



**ФОНД НА
ФОНДОВЕТЕ**
ФОНД МЕНИДЖЪР НА
ФИНАНСОВИ ИНСТРУМЕНТИ
В БЪЛГАРИЯ



Market Test Report

Technology Transfer Fund

Operational Programme 'Innovation and Competitiveness'

March 2019

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The present report ('the Document') is based solely on the outcomes from market consultations in the meaning of Article 44(1) of the Bulgarian Public Procurement Act (PPA) ('Market Test') conducted in compliance with the conditions set out in Article 44(3)(1) PPA in respect of Financial Instrument 'Technology Transfer Fund' (the 'Financial Instrument'), which is funded by Operational Programme 'Innovation and Competitiveness' (OPIC) 2014–2020, and cannot be used for other purposes.

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Introduction

Between 4 January and 31 March, 2019, FMFIB conducted market consultation (Market Test) meetings in relation to the design of Financial Instrument (FI) 'Technology Transfer Fund' (TTF, the Fund) supported by Operational Programme 'Innovation and Competitiveness' 2014–2020 (OPIC). Due to the strong interest expressed in the FI, FMFIB extended the market test and report preparation period, as well as its approval by the Management Board from 31 March 2019 to 12 April 2019.

The public funds allocated to the establishment of the TTF amount to ca. EUR 28.5 million. FMFIB will be the core investor in the Fund. The instrument requires a combination of public and private financial resources. The TTF will invest in a diversified portfolio of equity and quasi-equity investments, pure debt excluded, to foster the development of an entrepreneurial ecosystem in Bulgaria in collaboration with Research and Development (R&D) organisations, and to facilitate technology transfer in Bulgaria.

During the market consultations process FMFIB sought to obtain feedback from a wide range of stakeholders in the equity and R&D sectors. The objective of the Market Test is to establish the requirements and the potential of the prevailing market environment and thereby facilitate the optimisation of TTF's environment and structure.

Respondents

The likely groups of stakeholders in this process, including potential Financial Intermediaries (FIMs) and market actors, were identified through a preliminary analysis based on certain individually applied criteria, the most important of which are:

- Experience in the financing of enterprises which are about to achieve or have recently achieved positive financial performance;
- Experience in the management of equity and quasi-equity investments;
- Presence or interest in Bulgaria and/or Central and Eastern Europe (CEE);
- Strategy and process applied to identify Final Recipients (FRs);
- Application of transparent market practices; and
- Existing reputation in the market.

The preliminary analysis revealed that several groups of actors are well placed to put forward meaningful and relevant insights about the FIT design:

- Investment professionals with existing investment fund managers, focused *inter alia* on pre-seed, seed or growth investments;
- Leaders of associations and R&D organisations; and
- Potential investors.

In order to capture the interest of the widest possible range of potential stakeholders, the market consultations (Market Test) process was launched with the publication on FMFIB's corporate website of a public notice accompanied with various marketing materials, including an Indicative Term Sheet and Product Presentation. In addition, on FMFIB's initiative the start of the Market Test was covered by national mass media.

FMFIB contacted the stakeholders identified and between 4 January and 31 March 2019 conducted around 21 individual meetings with local and international organisations, including 41 investment fund management professionals, investors and actors in the ecosystem.

Maximum completeness and consistency of the feedback was ensured by holding each meeting in a *structured interview* format using on a predefined questionnaire (cf. Annex 2). The main areas, which FMFIB aimed to cover in the process, were based mainly, albeit not exclusively, on the good governance standards of InvestEurope/ ILPA and included:

- Overview of the market opportunity provided by the TTF;
- Corporate structure and management of the Fund and of the Fund Manager. Preferred jurisdictions;
- State Aid Regime (SAR);
- Potential investment strategy;
- Optimal approach to the recruitment of private capital;
- Details and specifics of the investment process;
- Portfolio management and reporting practices applied;
- Structure, members and optimal competences of the prospective Fund Manager's team.

Market opportunity

While the uptake of equity and quasi-equity investment instruments is improving in Bulgaria, the use of these instruments is still relatively low, compared to the requirements of the Bulgarian market. The unavailability of fund managers with relevant experience in equity and quasi-equity investments is increasingly reversed.

