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Tackling the Scale-Up Gap : Should EU policy intervene ?

Julie Ferrari
Karoline Hallmeyer

Reports

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Bridging the Gap in European Scale-up Funding: The Green Imperative in an Unprecedented Time

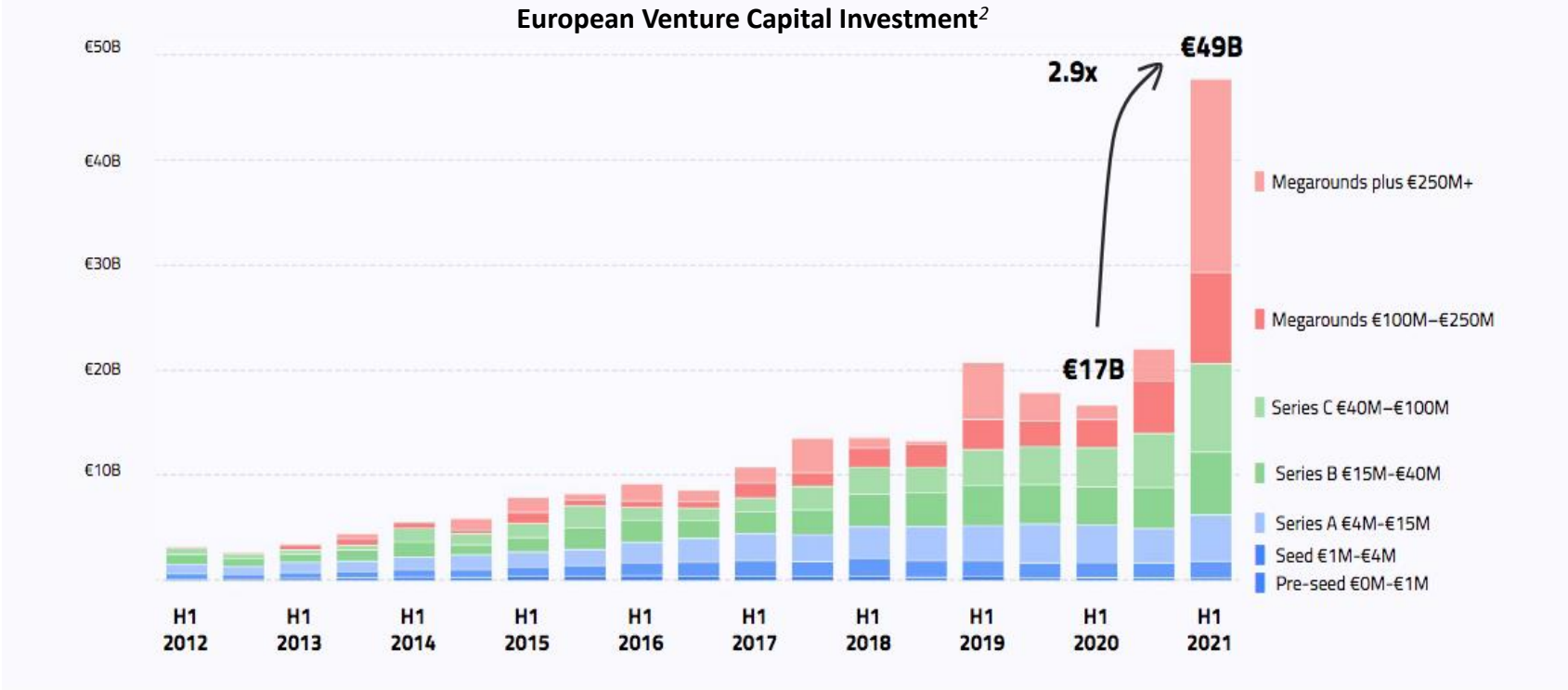
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What happened since June 2020?

Funding for European Series C+ went to an all time high, up >300% since 2020 including megarounds of €250M+

▮ *The lion's share of funding was invested in late-stage venture — Series C and beyond funding rounds — and private equity into venture-backed startups. This totaled \$41.4 billion, up over 300 percent year over year and more than 200 percent compared to the second half of 2020.*¹ ▮ ▮



