

Innovation and medium to long term financing: what more is needed?

1. Setting the scene: innovation, competitiveness and the scale up financing gap

The Chair explained that innovation is the main driver of productivity, competitiveness and structural change, and is essential for addressing Europe's current competitiveness challenges, which are exacerbated by ongoing energy and price shocks. In his keynote address to the conference, Pierre Gramegna highlighted the importance of venture capital (VC) in fostering innovation and addressing the significant challenges around scale-up funding. In the first round of the discussion, the panel identified the key structural challenges affecting Europe's capacity to finance innovation and scale up companies, using the recent report by Jörg Kukies and Christian Noyer as a starting point. The second round addressed non financial sector factors that inhibit innovation and examined the prospects for the EU's new 28th regime.

1.1 Diagnosing Europe's scale up financing gap

1.1.1 Insufficient fund size and limited institutional participation

An official explained that the Kukies/Noyer report diagnosed Europe's key structural weakness as the difficulty of scaling up innovative firms. The first key issue is scale. EU venture and growth funds are smaller than their non EU counterparts, particularly in the US and UK. This results in smaller investments and hinders participation in larger funding rounds, limiting the potential for European scale ups to grow. Institutional investors in Europe have limited exposure to venture and growth assets due to regulatory restrictions, allocation frameworks and a lack of familiarity with the asset class.

1.1.2 Market fragmentation and weak exit conditions

Another key challenge is market fragmentation. The European capital markets are segmented along national lines. The variations in legal, tax, regulatory and supervisory frameworks obstruct cross border investment and the creation of pan European funds. Europe's shallower and less attractive exit markets cause a liquidity bottleneck, which affects everything from fundraising to development. These factors hinder access to the scale up capital and are even often more pronounced in smaller and less developed capital markets. The Kukies/Noyer report calls for amendments to the regulatory framework and a concerted effort to mobilise long term savings on a large scale.

1.2 Structural constraints in smaller markets: scale, home bias and institutional participation

An IFI representative set out the key challenges encountered by the European Bank for Reconstruction

and Development (EBRD). First, market size has a significant impact in smaller economies. Despite substantial EU support, there are still challenges relating to depth, liquidity, diversification and asset structure. Home bias is another challenge which is present in both bigger and smaller markets. Finally, in some cases institutional investors, specifically pension funds, are prevented from participating in private equity and venture capital by various national rules and regulations. In many EU nations, there is a reluctance to allocate to private equity due to the perceived risk, which can be due to unfamiliarity with the asset class. A recent study in Poland highlighted the challenges created by the limitations of the investor base.

1.3 Lessons from regional integration: the Baltic experience

An IFI representative described how the EBRD and the EC have helped the three Baltic countries to establish a shared market framework. These countries have developed shared infrastructure, including unified exchange ownership and central securities depository (CSD), and launched joint financial products. Uniquely within the EU, they are classified by MSCI as a single market with a common index classification, reflecting a level of integration beyond the EU as a whole. However, the common Baltic market still lacks the scale and liquidity required to reach emerging market status. This highlights the structural challenge of achieving sufficient market depth. The Chair added that the establishment of a shared capital market or stock exchange in the Baltic countries enables greater economies of scale.

1.4 Addressing specific financing barriers: IP valuation and access to scale-up funding

A policymaker commented that the Kukies/Noyer report highlights the importance of scale-up finance and its relevance to the Savings and Investments Union (SIU). Scale-up financing is crucial to fostering innovation, which in turn is vital for competitiveness. Although around 24% of global unicorn founders originate from Europe, more than half relocate to the United States, highlighting Europe's difficulty in scaling up innovative companies domestically. Innovative companies often lack tangible assets and therefore face significant difficulties accessing bank lending due to the lack of, or inadequate valuations of intellectual property (IP). The Commission aims to address this gap by exploring the development of a public guaranteed scheme with the EIF, secondary markets for IP rights, IP securitisation and IP tokenisation. These initiatives are expected to be further developed for the next Multiannual Financial Framework (MFF).

2. Financing innovation: market dynamics and investment channels

Building on this diagnosis, the discussion turned to the functioning of the financial markets and the different channels through which innovation can be financed in Europe.

2.1 The Nordic financing model: building a supportive ecosystem for venture capital

An industry speaker explained that the Nordic financing model comprises numerous 'pockets' of finance that bolster venture capital at different stages. This financial structure diversifies the risk and attracts local and international capital.

2.1.1 Strong domestic capital and local ownership structures

To establish this kind of ecosystem, there must be a robust domestic capital base. Early stage national financing attracts international investors, which look for reliable local partners and liquid markets. Equally, the existence of a local ownership framework and substantial domestic capital reserves ensures competitiveness and fosters the development of high quality projects.

