

Early stage/expansion financing to Small Innovative Enterprises in Russia

Ivan M. Bortnik, Director General

Federal Foundation for Assistance to Small Innovative Enterprises, Russia

a) Overall financial conditions in Russia now are not favourable for financing of innovation. From one side there is enough money to be involved into early stage/expansion financing of innovation. Moreover, all elements of infrastructure for such financing do exist in Russia now:

- programmes of seed financing by the State (SMART and START programmes, about 20M€);
- public (federal and regional budget) – private venture funds (about 500 M€);
- private venture funds (about 500M€);
- business-angels. Some surveys show that about 2.5 mln. persons participate in early stage financing though with small money. But even with average investment 4 k€ the whole amount of financing is impressive);
- commercial banks (especially banks with the large State' share) started aggressive company to attract clients from small business.

From another side:

- resource of federal and regional budgets are still quite limited for proper financing;
- private finances are reluctant to be invested into real financing. Mostly they are claimed to be used for this purpose;
- public-private venture funds are still searching for good (to invest several M€ into one project) projects, are busy with due diligence;
- the rates for loans from bank are still high for most of small enterprises;
- intangible assets are not used as mortgage.

Finally, real investments are rather small to influence Russian economy.

b) main trends of business-angel financing related to financing of innovation:

size of each investment is quite small - not more than dozens and (rare) hundreds of thousands euros;

- there are no clear priorities (like bio-, nano- or any other technologies) for investments;
- prefer not to be well seen;
- prefer to give love money, loans, not to invest.

For main trends of venture capital industry in Russia see separate report.

c) Debt and hybrid instruments:

- commercial banks started to issue micro- and mini- credits to early stage entrepreneurs, however they are not necessarily are innovative;
- compensation schemes are used on regional level when federal and regional budgets compensates credit's rate through programmes of small business support.

d), e) approaches and experiences in financing innovative development in Russia:

- political level (federal and regional) is in favour of innovative economy. The national doctrine and concepts of how to build innovative economy in Russia are approved on the highest political level;
- there are no economical incentives for large corporations to become competitive within open market economy as a result of their innovative policy. Then their R&D

expenses are small (as a part of revenue), therefore existing tax exemption for R&D expenses is not effective instrument;

- fiscal policy claimed to be liberal – no any type of activity (including innovation) should have preferences. Then private investments into financial instruments, low-tech and short-time projects are more reliable, with better and faster return;
- the strong part of national approach is that all known mechanisms (from seed to venture financing) are in use. However, the weak part is that the scale of their use is too small to influence national economy;
- FDI plays important role as most of national investments because they at least bring new technologies (including management) and equipment to Russia;
- well coordinated policy between different Ministries to recover and develop S&T potential does not exist yet;
- the Universities are still considered mostly as places for education not for science and innovation;
- The State makes now large investments into infrastructure of innovative universities and concentrate R&D budget on national S&T priorities however it will take time for scientific potential to recover;
- Ministry of Education and Science, Federal Agencies, Foundations responsible for Science and Innovation have special programmes to support innovation along whole innovation cycle – oriented basic research, seed and start-ups financing and specifically for young people, development of technology transfer infrastructure (technology transfer offices, business-incubators, innovative technology centres, information network for technology transfer), business-university partnership, innovative “mega”-projects and so on;
- harmonization of laws for IPR with European system.

f) Russian innovative companies are even much less known on international than on national market. Even for those of them which have competitive product there are many problems:

- no special custom regime exists to stimulate export of innovative products, on the contrary there is quite complicated regime to service and repair exported products;
- no special scheme exists to finance export activity and international cooperation, except matching financing for joint R&D projects with EU – partners and compensation scheme of some export expenses for small innovative enterprises;
- Russia is not Associated country for EU’ programmes, especially for innovation ones.

g) Specific features of situation with innovation now in Russia are not only either economical or financial but are also strongly connected to situation in Russian science:

- there is still a large scientific reservoir (people and results) as potential resource for innovation;
- quite a large portion of this reservoir is old (personnel, results, instruments);
- Soviet scientists were not used to “sell” their skills and knowledge to industry for joint projects. They were “involved” into such projects by planned system;
- Soviet scientists’ mentality does not fit quite well mentality of venture investors and business-angels;
- for about 15 years Russian science was underfinanced;
- science was one of few attractive profession in USSR for ambitious young people. During transition period it became one of many others;

- a good portion of the most active scientific and innovative potential has left country.

h) the public sector in Russia provides:

- seed and matching capital for start-ups to stimulate private financing;
- compensation up to 100% of rate for debt financing to make it acceptable for small enterprises;
- up to 50% of venture funds to make the risk of venture financing more acceptable for private investors.

i) Policy recommendations:

- transition economy needs transition scheme to become innovative as a market economy. Although the most effective way to make economy innovative is to open it to free competition, however country may lose economy as a whole. Transition scheme depends on country and set of economic instruments to be used in a given situation could be different. However main criteria to say that scheme fits given situation is that private enterprises spend for innovation not less than 20% of their revenue. It is supposed that statistic fits international standards. If this is not a case then reasons for that should be analysed and necessary correction of instruments' set should be made;
- the seed capital should be provided by State in proper amount (around 2-3% of nation's R&D expenses);
- the capital for start-ups should be provided by State and matched by private investments of either business –angels or early stage public-private venture funds. Private investments should be tax-free;
- support of education and R&D by the State in the best universities is crucial during transition period;
- policy and real action to attract young generation to science and innovation is important during transition period.