The FMFIB addressed the funding gap for Small and Medium-sized Enterprises (SMEs) in their growth or maturity phase by setting up two new financial instruments structured as equity co-investment funds, the Venture Capital Fund (VCF) and the Mezzanine/Growth Fund (MGF). The FMFIB also implemented a Seed/Acceleration and Start-up Fund (SASF) to support the establishment and development of new business models as part of its continuing efforts to foster and improve the entrepreneurial ecosystem in Bulgaria. The equity and quasi-equity investments market is increasingly available to unlock the innovative potential of the entrepreneurial community.

The present financial instrument is funded by Priority Axis 1 'Technology Development and Innovation' of the Operational Programme, which is directly linked to the achievement of smart growth through investing in a knowledge- and innovation-based economy. The main objective of the TTF is to encourage innovative activities, enhance the benefit of innovations, and generate new innovative potential by building a bridge between innovative enterprises and the entities in which the innovative potential resides.

All participants (respondents) in the Market Test exercise agreed that a good practice, which is lacking in Bulgaria at present is cooperation between R&D organisations and businesses to encourage a more active demand for solutions to business problems developed through the instruments of science. The fundamentally different structure, objectives and missions of Research and Development organisations on one side and business entities on the other side mean that these two sides are not 'natural' partners. Against this backdrop, the TTF provides an opportunity for the establishment of good practices for investments in R&D. Above all, the TTF aims to produce a strong impact on both the economic and technological development of Bulgaria. Research

organisations will be encouraged to take a key role in the 'incubation' of new business initiatives and to generate income from them. The prevailing majority of the participants in the Market Test share the view that the science-to-business cooperation generated by the TTF would have a positive impact on the country's innovative and technological potential, which in turn is the main driver of economic progress.

The target investment segment

Following the meetings, the FMFIB team was left with the impression that the respondents have divergent ideas about the target market of the TTF and about the segmentation of the target market.

In the area of innovation and technology transfer, three types/roles of market actors are clearly distinguishable: technology providers, technology recipients and technology brokers that facilitate the technology transfer process. **Technology providers** include scientific institutions, universities and other organisations, which engage in R&D and innovations.

The technology recipients are equally the final beneficiaries of the TTF. The segmentation of this target group is determined by the (i) development phase, (ii) the Technology Readiness Level (TRL) and (iii) the potential for commercialisation and internationalisation. According to the participants in the Market Test, the final recipients of the financial resources are enterprises at an early development phase (pre-seed), companies at an initial development phase (seed) as well as existing companies, which can achieve technology transfer by spin-offs or by acquiring an innovation or patent.

Last but not least, the respondents defined the **technology transfer brokers** as innovation centres, business incubators or research and technology parks.

Key risks

The participants in the Market Test identified several key risks associated with investments in technology transfer. Above all, they believe that the most important handicap of the market is the existing divergence between the objectives and focuses of business actors on one side and research organisations on the other side as well as the absence of sustainable and constructive relationships between them, which in turn is a factor for the low level of market commercialisation.

Another major issue is the scarcity of fund managers with relevant experience in the area of equity investing in general and in the technology transfer (TT) sector in particular, as well as the limitations imposed by the minor scale of the Bulgarian market. Not unimportantly, the participants in the Market Test are mindful of the high risk of losing investments made in start-ups with TRLs in the lower ranges.

Definition of TT and of eligible investments in TT

TTF aims to increase the level of cooperation between business and R&D qualitatively and quantitatively, through investments in commercialization of research, as well as the development of innovation capacity and resources. The investments that TTF is set to realize according to its strategy, aim to support early-stage companies, newly formed businesses and large company spin-offs, which will develop and commercialize intellectual property, R&D and innovative products or services.

The potential end users develop and/or implement R&D projects while aiming to acquire intellectual property (IP). The acceptable companies are those that implement innovation, i.e. new products or processes, which are new to the firm, as well as to the market.

In light of the strategic objectives of the TTF, the Market Test also highlighted the need for a more focused formulation of the *technology transfer* concept per se and of the range of eligible investments in TT. According to the respondents, technology transfer is in place when knowledge is passed from academia (universities, R&D organisations, etc.) to the market and when an innovation is successfully implemented and commercialised. An insightful observation of the existing market reality was that there is a major pipeline of intellectual property rights (IPR) and novel developments, which have not evolved to commercialisation, while the innovations that have been successful in the market come from the private sector.

The innovation process includes two important components: generation of knowledge and successful dissemination of the generated knowledge leading to the offering of new products or services to customers, in other words – an invention and its successful implementation. In order to be successfully commercialised, these innovations need to be transferred to organisations, which possess adequate market experience and potential.

