european working group of innovation consultants

EWGIC POSITION PAPER

Will COVID-19 kill the EIC Accelerator? Or will the EIC Accelerator be the medical ventilator of distressed European SME champions?

A CALL FOR AN EIC AIRDROP

Foreword

We live in unprecedented times. While the most serious healthcare crisis of the last 100 years is unfolding in real-time right in front of our eyes, the economy is crashing and all components of our economic infrastructure are at risk. This position paper focuses on one of the most fragile of these components – SMEs – and the role that the European Commission must play to protect them, via the Horizon 2020 EIC Accelerator programme.

The EC units managing various aspects of the Horizon 2020 programme are facing several challenges which, combined, have a strong impact on the future of European SMEs:

- **EASME:** The unit in charge of administering the EIC Accelerator programme is one of the most agile of all units. However, the call for companies to file for the March 2020 deadline with COVID-19 solutions (only 5 days before the deadline, without freeing up additional budget) led to a tsunami of applications (~4,000 instead of ~1,800 in a normal cut-off). This will make it impossible to select all the excellent applications to interviews (on a regular deadline, EASME typically invites 180 companies and funds 40-45 of them). In addition, project officers seem to be overloaded and several grant agreements from the October 2019 cut-off have not been signed yet. Time-to-grant is increasing dangerously, which threatens the cash-flows of the (future) grant recipients.

- **REA:** In the unit in charge of validating entities that have won H2020 funding, administrative procedures are slowing down access to funding for EIC Accelerator funding recipients. We documented a case where a company that had won funding in the October 2019 cut-off was still trying to get their entity validated in March 2020, and finally signed their grant agreement in April 2020. It took REA 3 weeks to analyse the most recent document update they requested.

- **EIB:** In the unit in charge of the new equity instrument of the EIC Accelerator the funding process takes significantly longer than expected (official EASME documents initially stated 6 months, but the EIB is now saying informally 9-12 months, because the investment infrastructure is not ready yet for deploying capital). This will have a strong negative impact on companies that won "blended funding "in October 2019 and have no access to other sources of capital in the current crisis.

It is understandable that the brutal lockdown required a temporary readjustment from all EC units, and led to a lack of coordination. **It is now time to step up to the Herculean task that is awaiting us: saving our European SME champions.**

This position paper summarizes the most urgent problems to solve, with regard to the EIC Accelerator programme.

Challenge 1: oversubscription will have serious adverse effects on the programme unless the effort is made to increase budgets or curb the number of submissions

An unprecedented number of applications (~4,000 in March 2020 vs 1,800 for previous cut-offs) was submitted to the most recent cut-off. With a budget of €164M and average funding ticket of €4M, the EIC will only be able to fund ~40 companies in March, i.e. 1% of the applicants.

In general, the EIC programme has always suffered from a “snowball” effect as it allows resubmission of all proposals, regardless of the score they achieved in the previous submission (we are aware of a proposal that was submitted 14 times before getting funded). This has led the success rate to drop over time, from 4% in October 2019 to 2.4% in January 2020.

In the March 2020 cut-off case, the oversubscription was made even worse by 3 factors:

1) **EC emergency request for COVID-19 proposals** (without budget increase): around 1,000 proposals were submitted in 5 days with some consultants stepping up with pro bono support to be able to deliver high quality proposals in the required timeframe.
2) **rush from "non-green deal" companies to submit:** companies knew that they would not be able to submit in May 2020 and would have to wait until October 2020 (an eternity in start-up time) otherwise.
3) **general panic from SMEs:** the private funding market dried out overnight, and most VCs are not “open for business” any more, focusing on saving their portfolio companies instead.

Oversubscription is now a very serious issue that should be urgently addressed by the EIC.

Applicants need to invest around 200 hours on their application, and it is not realistic to expect SMEs to do this with the current success rates.

Our recommendations:

- **Fix the supply:** increase the EIC budgets by 200% to reflect the growth in applications between 2019 and 2020, create specific ring-fenced calls for COVID-19 so they don't crowd out all other domains, and increase EASME staffing to cope with the additional application load without delaying the evaluation process.
- **Fix the demand:** limit the number of resubmissions, for example by establishing a "cooling-off period". For example, if the proposal score is lower than 13 at two consecutive cut-offs, then the applicant is not allowed to re-submit for another two consecutive cut-offs, which will cut in half the number of resubmissions of this proposal. A similar approach is already implemented in the ERC programme.
- **Simplify and clarify the rules of the game:** reduce the application requirements so it does not take 200 hours to build one (the current structure with document 1, document 2, annex 4, annex 5 is extremely complex to handle for all applicants, as well as for evaluators to review in sufficient level of details with only 2.4 hours allocated per case).

