IRISH VENTURE CAPITAL ASSOCIATION

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Mr Cian Daly
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30th May 2014

Re: Future Focus of the Seed & Venture Capital Scheme (2013-2018)

Dear Cian,

I attach the IVCA's response to the Public Consultation on the future focus of the Seed & Venture Capital Scheme 2013-2018.

Yours sincerely

Regina Breheny
Director General

IVCA

Funding Innovation for Ireland

Seed and Venture Capital Scheme
(2013-2018)

Submission in response to the Public Consultation on the Future Focus of the Scheme

30th May 2014

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1. Recommendations

The Ministers for Jobs, Enterprise and Innovation and for Public Expenditure and Reform announced in the 2013 Budget that the State would continue to invest in the Irish venture capital sector through a new €175m Seed and Venture Capital Scheme (2013-2018).

The overall vision of this new Scheme is:

- to increase the availability of risk capital for SMEs;
- to support economic growth through the continued development of the Venture Capital industry in Ireland and
- to achieve a more robust, commercially viable and sustainable sector.

The first competitive call for expressions of interest under the Scheme resulted in Enterprise Ireland committing to invest €99.5m to a number of venture capital funds in the wider technology and life sciences sectors that will invest in high growth companies with the potential to generate large amounts of additional export sales.

An objective of the Scheme is to encourage and leverage private sector capital into investment stages and sectors that find it difficult to secure appropriate funding. The IVCA believes that the current market need for capital is at the seed/start-up stage of development and recommends the following;

- The remaining €75.5m should be committed in one further expression of interest;
- The full amount should be allocated to Seed/Start-up Funds who operate at the seed, start-up and early stage;
- This capital should be invested in ICT, Lifesciences and other innovative sectors in Ireland;
- This capital should be committed to Seed/Start-up Funds that are professionally managed and that operate on an economic basis i.e. where sufficient fees are generated to sustain the Fund on a stand-alone basis.

2. Venture Capital Landscape in Ireland

European policy supports a strategy of continued state investment in the venture capital market to ensure a more robust and commercially viable sector. *"The public sector should initiate financial instruments that attract a greater amount of private finance and close the "equity gap" in investing in SMEs and in research and innovation".* Venture capital is therefore directly relevant for the development of new products and technologies and the early growth of innovative enterprises and is regarded as an intrinsic component of any innovation system and is recognised as a driver of entrepreneurship and significantly contributes to the scaling of innovative companies.

The economic characteristics of venture backed companies in Ireland have encouraged and influenced policy makers to recognise the importance of venture capital activity and consequently innovation and venture capital are at the centre of Ireland's economic policy. This is evidenced by the funding initiatives from Enterprise Ireland at the seed/start-up stage and in the growth capital space and by the establishment of a later stage expansion fund by the NPRF (National Pension Reserve Fund). In recent weeks the ISIF (Ireland Strategic Investment Fund), formerly the NPRF, unveiled its plans to invest a €6.8bn Fund in Ireland and indicated that venture capital has a central role to play in growing the Irish economy.

The investment activity associated with the VC funds supported by the Seed and Venture Capital Programme 2007-2012 peaked during 2010 and available funds for new investment has now begun to decline. Investment activity by the existing Seed Funds is also in decline. As a result the number of new investments has started to fall off, bringing about a funding gap for indigenous companies seeking capital to grow and expand their businesses. In response to this the Venture Capital industry is in the process of raising new funds to fill this gap.

For the period 2014 to 2019, the IVCA estimates that the capital required to fund innovative Irish SMEs is €1.65bn. The IVCA assumes that €500m (30%) will be attracted into these innovative companies by international VC firms co-investing alongside the Irish VC funds. Other Funds operating in Ireland, under the IFI, DCF and other initiatives will provide an additional €400m (24%). Hence the Irish venture capital industry will need to raise €750m (46%) from Irish investors to fund the innovative SME sector.

Support from the State has been pivotal to the success of Irish VC Funds in raising capital from the private sector. Since 1997 the Irish venture capital industry has been developed and nurtured by the Government through investment of €348m via the Enterprise Ireland Seed and Venture Capital Scheme over three investment rounds. The VC Funds leveraged this commitment by raising additional private sector investment both for the Fund itself and then through syndicated deals for the individual companies. As a result nearly €4bn has been raised by Irish SMEs. The State's commitment has been leveraged upwards by a factor of 10. The renewal of the Seed & Venture Capital Scheme for 2013-2018 where the State will commit up to €175m as a cornerstone investor to venture capital funds meets the "additionality" objective set out by Government.