Definition of a Research Organisation and collaboration with a Research Organisation

Most of the respondents to the Market Test exercise were of the opinion that collaboration with Research Organisations (ROs) can be a major driver of the innovative capacity of the individual companies and of economic growth in general. The participants believe that such collaboration should be a two-way process in order to be successful and generate meaningful results. In one vein, ROs seek collaboration with enterprises in order to assert in the market and successfully commercialise their newly created innovations. On the other side, there are situations in which the private sector would benefit from collaborating with ROs, mainly along the lines of validating the concept behind a certain innovation or the scientific applicability of a particular product. The Market Test team did not hear clear statements about a major need for businesses to cooperate with ROs in order to *develop* an innovation (i.e. not just to test or validate an innovation).

Some of the participants pointed out to the mediation infrastructure as an important interlinking component for successful partnership with research organizations, while accenting on the forming of an environment supporting innovation. Such intermediaries are innovation centers, business incubators, as well as science-technology parks. The connect research labs, researchers, inventors and academia with investors, large enterprises and SMEs, which on their side procure practical implementation of scientific research.

Those participants who commented on the different forms of collaboration, pointed out a number of examples including signed agreements for commissioned research, sale of intellectual rights from research organizations, forming of joint ventures, licensing agreements, etc. One of the interviewees stated that an integral element proving collaboration is payment for research services.

The need for technical support (technical assistance for final recipients – TTO)

The FMFIB explored the option of allocating certain financial resources for the provision of technical assistance (TA) in the framework of the financial instrument. In this way, the scheme aims to provide a coordination platform to all members of the ecosystem. The funds can be deployed to the establishment of a TTO or regional TT centres which will liaise between the TTF and ROs.

The respondents agree that the actors, which are in greater need for technical assistance, are primarily research organisations since they lack both capacity and experts, especially in the area of Intellectual Property Rights (IPR). The market consultations unequivocally identified the need

for educational and related technical support aimed at strengthening the bond between enterprises and applied science.

All respondents that have investment experience assert that while TA is necessary, it would be more appropriate to use these resources for investments. Allocating part of the resources to technical assistance would leave fewer resources available for investments. One respondent with investment experience indicated that one of the effects of having a TA allocation for higher-risk activities would be an improvement of the financial performance of the potential fund.

Two respondents believe that technical assistance should be available for the Early Phase sub-fund in the form of an accelerator programme for start-ups.

A limited number of respondents hold that the most appropriate form of technical support would be IPR-related mentorship and/or education provided by the Fund Manager. One respondent suggested that TA funds should be assigned to a grant-based programme for scientific experiments. In this regard, consideration was given to the risk that TA in such a scope would duplicate the scope of the potential financial intermediary, which in turn would make the structure more susceptible to incompliance with the applicable regulatory framework.

The information collected from the meetings is not sufficient to arrive at a clear definition of the scope of the technical assistance and of the concrete TA activities. Thus, the decision about allocating part of the resources to technical assistance for Final Recipients will be left to the Fund Manager.

Investment strategy

Economic sectors

TTF's goals of linking science and business, commercializing and internationalizing research, and fostering innovation, drive the broad investment and sectoral scope. The projects supported by TTF could be from any sector as long as they have activities connected to the four thematic areas of intelligent specialization according to the 'Innovation Strategy of Intelligent Specialization of Republic of Bulgaria 2014-2020', presented to the participants in the meetings:

- Mechatronics and clean technologies
- Informatics and ICT
- Life sciences and bio technologies
- New technologies in creative and recreational industries

The market actors shared their observation that economic sectors other than Information and Commercial Technology (ICT) have not received sufficient development funding from fund managers in Bulgaria. More than half of the respondents put their stakes on mechatronics, and especially healthcare (life sciences) as the sectors having the highest potential for development and commercialisation of innovations. As determinant factors for commercial success of enterprises in these sectors are the availability of key technological competencies and their rapid transformation in unique products.

Some of the participants emphasized on the concentration of investments in one of the thematic areas (for example mechatronics and biotechnologies) to help the better focus of the investment activity of the Fund and the attraction of private investors with specific interest and experience in this field. On the other hand, feedback for the presence of potential projects in several of the thematic areas and the need for a broader scope of investment outside the ICT sector, points to

the particular focus of the investments in the framework of the strategy is best to be determined through suggestions of potential participants based on their submitted projects pipeline.