Challenge 2: evaluation criteria must be clarified to ensure fair treatment of all proposals

The introduction of new criteria (in particular: non-bankability) has resulted in a drop in average scores. The interview threshold went from 13.8-13.9 in 2019 to 13.65 in 2020 (out of 15), despite the fact the number of applications was stable or increasing.

Has the applicant pool weakened? Unlikely, given the fact resubmissions make over 60% of the applicant pool.

But this drop is likely to be related to the instructions sent to the evaluators:

Please pay particular attention to the 'bankability' sub-criteria under Implementation in the IER "Evidence that the applicant company cannot leverage sufficient investments from the market and/ or, particularly for applicant companies requesting blended finance support, evidence that the applicant company is deemed 'non- bankable' by the market, in view of the activities to be developed".

- *If your assessment finds that the company* ***is able to raise sufficient funds for development of the described activities*** *then you should consider it to be bankable and* ***score below 5*** *with supporting comments.*
- *If your assessment finds that the company is NOT able to raise sufficient funds for development of the described activities, then you should consider it to be non-bankable and score above 8 with supporting comments.*

The sensitivity of the evaluation process means that, if a majority of evaluators scores this individual criterion below 5 (out of 10), the score will move by 0.2-0.3 (out of 15) and a 13.8 score (invited to interview) will turn in a 13.5 score (not invited to interview).

Is that a bad thing? Not necessarily, if the criterion is well understood by the evaluators and applied fairly throughout all cases.

Unfortunately, this is not the case, as shown by these two real-life examples:

- A Turkish medtech SME was invited to the interviews in January 2020. They had bootstrapped the company with €120K of national grants and requested €2.5M of EIC grant. The jury decided against funding them and noted in the evaluation report that in their space (point-of-care diagnostics), it should be easy to get funded (despite an almost non-existent Turkish VC landscape).
- A French ICT SME was invited to interviews in January 2020. They had raised $81M in 3 rounds of financing (A, B,C) and requested €15M of equity as a D round. The jury decided to fund them. While they might have been able to justify their non-bankability, is the goal of the EIC to fund such late stage companies?

We have noticed 3 major biases with regards to the application of this new criterion:

- Some evaluators believe that only companies that have not been able to raise any funding are non-bankable. This means they only select the weakest and the least convincing companies to the interviews.

- Some evaluators evaluate companies that are in D or E rounds as non-bankable just because it is difficult to raise such large rounds. While some of them could indeed be non-bankable, it feels dangerous to start focusing on these companies, as they will naturally absorb most of the budget available (€164M of funding = 11 companies raising a D-round out of a pool of 4,000, i.e. a 0.25% success rate).
- Some evaluators evaluate bankability in terms of funding raised. For example, a company that has raised over €5M must be bankable, regardless of the industry in which it operates (in practice, €5M is a significant amount of funding for a SaaS start-up but not so much for a deeptech hardware start-up).

Our recommendations:

- **All evaluators should receive detailed guidelines** to evaluate the non-bankability criterion based on the same rules. The guidelines should include concrete cases of what is deemed "bankable" or "non-bankable".
- **The criterion should be renamed "risk" and not "bankability":** for example, a quantum computing company may have raised €10M last year and ask for €20M this year because it is extraordinarily difficult to get funded in this "high-risk" domain. This does not make them bankable, quite the opposite, in fact.
- **Evaluators should be evaluated:** some evaluators do not use the full scoring range, and as result, always score their best proposals below 14, which prevents those from being selected for interviews. Data analysis (simple standard deviation analysis) could flag where evaluators are constantly outside of the normal scoring range (over a large number of evaluations) and should be further trained, or removed from the evaluation pool.

Challenge 3: running EIC projects must be protected, with additional pre-financing and simplified periodic reporting

We are all experiencing the blunt force of the economic trauma generated by the current crisis.

All around us, start-ups are suddenly struggling to raise funding. The worst-hit are the companies that were about to close a private funding round, but have now seen investor interest disappear overnight. Many high-profile EIC grant recipients are in this category.