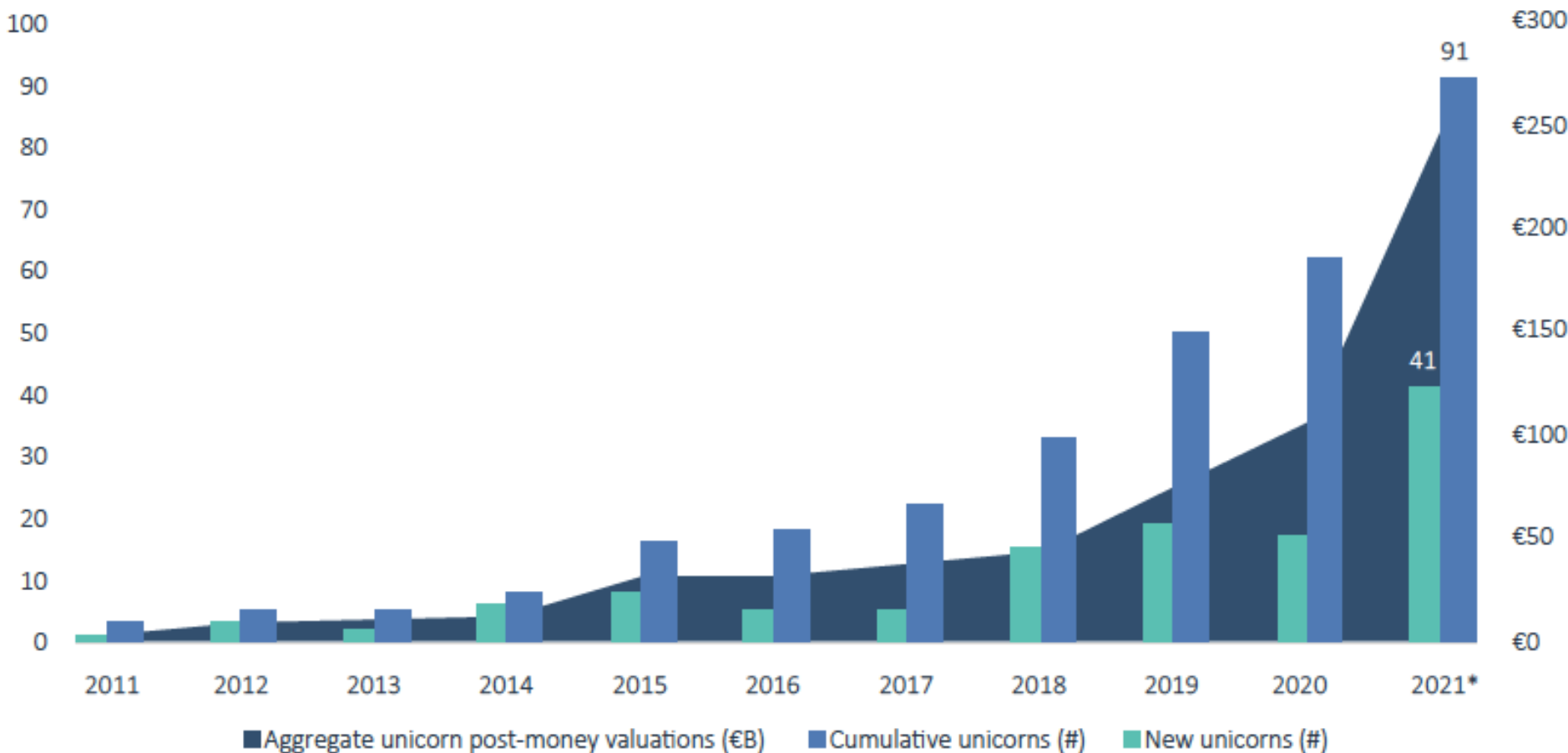
dealroom.co | sifted/

1. Source: Crunchbase.com, "European Startups Got a Bigger Share of Record Global VC Invested in H1 2021" July 15, 2021
2. Source: Dealroom.co, "Startup Cities in the Entrepreneurial Age", 8 July 2021

Europe created 41 new unicorns, for a total of 91 unicorns with an aggregate value of €300 **BILLION**

Late-stage rounds have grown in size and now contain a wide variety of investors, similar to large-scale VC rounds witnessed in the US ecosystem.³

Unicorn count and aggregate post-money valuations ³



Source: PitchBook | Geography: Europe
*As of June 30, 2021

3. Source: PitchBook, [Q2 2021 European VC Valuations Report](#)

Is there a market failure?

market failure [**mahr-kit feyl-yer**]

noun

A situation defined by an inefficient distribution of goods and services in the free market. In market failure, the individual incentives for rational behavior do not lead to rational outcomes for the group.

Market failure can result from challenges surrounding the use of public goods (tragedy of the commons), inefficiencies of allocation, and asymmetries of information.

Market failures can be solved using private market solutions, government-imposed solutions, or voluntary collective actions⁴.