Development phase

As regards the Final Recipients, the TTF has an extensive investment scope and is not bound by the size or development phase of the enterprises.

Within the process, FMFIB presented the possibility of capital allocation in two areas, namely investment in early stage (pre-seed/seed) and in a more advanced stage of development with focus on commercialization of an innovative product or service. Thus, the investments of the Fund could be focused in two directions: supporting projects at the proof-of-concept or product development level and more mature investments similar to those in venture capital for further development and innovation, often in large companies or their affiliates.

All respondents except two agreed that the TTF will achieve higher return on its investments if it focuses on two segments, namely companies/enterprises in the early phase of their development (pre-seed, proof-of-concept level) and at initial (seed) phase of development, as well as companies in more advanced phases of development which are able to implement technology transfer by spin-offs and seek to commercialise innovations.

Two respondents from research organisations consider that in assessing the development phase it is important to consider the Technological Readiness Levels (TRL)¹ achieved. In their opinion, investments in low-TRL projects, i.e. ones below TRL 6, involve higher investment risk. It was noted – in light of the specificities of the Commercialisation sub-fund of the TTF, which was defined as a working hypothesis in the Market Test materials – that the projects most appropriate for investments would be those that have reached TRL 7, 8 or 9.

These respondents defined TRL 8 as the level at which it becomes clear whether the project or the novel development has a commercialisation potential. The respondents indicated furthermore that projects with TRLs below 6 (including 3, 4 and 5) are in principle eligible for investments from the Early Phase sub-fund.

The respondents, which have investment experience, believe that both the development phase and growth potential should be measured on basis of the enterprise's market valuation and business model.

Forms of financing

The majority of interviewees are of the opinion that investments in the commercialisation of a research project or novel development are best financed by pure equity financing; while one-fourth believe it is appropriate to provide a convertible debt option too.

FMFIB explored the availability of alternative forms of investments, outside the supplied equity and quasi-equity financing, given that the investment strategy of TTF also includes investments in collaboration with R&D organizations. Examples of such are:

- Licensing contracts and agreements
- R&D contracts focused on creation of new IP
- Cross-licenses (exchange of patent rights in related scientific areas)

¹ Technological Readiness Levels (TRL): TRL 1 – Basic principles of the technology formulated; TRL 2 – Technology concept formulated; TRL 3 – Experimental proof concept; TRL 4 – Technology validated in lab; TRL 5 – Technology validated in relevant environment; TRL 6 – Technology demonstrated in relevant environment; TRL 7 – System prototype demonstrated in operational environment; TRL 8 – System complete and specified; TRL 9 – System tested in operational environment.

- Emergence of joint venture companies between research organizations and private companies.

A few of the participants in the market test pointed that in countries with a developed technology transfer financing sector, in some cases the financing is applied through a contract by virtue of which the fund invests directly in the organization to perform specific R&D activities, which, as a result, transfers the rights to the Fund or a share in the future company which will commercialize the results of the research.

A limited number of respondents refer to worldwide practices and suggest that the investment should be in the form of purchasing or organic development of royalty-generating IPRs. According to one respondent with extensive experience in the commercialisation of research products, equity and quasi-equity instruments are the most appropriate for the purposes of the TTF, however, in case that IPR acquisition is allowed, from the investor's perspective it is advisable to have the IPRs protected through a Special Purpose Vehicle (SPV).

Most of the respondents recommend keeping the form of financing open and giving the selected Fund Manager the flexibility to choose the form most appropriate to the requirements of the particular enterprise.

Design (structure) of the Fund

As part of the Market Test exercise, the FMFIB team presented to the respondents two concepts for the design of the financial instrument, namely (1) setting up a single fund with two sub-funds for Early Phase and respectively for Commercialisation investments, all managed by a single fund manager or (2) setting up two separate funds (TTF for Early Phase and TTF for Commercialisation) managed by two fund managers. FMFIB examined as a more appropriate the idea to divide the resources in one single fund with two sub-funds and this way they will support two separate segments of potential final recipients, namely, projects from the proof-of-concept to the production phase, as well as companies that need financing to implement an innovation.

All respondents except two confirmed that the optimal design for this type of instrument would be a single fund with two sub-funds. The main reason in their view is the short supply of sufficiently experienced fund managers capable to efficiently manage financial means distributed in two funds. Another argument is that a single-fund structure would be more successful for the technical transfer and for its spill over effect.