In fact, high-growth companies are the most at-risk in the current situation. In contrast with early stage start-ups that can afford to continue bootstrapping their operations, high-growth high-risk start-ups – the focus of the EIC Accelerator – must raise significant funding as they have started to expand their team and prepare their market entry, or lay off most of their team members.

Some countries have implemented immediate support measures while other are still not there:

- France's €4Bn rescue package for start-ups is an example of what to do.
- Switzerland's rescue package focusing only on companies that generate revenues attracted a lot of criticism from the start-up community.

EBAN recently called on the EU Parliament and Commission to take immediate action and work with Member States and local institutions to set up and implement a pan-European program that can offer liquidity to start-ups, innovative SMEs and small research and innovation projects affected by the current crisis.

Call to the EU and Member States to Provide Liquidity in Support of Startups and Innovators

eban

The European Trade Association for Business Angels, Seed Funds and Early Stage Market Players

EBAN, the trade association representing business angels, seed funds and early stage market players in Europe, expresses its worries and concerns on the effects that the current COVID-19 virus crisis is already having on the European startup and innovation ecosystem.

Our association urges the EU and its Member States to take immediate extraordinary measures to counteract the current crisis and foreseeable future consequences.

Startups (also defined as micro enterprises[1] and high growth enterprises[2]), research and innovation projects, will be the first to suffer the effects of a liquidity crunch. We are already witnessing postponements of private investment decisions, supply chain disruption and serious reductions of customer orders. Limited access to cash, without any doubt, will force many startups into bankruptcy, interrupt innovation projects and delay the continuation of research in many fields. The most imminent issue that startups and innovators face is the lack of resources to fund their day to day operations and teams. With limited cash reserves and virtually no access to the traditional banking sector, startups and innovators are entirely dependent on their personal savings, on investors and on grants to support their growth and development.

In these extraordinarily uncertain times, the EC must act as a lender of last resort, and grant additional pre-financing to all EIC grant recipients in distress.

In the last few days, project management consultants all around Europe received many questions from EIC grant recipients about the impact of the coronavirus crisis on the EIC projects and possible project delays. All feedback received by EASME project officers so far refers to Art. 51 of the Grant Agreement, which regulates "force majeure" cases and opens the possibility to suspend the project for the impacted period:

If an extraordinary and unforeseeable event or situation that is beyond the beneficiaries' control and that prevents them from fulfilling their obligations under the action occurs, beneficiaries must immediately inform the Commission/Agency, ***which will examine on a case-by-case basis the possible application of the rules on force majeure.*** *Moreover, beneficiaries must immediately take all the necessary steps to limit any damage due to force majeure (e.g. try to cancel the flight ticket, claim the reimbursement from the cancellation insurance (if applicable)) and do their best to resume implementation of the action as soon as possible. Force majeure normally has no specific effects on eligibility of costs. Costs are eligible, if they fulfil the general eligibility conditions set out in Article 6 H2020 MGA like any other costs incurred under the action. For example, if a meeting/event cannot take place due to force majeure, travel and accommodation costs may still be charged to the H2020 action if they fulfil the cost eligibility conditions, even if the beneficiary did not travel and did not take part in the meeting/event. If force majeure entails extra costs for the implementation of the action, these costs may be eligible if necessary for the implementation for the action (e.g. a cancelled conference is reorganised at a later stage). However, the maximum grant amount cannot be increased.*

Despite the good news about the eligibility of costs, it seems that the EC position could be to suspend projects that cannot perform their work properly due to the crisis: suspension would cause delays on payments (as well as render ineligible the costs occurring during suspension) and therefore severely impact cash-flow, but, more critically, an evaluation will be made afterwards about the feasibility of the project and, if not positive, could lead to project termination.

Related to the Covid-19 outbreak, what happens in Horizon 2020 grants if beneficiaries cannot submit all/complete elements for their reports related to interim and final payments?

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For interim payments:

Given the Covid 19 situation, flexibility will be given regarding the completeness of reports submitted in relation to interim payments. Beneficiaries must still submit scientific and financial reports. However, given the Covid-19 situation, beneficiaries will be entitled to submit a shorter narrative part of their scientific report, e.g. focusing only on key explanation of work performed (e.g. key achievements; explanations on difficulties to perform tasks due to this situation etc.) The remaining documents may be submitted at the next reporting period.