2.1.2 Expanding the venture ecosystem and widening institutional participation

The capital markets must support companies throughout their growth lifecycle, particularly those operating outside traditional lending models. The venture ecosystem must expand. Increasing the number of limited partner investors and using state supported fund of funds structures can deepen the market and promote fund development. Institutional investors need to invest in illiquid alternatives to expand the capital base. In Sweden, pension funds invest in start ups and risk capital through a state pension fund dedicated to unlisted equity. Denmark has a similar structure, which has indirectly invested in over 800 companies in the last decade.

2.1.3 Public private cooperation and risk sharing mechanisms

Collaboration is essential. Risk sharing through public private partnerships has become more common in the Nordics and the EU. Instruments such as InvestEU are vital for fostering innovation. Enhanced public private cooperation can ensure genuine risk mitigation and mobilise more private capital. Alongside traditional equity financing, alternative sources of capital are becoming more important.

2.2 Private credit as a growing pillar of Europe's innovation financing and risk capital

An industry representative highlighted a structural gap in risk-bearing capital within European capital markets, noting that around 75% of corporate funding in the United States comes from non-bank sources, compared to only about 12% in Europe, which remains largely reliant on bank lending. Private credit can be a viable alternative for long term risk capital. It is flexible enough to adapt to companies with uncertain or evolving cash

flows and specialised collateral structures, and it can address underserved or complex market segments by providing financing solutions where traditional funding is unavailable. The private credit market is projected to reach between €680 billion and €760 billion by 2028, driven by demand from infrastructure, renewable energy, artificial intelligence and data centres as well as stronger institutional backing. The development of private credit should lead to more flexible financing solutions, which are particularly beneficial for start ups and innovative companies.

The Chair noted that several significant credit risk issues have arisen recently in the US and Europe. An industry representative acknowledged that private credit is not risk free and is currently subject to increased market scrutiny. Maintaining strong credit quality remains critical. The Chair replied that private credit offers some benefits, but it cannot be an area of unlimited risk taking.

2.3 Mobilising European savings: pension funds, retail investment and tax reforms

A policy maker highlighted several key EU level initiatives to improve market financing. First, there is the proposed savings and investment account, which is intended to direct the €10 trillion of domestic savings in the EU towards more productive investment. Secondly, pension funds can provide crucial support for start up financing. However, pension funds remain significantly underdeveloped in Europe, representing around 25% of GDP compared to approximately 150% in the United States. The Commission intends to revitalise the Pan European Personal Pension Product (PEPP) by encouraging member states to grant the PEPP a tax advantage that is similar to those offered to domestic products. Finally, there is still a key challenge around withholding taxes. Despite the existence of a single market, withholding taxes act as a customs duty on financial flows. The Commission is seeking to make significant progress in this area in the upcoming omnibus initiative scheduled for June.

2.4 Reassessing Europe's funding model: misallocation and the shift to innovation capital

A public representative argued that Europe is facing a shortage of innovation capital and a fundamental misallocation of resources. More private capital must be directed towards public private collaborations and the process for allocating EU funds should also be reconsidered. Currently, two thirds of financing is spent on cohesion and agriculture, leaving one third for industrial policies and other impactful areas. The majority of these funds are distributed to large corporations, which have the financial capacity to finance projects without public support. The EU's funding model should focus on closing the innovation capital gap. There must be a fundamental reorientation of EU funding priorities towards innovation capital rather than a series of incremental adjustments.

2.5 Unlocking investment: reforming EU funding instruments and mobilising private capital

A public representative emphasised that InvestEU must be significantly enhanced to leverage funding more

effectively. First, a small and medium sized enterprises (SME) quota should be implemented within InvestEU. Secondly, procurement must be modernised. Less than 1% of EU public spending supports innovative companies. The relative lack of significant companies founded in Europe over the past 50 years illustrates the need to reevaluate the EU's industrial policy. Institutional and retail investors need to be encouraged to invest in venture capital rather than in private equity. By capping returns and losses with public guarantees, venture capital could become a more attractive option. The currently proposed measures are insufficient to increase innovation capital to the necessary levels, and further securitisation reform is needed to support the housing market and other areas.

3. Policy responses and the future of European capital markets

In light of these challenges, the panel discussed the policy responses required to strengthen Europe's financing ecosystem and support long term investment.

3.1 Boosting long term financing and scale up investment: EU policy responses

An official remarked that Europe's long term capital base must be strengthened by creating the conditions for larger and more resilient growth funds. EU level action should focus on removing fragmentation and building scale. This includes advancing the 28th regime; using the EIF and the European Tech Champions Initiative (ETCI) 2.0 as cornerstones of the scale up architecture; and delivering concrete progress on the SIU.