The respondents believe that it makes more sense to divide the Fund in an arm for accelerated development and initial investment and an arm for investing in more mature companies, as the TTF Term Sheet equally suggests.

Besides the design concept proposed by the FMFIB, two respondents endorsed the idea of two separate funds with equal capital and two fund managers. Which such a design, they assert, the ecosystem will benefit from the competition between the two funds.

As regards the allocation of certain resources to the provision of Technical Assistance (TA) in the framework of the financial instrument, regardless of which TTF design option is approved, most respondents believe that it would be better to use these resources for investing in the Final Recipients.

One participant in the market consultations suggested that one possible form of TTF governance would be joint management of the investment fund through a partnership between the FMFIB and the organisation concerned.

Number and size of the individual investments (Tickets)

Having regard to the OPIC policies, the success of the Fund and the achievement of its investment goals will be measured by the companies invested and by the amount of private resources raised. According to the investment strategy laid down in the Financing Agreement between the FMFIB and the OPIC Managing Authority, the indicative number of TTF investments would be 22, wherein half (11) of the Final Recipients should collaborate with R&D organisations – an important factor, which predetermines the fund manager's investment strategy and approach. The respondents believe that the indicative number of Final Recipients is very well balanced to the size of the Fund.

Despite the consensus among the respondents on this matter, one of them believes that, having regard to the development phase, the number of investments in the Early Phase sub-fund should be significantly larger due *inter alia* to the size of the individual tickets.

As regards the size of the individual tickets, in line with the broad investment profile of the instrument, the individual tickets will range from EUR 25,000 to EUR 200,000 for early-phase and up to EUR 5 million for commercialisation. All respondents were satisfied that these ticket ranges enable sufficient flexibility in implementing the investment strategy. They also expect that the average ticket size will be relatively higher and will depend on the sector as well as on the level of development of the innovations. Based on their experience, some respondents expect tickets in sectors other than ICT to be substantially higher as product development projects are more resource-intensive in the general case. The interviews also discussed whether it might be possible to make investments below or above the above limits; however, specific recommendations or suggestions in this respect were not tendered.

Last but not least, the consultations touched on the possibility to allocate certain resources for additional support in the form of follow-on investments depending on the specificity and on the development of the enterprise or product concerned.

The respondents with investment experience consider that the Early Phase sub-fund and its synergetic interaction with the Commercialisation sub-fund would require an allocation for follow-on investments, especially in enterprises, which successfully clear the seed phase of their development. In other words, they say, the Commercialisation sub-fund can also operate as a follow-on facility to the Early Phase sub-fund. However, when discussing this aspect in deeper detail, we were unable to confirm unequivocally whether the investment period would be long enough for a company, which has been supported by the Early Phase sub-fund to reach a level where it can benefit from a follow-on investment from the Commercialisation sub-fund.

Raising private capital

The limited geographic scope and the specificities of the local market and of the TTF itself cause the participants (respondents) in the Market Test exercise to believe that recruitment of private investments would be difficult, although there is certain scope for leveraging private funding from investors in Bulgaria and beyond. Potential contributors in the Bulgarian market are strategic investors as well as high net worth individuals (HNWI).

The respondents are of the opinion that private funding can be raised from individuals or companies with a specific sectoral focus.

Having regard to the high-risk profile of the TTF, the recruitment of private investments at Fund level would be extremely difficult and fund managers having experience in doing so should be highly appreciated. Furthermore, the fund manager's reputation would be crucial for signing up private investors. According to the majority of respondents, the Transaction level is where most private capital would be raised, although some believe that a co-investment scheme with 30 % independent contribution is also achievable at Fund level. It was also suggested that international

private investments would be more readily available since investing in technology transfer is a new notion only for the Bulgarian market.

Timeline of the Fund and indicative investment schedule

The participants in the Market Test exercise approved the proposed term of the Fund, i.e. ten years extendable by a maximum of two years. In their opinion, the implementation of TTF investments would be more time-consuming and the most important factors will be the sector and the development level of the innovation at hand.

The (approximate) three-year investment period set out in the TTF Term Sheet was confirmed as consistent with realistic market practices.