Market Failure in (some) European Scale-up Funding Scenarios, where there exist:

Inefficiencies of allocation / non commercial solutions – where solutions with real benefit and a demonstrated need fail to generate investor activity due to indirect or long term commercial models
not for: scale-ups with a clearly commercial solution and reasonable expectations of short-term returns

Tragedy of the commons – where business viability requires dependence on public resources (including data), or fails to account for negative externalities or governance risks, but investment levels are still high
not for: scale-ups that account for environmental, social, and governance (ESG) factors

Asymmetries of information – where novelty of an investment opportunity or lack of familiarity with a new business model prevents investors from selecting the best options and/or creates decision paralysis
not for: scale-ups using technology and/or business models already familiar to investors

Are there policy driven solutions?

YES!

Focus on impact – use policy drivers to stimulate funding activity for scale-ups that are most likely to have the greatest impact aligned with the European Commission’s strategic agenda, like the European Green Deal

- **Understand and address market pricing mechanisms** that are fundamental to decarbonize CO2-intensive sectors (in a net zero scenario utilities are paid for capacity not produced electricity)
- **Allow tax breaks for funds with patient capital** (deep tech companies are less liquid and will take a longer time to reach profitability than software companies)
- **Subsidize deep tech companies** that are crucial to reach net zero (batteries, hydrogen, hydrogen-based fuels, bioenergy, CCS, synthetic fuels, ammonia)

Only one of the top 5 largest funding rounds in 2021 in climate-related deep tech

Top five largest rounds for unicorns in Q2 2021

Company	Deal size (€M)	Pre-money valuation (€M)	Post-money valuation (€M)	Industry group	Location
Northvolt	€2,258.8	€7,392.4	€9,651.2	Commercial products	Stockholm, Sweden
MessageBird	€1,030.6	€2,348.0	€3,186.6	Software	Amsterdam, Netherlands
Celonis	€822.6	€8,226.4	€9,049.1	Software	Munich, Germany
Trade Republic	€744.0	€3,389.3	€4,381.3	Software	Berlin, Germany
Mollie	€665.0	€4,735.0	€5,400.0	Software	Amsterdam, Netherlands

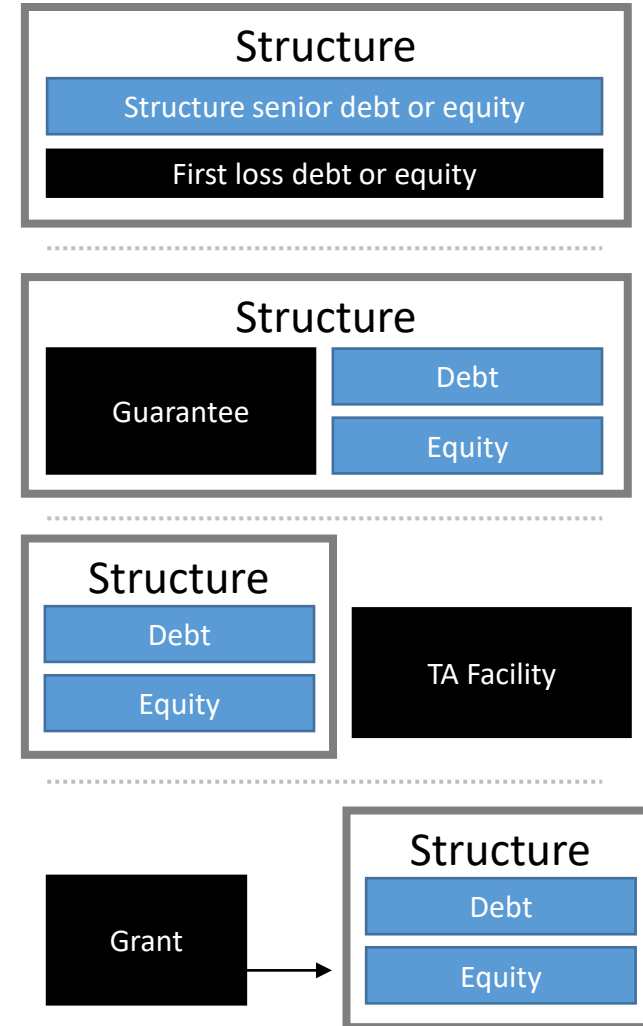
Source: PitchBook | Geography: Europe

Maximize every € of capital – implement policy levers to create efficient structures, remove barriers, and reinforce long-term excellence through knowledge capture

Blended Finance uses public funds as

- Junior equity investors, guarantors, or insurers to promote private participation in strategic sectors
- Providers of lower risk technical assistance – legal services, product testing, access to research/data and provide knowledge capture
- As levers to reduce long term costs of financing, not as risk capital

Blended finance is a common tool to catalyze markets for climate adaptation and mitigation technologies in emerging markets and to crowd-in private investors by de-risking their investment. In the long-run, these funds build the essential financial track-record for low-carbon climate-resilient investment.



