.

Phase 2:

The policy track could be carried out by FORA in close co-operation with members of the Consortium. FORA's should manage the process and produce the policy overview bringing together the various national policy questionnaires. This track can be devoted large amounts of resources although a light version is recommended. Members of ICE should be given an overview of policies for inspiration and not a long report. The cost for this phase would be €20000.

The data track could be carried out by the OECD. The OECD will be asked to provide a more detailed estimate of the cost of the part of the project, but an overall budget of €40000 would probably be sufficient.

Phase 3:

Not to be decided upon until next year

Phase 4:

Not to be decided upon until next year

Next steps

In order to proceed with the proposed project, consortium members are kindly asked to consider and discuss the following options for future risk capital activities in the consortium:

- Option A: FORA should continue with finalising the analytical framework including wrapping up the framework paper, establishing an international advisory group and preparing a policy questionnaire. Total cost €20000
- Option B: Once completed phase 1, FORA should only start the policy track including policy mapping and policy handbook (part of phase 2). Total cost €40000 (incl. option A)
- Option C: Once completed phase 1, FORA and the OECD should start both the data and policy track including data and policy mapping. The policy mapping results in a policy handbook. Total cost €80000 (incl. option A)
- Option D: FORA and the OECD should not engage in further risk capital activities through the ICE.

Activities involving the OECD require more time for planning and should, if possible, be decided upon as soon as possible.