Benefit-for-Bulgaria test

In order to satisfy the provisions, set out in the strategy of the financial instrument, the investments made should be beneficial for Bulgaria. The test developed for this purpose by the FMFIB and the OPIC was explained to the participants in the Market Test exercise. Their feedback was that the definition is sufficiently flexible and facilitates the successful implementation of the investment strategy, although some respondents believe that such a test is not relevant from technology transfer perspective.

Loss level

The interviews did not capture consistent data as regards the expected loss levels. A few respondents expect high loss levels (in the region of 70–80 per cent) of investments in start-ups engaged in innovations and R&D. Indicative loss levels were not suggested in the case of larger Commercialisation investments.

Structure

Indicative size of the TTF

In line with the envisaged strategy, the minimum indicative size of the Fund is around EUR 29 million including only the capital of the potential fund manager.

The indicative requirements provide for the need to attract at least 30% in the case of investments exceeding 200 thousand euros (including the resources of the Fund Manager), and for those under that amount from third parties are not required. On the other hand, the indicative structure does not impose a ban on the recruitment of committed at the level of the Fund.

The majority of respondents indicated that they expect difficulties in the recruitment of foreign investors at the Fund level, but confirmed that the flexibility in the process of raising funds is appropriate. In this connection, a hard cap on the indicative amount of the Fund could be set.

SAR and risk sharing among investors

As per the expectations of the respondents that it would be difficult for the Fund Manager to raise private support for seed investments, de minimis regime was pointed out as an option. The participants supported the applicability of the regime of no-support (i.e. 30% private funds pari-passu) for investments bigger than 200 thousand Euro.

While the option for asymmetrical allocation was considered as well, it is believed that this approach would create additional limitations for the Fund Manager's activities.

The intermediary's commitment to the capital of the fund

A proposal was tabled for setting a range, including floor and cap, of the Fund Manager's commitment as a proportion of the overall size of the Fund.

The argument brought forth for using a range rather than floor only was that too high commitment rates would make the fund managers cautious about investing in more risky enterprises, which would impair the overall yield of the portfolio. On the other side, according to some respondents, the mandatory commitment requirements to the Fund Manager would help sieve away part of the aspiring TTF managers.

Management fee

The participants in the market consultations consider that the level of the management fee set out in the TTF Term Sheet is acceptable, but did not expand on its sustainability, i.e. whether it would ensure that the financial intermediary remains financially autonomous and capable of generating sufficient cash flows for the Fund Manager to cover its operating expenses. The FMFIB team did not receive concrete proposals for adjusting the fee, however, the respondents find the cost allocation structure complicated.

With regard to the technical assistance for governance and to the outsourcing of certain services (legal services, verification, checks of circumstances, etc.), preference was given to allocating a fixed proportion of the base commission to cover these costs.

Revenue distribution cascade

The more important aspects of the discussions on the distribution cascade, including comparisons between the asymmetrical mode and the pari-pasu principle for the Fund Manager, were mentioned in the State Aid Regime section above.

The proposed carried interest split, 80 % for investors and 20 % for the FM, is regarded as the most applicable in the market. The respondents believe that distribution of carried interest for each successful transaction is a good approach, which would significantly accelerate investment yields.

Another well received and discussed idea concerns an individual cascade for pre-seed and seed investments, considering *inter alia* its potential for better coordination of the interests of all stakeholders in light of the high-risk profile of investments in enterprises at early phases of their development.

Minimum rate of return (hurdle rate)

The hurdle rate is expected to be within the market levels prevailing at present. Most interviewees see the proposed hurdle rate as reasonable and consistent with the specificity of the instrument. One interviewee defined a hurdle rate of 4 % as a good choice. Another interviewee also identified potential issues, which may arise from a low hurdle rate level. In his view, fund managers tend to exit the investment as soon as it reaches the target hurdle rate, which often leads to loss of potentially profitable investments.

Most respondents concur that the hurdle rate should be low due to the high-risk profile of the investments.

Domiciliation, legal form and governing law of the Fund Manager

In the market consultations on the design of the two previous financial instruments, Venture Capital Fund (VCF) and Mezzanine/Growth Fund (MGF), most of the market actors interviewed believed that the future fund and the related management company should preferably be domiciled in foreign jurisdictions which have gained experience in the formation and regulation of alternative investment funds (AIF), such as Luxembourg or the Netherlands. As concerns the TTF

Market Test, the FMFIB team did not receive a clear indication as to the preferred domiciliation of the Fund, however, it appears that the uncertainty about establishing an AIF in Bulgaria has been overcome. According to almost all investment professionals interviewed, the choice of jurisdiction will hinge mainly on the establishment and administration costs, in other words, the expectations are that Bulgaria would be a more attractive jurisdiction than e.g. Luxembourg or the Netherlands. However, one interviewee noted also that the lack of sufficient judicial case law in this specific sector might weigh negatively in this respect.