For final payments:

- Given the Covid 19 situation, the funding bodies will make the final payment even if the beneficiaries are unable to submit the Certificate on Financial Statements ('CFS') with their final reporting obligation (see Article 20.4 H2020 MGA). However, the amount of the payment for those beneficiaries who do not submit the CFS will be capped at the threshold required for CFS of EUR 324.999. Beneficiaries will receive a complementary payment once they submit the CFS for the remaining amount covered by the CFS.
- If a final report is not yet complete due to other aspects (e.g. because of some tasks are not fully accomplished), coordinators may request an amendment for an extension of the action duration, up to 6 months, to complete the tasks (see FAQ on 'project duration'. If so, beneficiaries will have still to submit their CFS with their final report later on.

Although the EC has tried to address the issues for some of the H2020 grant recipients, the solutions so far do not solve the problem of EIC grant recipients. For example, the EC now allows the final report to be submitted without the audit report (certificate of financial statement) but in this case, **it will not pay more than €325,000**. This unfortunately does not solve the problem for EIC Accelerator grants which are by definition always larger than €325,000.

Our recommendations:

- **Instruct REA to fast-track all SME validation activities**, with a guaranteed response time of 48 hours, and more flexibility than usually. It's not the time to burden SMEs with additional administrative tasks.
- **Instruct EIB to fast-track all blended finance cases**: the timing of equity funding can make or break the scaling up process in competitive markets. In fact, "right-timing" is one of the application evaluation criteria.
- **Relax the periodic reporting requirements:** give clear instructions to EASME project officers NOT to suspend any grant agreement, and to accept reduced reporting output in order to approve interim financing.
- **Grant additional pre-financing** (within the limit of 85% of the total funding request) to any current EIC grant recipient that is in financial distress: a simple measure that can help many grant recipients to survive the current crisis.

Conclusion: it's time for an EIC Accelerator Airdrop

EASME has been able to implement a system that is able to evaluate over 2,000 proposals in 4 weeks, provide applicants with funding decisions within 8 weeks, and actual cash on their accounts within 16 weeks. EASME does not employ directly evaluators and has to rely on independent third-party experts, who have their own activities and have to deliver their evaluations in addition to their main line of work. EASME typically only gives 7 days to evaluators to conduct their proposal evaluation (each evaluator has multiple proposals to read and score). EASME does not have a direct managerial link with their evaluators and therefore has to rely on their goodwill to deliver on time and with quality (of course, EASME can stop working with evaluators who consistently underdeliver).

Despite all these challenges, EASME has consistently managed to deliver evaluation results within 8-10 weeks of submission for all cut-offs, so unsuccessful applicants could resubmit at the following deadline (the only exception being the November 2015 deadline which could not be evaluated in time for the following cut-off).

This outstanding capability makes the EIC programme **the ideal vehicle to quickly provide emergency funding** to the best European deeptech start-ups, and prevent many unnecessary bankruptcies.

Given the fact that the May 2020 cut-off is restricted to the Green Deal, this leaves only the October 2020 cut-off for other high-growth high-risk start-ups looking for funding. In many cases, these companies have now to rely entirely on public funding, as the private markets have shut themselves down and are unlikely to restart until late 2020, even in the most optimistic crisis recovery scenario.

We understand that one option currently discussed internally at EASME is an additional budget of ~€140M for the October cut-off, but **this will be too late for many high-growth high-risk companies as the funding will not reach them until Q1 2021**.

It is our belief that the EC already has the perfect tool to help European SME champions in distress: the EIC Accelerator. However, using this tool properly requires **swift and decisive action**. Going forward, the EIC would benefit from becoming an independent entity able to put its agility to the service of European SME champions, without being encumbered by additional administrative burdens.

Our recommendations:

- **Request a new line of emergency funding** to implement an additional call deadline between May 2020 and October 2020.
- **If the call is re-opened to COVID-19 proposals,** reserve a ring-fenced budget so that other innovations are not crowded out.

Will COVID-19 kill the EIC Accelerator? Or will the EIC Accelerator be the medical ventilator of distressed European SME champions? Only time will tell. But it is still in our power to influence this outcome if we all act now. There is no time to lose.

About EWGIC:

The European Working Group of Innovation Consultants (EWGIC) gathers active Innovation Consultants in the field of European research and innovation projects. The group aims to facilitate the exchange of experience and good practices among its members, as well as to promote professional skills and expertise in European RDI Projects.

More at https://www.ewgic.eu/