A policy-maker underlined the importance of InvestEU in mobilising investments. With a guarantee of €26.2 billion, InvestEU has successfully leveraged over €372 billion in public and private investments. The aim is to continue this trajectory in the next MFF by making an additional investment of €200 billion and seeking to achieve a multiplier effect of 14.8. Across the €234 billion budget for the European Competitiveness Fund (ECF) and the €175 billion budget for Horizon Europe, there will be €409 billion focused on accelerating growth in strategic technologies, particularly clean transition and industrial decarbonisation. Two of the key initiatives are the ETCI and the fund of funds launched by the European Investment Bank (EIB) Group in 2023. These initiatives aim to mobilise over €20 billion in EU scale up investments. The upcoming European Innovation Investment Pact (EIIP), developed with the EIB Group, aims to encourage institutional investors to allocate a portion of their assets to EU funds of funds and venture capital funds. The Chair commented that a significant amount of public private cooperation will be needed to achieve a multiplier of 14.8.

3.2 Strengthening EU integration: legal frameworks, capital mobilisation and strategic priorities

3.2.1 Strategic context: integration, savings mobilisation and geopolitical shifts

A public representative observed that the 28th regime is an innovative digital legal framework designed to

complement national corporate structures and facilitate cross border scale up. The SIU aims to channel savings in low risk deposits towards productive investment. There have also been efforts to encourage retail investment, develop supplementary pensions and integrate market supervision by transferring responsibilities to European Securities and Markets Authority (ESMA). However, the militarisation of Europe's finances is irreversible. It has become a defining factor in investment because security is now the top priority. The rediscovery of mutual security is addressed in Article 41.7 and this factor will influence the next MFF. The Chair agreed on the need to understand the macroeconomic implications of the huge increase in defence spending.

3.2.2 Addressing legal fragmentation: the 28th regime as a core integration tool

A policy maker noted that the EU's fragmented legal landscape delays company formation, increases costs and discourages scale up. The 28th regime is a strategic response to these challenges. The EU Inc. proposal is an ambitious legal regime designed to facilitate seamless operations and growth across the EU. The aim is to retain firms that might otherwise move abroad by allowing them to benefit from a single EU legal system. EU Inc. offers expedited registration, enabling companies to register within 48 hours for under €100 with no minimum share capital requirements. The regime proposes streamlined and fully digital procedures for setting up a company, helping founders to start or restart ventures quickly and cost effectively. It also aims to create better conditions for investment and talent acquisition and to provide complete access to the single market, Europe's greatest asset. The proposal also has important tax and fiscal implications. It includes rules on insolvency, among other provisions, which are currently under review by the co legislators. It is hoped that the European Parliament and the member states will support the proposal to enable regulatory convergence, which will be crucial for the success of the 28th regime in achieving comprehensive integration.

3.2.3 From design to implementation: limits and conditions for success

A public representative expressed his appreciation for the EU Inc. proposal, which was prompted by developments in the start up industry. The fact that the proposal is contained in a regulation ensures uniform application across Europe. While the swift digital registration process is commendable, the digital opt outs could allow notaries to reintroduce complexity through exemptions. Notably, there are no provisions on labour mobility in the proposal. A de minimis clause could permit temporary employment contracts under national terms and conditions, which would address some of the practical difficulties of navigating the single market. There are also concerns around the disparities in judicial interpretation.

An official stated that scope and taxation are essential for the success of the 28th regime, particularly with regard to employee equity and stock option plans. Addressing these issues is vital for start ups and scale ups to avoid bottlenecks. The regime must be simple. If it is too complex or incomplete, adoption rates will be low.

Balancing harmonisation and political feasibility will be the key to effective implementation.

3.3 Simplification and investor confidence: key conditions for a strong VC ecosystem

From an investor perspective, these reforms must also ensure confidence and predictability. An industry speaker highlighted the importance of maintaining investor confidence and robust pricing mechanisms. Equity investors play a critical and highly sensitive role in the scale up phase. They are highly reactive to policy uncertainty and have the potential to withdraw rapidly in the face of indecisiveness. Therefore, policy stability and predictability are key to sustaining market confidence and attracting venture capital. By reducing the complexity of dealing with multiple stakeholders, the 28th regime could significantly enhance the venture capital ecosystem.

3.4 Geopolitical shifts and their implications for Europe's financing priorities

Concluding the panel, a public representative noted that geopolitical realities will likely shape European financial priorities in the future. The growing emphasis on defence and security is already altering the course of European investment priorities. Clearly, action is necessary at both national and European level to address the shortfall of private capital. Despite its bureaucratic machinery, Brussels is beginning to respond to these challenges.

Overall, the discussion highlighted a broad consensus on the structural barriers to scaling up innovation in Europe and the urgent need to mobilise public and private capital more effectively. While a wide range of policy initiatives is underway, their success will ultimately depend on effective implementation, stronger investor confidence and Europe's ability to act at scale. In a rapidly changing geopolitical and economic environment, strengthening the financing of innovation is not only a policy objective but a strategic imperative for Europe's long-term competitiveness.