Exit strategy

The respondents consider that the level of development of the investment and capital markets in Bulgaria tends to limit the exit options. The likely exit strategies mentioned were selling to strategic or financial investors or redemption of shares by the initial holders of the capital. The opinions shared by the majority of investment-savvy respondents is that due to the specificity of the technology transfer business and the level of its development in Bulgaria, the exit expectations will be focused primarily on international companies.

Investment team and experience

When discussing the optimal composition of the FM team, the respondents were relatively consistent both with regard to the number of the key personnel required and to the specialisation of the individual team members.

The participants gave suggestions for indicative number of team members of Fund Manager for both the management and the entire investment team. Most of the participants who expressed their opinion on the matter, agreed that the optimal number of members of the management team is at least four people, because of the need to manage the investments of two sub-funds with different investment focus.

Only two participants believe that, for each of the funds is necessary only one investment manager, on account of the number of persons of the investment team, which should be at least six. Six or seven persons to support the activities of investment managers, is the optimum number of the investment team according to interviewees. According to the majority, the team should have an investment professional, for example in the field of risk financing, a professional with experience in dealing with the scientific community, ideally experience in technology transfer. Some participants emphasised the need for professionals in specific scientific or engineering areas, people with entrepreneurial experience, junior professionals, a person responsible for relations with investors, etc.

For the equity investments in initial- or early-phase SMEs, the TTF envisions a team of managers whose specialisation and professional qualifications would be characterised by experience in investing in start-ups (pre-seed and seed financing), and by substantial experience in venture capital investing. The TTF will also rely on business development experts and on professionals who can add value as mentors in the post-investment control of investees. Having regard to the TTF specificity, highly relevant is the experience in innovations or technology transfer and, albeit to a lesser extent, the scientific expertise.

The key aspects to consider in the evaluation of potential fund managers, as indicated by the respondents, are the following:

- Expertise in equity and quasi-equity investments;
- Experience with seed and pre-seed investments;

- Experience with accelerators and business incubators;
- Experience with innovations and technology transfer;
- Entrepreneurial experience;
- Experience in the area of corporate finance;
- Number of enterprises which the FM has worked with;
- Contribution of the FM to the development of these enterprises;
- Successful exits from previous investments;
- Assessment of the proposed list of potential investments;
- Experience of the sectoral experts;
- Success in mobilizing investments from independent private investors

Investment process

The participants (respondents) in the Market Test exercise acknowledge that TT-savvy fund managers are extremely difficult to find in Bulgaria. Accordingly, they believe that transmission of experience and knowledge from international fund managers is indispensable, which however does not mean that the experience and expertise of local market actors will be disregarded. Furthermore, the interviewees indicated that the efficient use of the FM's existing contacts and partner networks would be crucial for the identification of potential Final Recipients. Having regard of the specificity of the TTF, the respondents expect that many potential investments would come from academic and research organisations. Local and, above all, international bureaus for knowledge and technology transfer would generate an important number of transactions.

According to the majority of respondents, an indispensable part of the investment process is the assessment of the scientific viability of the projects.

Last but not least, the interviewees are of the opinion that the selected Fund Manager should provide operational and strategic expertise to the target enterprises to help them achieve the desired returns.

Annexes

Annex 1: List of the entities and individuals, which took part in the Market Test exercise

Annex 2: Questionnaire used for conducting structured interviews for the purposes of market consultations with potential financial intermediaries

**List of the organisations and individuals
participating in the TTF Market Test**

BESCO
Black Peak Capital
Bulgarian Association of the Information Technologies
Bulgarian Investment Managers Association
Bulgarian Private Equity and Venture Capital Association
Capricorn Ventures
EMV Capital
Endeavor
Euroconsultants
GIS-Transfer Center
Health & Life Sciences Cluster
INI-NOVATION
MBI Finance
META Group
NeoVentures
Open Horizon
Speed Invest
[Protected
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4, p.1
GDPR](#)