Create the demand you want to see in the market – use public procurement to create long-term predictable demand

Procurement

- Public procurement will have to go through a major transition if countries want to reach net zero
 - **shadow carbon price** to improve the financial prowess of low-carbon bidding offers
 - procurement formats that **lower outsized barriers to entry for innovative solutions**
- **Set up sizeable government contracts** with companies that are working on climate-related deep tech solutions to create demand (similar to NASA and DARPA in the U.S.)

Public procurement, the process by which governments purchase goods, services and works from the private sector, is a vast contributor to global spending and represents a colossal 12% of global GDP (\$11T), according to the [World Bank](#). **The potential share to be won by tech start-ups, 'GovTech', is estimated to be \$125B (€105B) in Europe, according to PUBLIC⁵.**

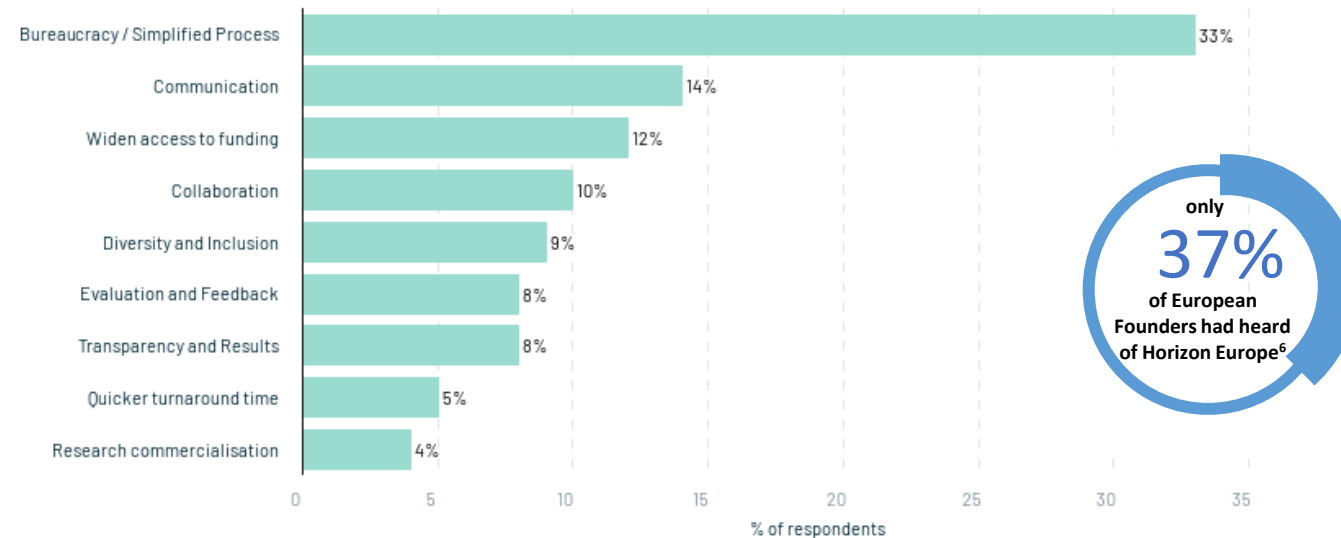
Be the best partner – challenge policy solutions to achieve operational excellence, making public funding the preferred choice for the best scale-up founders and CEOs

- **Ambiguity (real or perceived) around public funds** keeps fund-seekers with access to private alternatives from engaging – communication and raising awareness is key
- The best private investors offer value beyond capital – **expertise, community, networks, mentoring** – which public mechanisms must build up in order to compete for talent
- Public funders can have a strategic opportunity to act as **trusted intermediaries**, for example helping scale-ups/SMEs protect their **intellectual property** rights in procurement relationships

What would you recommend the European Commission do to improve the efficiency and effectiveness of its research and innovation programs?

NOTE:

Based on text analysis of 670 respondents - some respondents provided multiple recommendations for this question. Please interpret the data with this in mind.



SOURCE:

The State of European Tech Survey

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6. Source: [State of European Tech 2020](#), Section 07: Regulation & Policy

Successfully scaling strategic innovation is vital to the future of European competitiveness

▶▶ The twin transitions to tackle climate change and adapt to a digital future can offer companies of all sizes the chance to become more productive and competitive. It's also one where the waves of new technology will come ever faster – so our ability to innovate will make the difference between taking the lead and falling behind. The great task that we face today is to [...] help get European industry ready to grasp these opportunities. ▶▶

– Margrethe Vestager, Executive Vice-President of the European Commission for A Europe Fit for the Digital Age

Thank you.

Julie.ziskind@insead.edu

Karoline.Hallmeyer@gmail.com