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European Federation of Pharmaceutical Industries and Associations

EFPIA SMEs' position paper on innovative funding for biopharmaceutical SMEs

To support the development of a thriving and globally competitive European Biopharmaceutical Industry to compete against US and Asia, and to strengthen European healthcare systems

To make the European biopharmaceutical industry strong and sustainable, we must strengthen the network of small and medium sized enterprises (SMEs) which complement the innovation of large pharmaceutical players and benefit from their financial and commercial strength in a virtuous circle.

The European biopharmaceutical industry has a strong know-how and science, but its development is hampered by a number of challenges:

- It lacks flexibility in terms of human resources and administrative obligations
- It has uncertain and fragmented regulatory scenarios (especially for advanced therapies) and even more fragmented market access scenarios
- And it lacks capital from a sizeable Private Equity/ Venture Capital (VC) industry, fundamental factor for a sustainable growth of SMEs.

The European VC industry is smaller than in the US. Irrespective, performances of EU VC funds are comparable with those in the US when pulling out the effects of Nasdaq listings.

However, unlike in the US, there are no specialized funds in the EU which could allow growing companies to run Phase III registration studies, or launch a product by raising several hundreds of millions of Euros through private rounds and public markets that are fragmented. Additionally, the absence of a public market with the depth of Nasdaq renders IPOs much more challenging. This situation pushes many European biopharmaceutical SMEs to move to the US in order to fuel their further growth.

To mitigate the effect of these limitations, a set of measures and financial instruments to scale-up capital for the growth and expansion phases of biopharmaceutical SMEs could be set up. These tools would make such funds more attractive to a broader audience of large global limited partners investing in them.

Large institutional investors, such as pension funds, insurance companies, banks, which are the most important sources of VC capital in the US, play a much less prominent role in Europe, apart from certain cases in the UK, the Netherlands, Sweden and Denmark. One explanation for the lack of institutional investors in the European VC market is the historical risk aversion of large institutions and the unsubstantiated belief that venture capital funds deliver lower rates of return compared to other private equity funds. This could explain institutions' reluctance to invest in VCs and in particular in biopharmaceutical VCs.

In fact, while private equity funds are in certain cases recorded as non-risk equity investment, venture capital funds are treated as high-risk assets resulting in an overall asymmetric treatment of equity and debt financing.

The primary goal would be to have more European large life science funds investing in all phases of a public or private company's development from early stage to market launch, preferably all the way to late stage/growth. The goal would be to raise at least six VC Funds of more than 1 billion Euros each over 5 years with public and private limited partners investors.

Additional conditions would be:

- EU territory limitation
- No stage limitations but balanced portfolio towards later rounds: series B, series C to pre-IPO and IPO
- No limitation on countries where VC Team is based
- Pooling of Private and Public Limited Partners on an approximate 60%/40% basis.

In order to achieve this, a direct involvement of European investment vehicles (such as EIB, EIF) is needed as is an initiative aimed at incentivizing large institutional investors, e.g. pension funds, insurance companies, to invest in biotech VC funds. One way forward could be the creation of a 1 billion Euros guarantee fund for limited partners to soften hurdle rates and cover losses by risk sharing.

- The Guarantee Fund should cover e.g.:
    - A hurdle rate up to 50%-80% of the standard of the market (from 0% for certain National Promotional Institutions (NPI) sponsored funds, up to approximately 7%). If the performance of the fund is not in line with predictions, limited partners should have at least some return on their investment guaranteed
    - A non-performing or mildly performing fund would allow limited partners to access the measure
    - The fact that a hurdle rate is almost guaranteed would also allow accountancy rules to be changed and de-risking the asset of investment into VC funds, thereby inciting the limited partners of large pension funds, insurers etc. to invest in VC funds.
- A lower than standard hurdle rate would allow to have more return on investment to share and therefore further motivate the VC Teams to underwrite fund shares for getting a larger portion of carried interest. This would broaden the VC funds accessing the measures and improve the Teams competition and qualities.