Sofia TechPark

Questionnaire used for conducting structured interviews for the purposes of market consultations with potential financial intermediaries

Financial Instrument 'Technology Transfer Fund' Operational Programme 'Innovation and Competitiveness' 2014–2020

General

1. Market opportunity

- 1.1. In your opinion, which is the target market segment (including development phase – seed/pre-seed or large enterprises) and does it present an attractive investment opportunity?
- 1.2. What in your opinion would be the major risks and barriers to entry in that market segment and how would they affect the market opportunity under consideration? What measures do you think should be taken in order to appropriately address and mitigate these risks?
- 1.3. Do you find it feasible to introduce a technical assistance scheme for Final Recipients? What should be the scope of that scheme? Alternatively, should these resources be used for setting up a TTO or regional technology transfer centres to liaise between the TTF and universities?

2. Investment strategy

- 2.1. What in your opinion are the key components of the proposed strategy?
- 2.2. For the Investment Fund to be able to implement that strategy, what should be the minimum size of the Investment Fund?
- 2.3. Investment opportunities for the Fund are expected to come from certain economic sectors. Which of these sectors (in the framework of the ISSS) do you think have the strongest investment potential and would make good potential investments?
- 2.4. In your opinion, what development phases would present relevant investment opportunities in the context of the objectives of the instruments, including in the pre-seed, seed and acceleration range?
- 2.5. In what forms can the Funds provide their financial support (i.e. equity, quasi-equity investments) and what impact can each of these forms have on the market?
- 2.6. Having regard to the defined strategy, what is your estimation of the size of the shareholding to be acquired in the Final Recipients?
- 2.7. What are your expectations as regards the number and size of the investments in the portfolio? How do you see the indicative investment schedule (including reserves and potential follow-of investments)? What would be the expected structure/split of the Fund?
- 2.8. What is the average period over which you expect to see development of the investments made during the various phases?
- 2.9. What is your expected approach to exiting the investments?

- 2.10. What rates of return do you expect and what actions/measures would you undertake for achieving these RoR levels?

3. Investment team and experience

- 3.1. What experience should the investment team possess and what existing funds and capital (where applicable) should be managed by the investment team?
- 3.2. What is your concept about the needs and plans for hiring additional professionals and resources in the investment team?
- 3.3. Would you identify previous or existing activities of the investment team members (unrelated with the operations of the particular fund) that may be in conflict of interest with the Funds' operations or would require resources even if these activities were not related to the operations of the Fund?
- 3.4. Do you believe that the TTF should have a network of mentors?
- 3.5. Is it appropriate to have the commercial opportunity of each mature-phase ticket confirmed by an international expert in the area concerned?

4. Investment process

- 4.1. What channels do you see for the identification of investment opportunities?
- 4.2. What would be your approach to increasing the value of the enterprises once the investment has been made?

5. Raising private capital

- 5.1. Do you have concrete expectations as regards the intermediary's commitment to the capital of the TTF?
What are your preferred options for the structuring of private investments (co-investing or at Fund level)?
- 5.2. What are your views about the potential private investors in the Fund, the experience and the strategy for raising private capital and the likely process of approving potential investors before they can join the Fund (where applicable), and what conditions and/or special rights do you anticipate the investors to ask for?
- 5.3. What, in your opinion, is the estimated period for the mobilisation of additional investments and for getting the Fund up and running?

6. Structure of the Fund and of the team

- 6.1. What, in your opinion, is the indicative size of the capital/investment, which the potential intermediary would expect the FMFIB to commit to the Fund?
- 6.2. How would you perceive and identify the potential need for technical assistance for the governance of the financial instrument?
- 6.3. What is your view about the jurisdiction of establishment and domiciliation, and about the legal status/form of the Fund, of the Fund Manager and of other related companies (such as consulting and other appropriate firms)?

- 6.4. What is your understanding of the estimated structure of ownership of the Fund Manager and of related companies, potential sponsors, etc.?
- 6.5. The main financial terms, including but not limited to:
 - i. Management fee during and after the investment period?
 - ii. Carried interest and catch-up?
 - iii. Proposed allocation of potential preferences, related to the Stat aid regime, between the private investors and the Fund Manager?
- 6.6. What in your opinion would be the composition of the potential investment committee and the related voting rights?
- 6.7. What is your view, in detail, as regards the proposed management/advisory committees, including the potential contribution by individuals (in the form of time and/or money), including the method of payment?