3. Stage of Investment

The venture capital industry provides funding to companies operating at the seed/start-up phase to those at the early/expansion phase. Risk parameters are inherently higher for younger companies and consequently funding can often be more difficult. To address the funding gap that had emerged for young companies five Seed Funds were established from 2007 onwards with total capital of €134m. These Funds, financed by Enterprise Ireland and the banking sector have created a significant incremental pipeline of early stage companies with high growth potential. The success of this initiative is evidenced as follows:

- The investment by Enterprise Ireland of €34m was geared up by an additional €99m of investment from the banking sector to create Funds of €134m. In addition other Funds have invested significant amounts at this stage. Total funds raised by seed and start-up companies was €386m since 2007. The €134m in the Seed Funds helped to leverage in an additional €252m from private investors and other venture capital Funds. The State's commitment has been leveraged upwards by a factor of 10;
- This initiative has added significantly to the pipeline. The number of seed/start-up funding rounds has increase from 32 in 2008 to 85 in 2013, 390 rounds in total since 2007;
- As evidenced within the IVCA's study "*The Economic Impact of Venture Capital in Ireland - 2012" e*mployment growth in venture backed companies was 19% in 2012. In the age cohort of companies younger than five years the equivalent growth was 48%;
- The study also shows that export growth in venture backed companies was 11% in 2012. In the age cohort of companies younger than five years the equivalent growth was 42%;
- Venture capital fund managers believe that the calibre of start–ups has improved significantly and expect that at least 50% of companies being financed by the Seed Funds will go on to raise expansion capital.

In the Government's Action Plan for Jobs one of the three new disruptive reforms introduced in 2014 is entrepreneurship and a key objective is to transform Ireland's entrepreneurship and start-up culture. Regeneration of the Seed Fund model is essential to finance entrepreneurship and to maintain a pipeline of high calibre start-ups. Without government support companies at the seed/start-up stage will find it challenging to secure appropriate funding.

The previous generation of Seed Funds raised capital of €135m and the IVCA believes that this amount should be increased to €150m to sustain the momentum of new companies being created over the five year period, with a commitment of €75m from the Seed and Venture Capital Scheme (2013-2018) matched by at least €75m from the private sector.

4. Investment Sectors

Since 2009 94% of venture capital funds were raised by SMEs in the high technology sector. This investment preference by venture capitalists reflects sectoral strengths in Ireland including:

- Expected growth prospects;
- Access to global markets;
- Capital efficiency in terms of building the technology and business model;
- Available skill base to build the business and

- Domain expertise of the venture capitalists.

The IVCA's study "*The Economic Impact of Venture Capital in Ireland - 2012"* provides evidence to support this preference for high technology investments;

- Employment growth in venture backed companies was 19% in 2012. In the high technology sectors the equivalent growth was 31%;
- Export growth in high technology companies was 11% in 2012, similar to venture backed companies in general. However in the high technology sectors exports represented 80% of revenues (Lifesciences 97%, ICT 76%) whereas in the non technology sectors exports represented 49% of revenues.

The IVCA believes that this capital should be invested in the ICT, Lifesciences and other high technology sectors. In the US and Europe sectoral split is approximately ICT 50%, Lifesciences 30% and other 20%. Attractive sub-sectors will include; cloud computing, mobile technologies, the internet of things, healthcare IT, medical devices, drugs and diagnostics.

Since 2007 the Seed Funds have provided matching funds to a significant number of Enterprise Ireland's HPSU (high performance start-ups). This level of collaboration has supported the growth strategies of Enterprise Ireland's sectors by providing capital and expertise.

5. Funding Model

Enterprise Ireland's policy objective states that the preferred vehicle for investment commitments will continue to be Limited Partnerships in line with international best practice where commitments are drawn down alongside those of private sector investors over the lifetime of a fund.

In this context the IVCA recommends that the €75.5m remaining in the Seed and Venture Capital Scheme (2013-2018) should be committed to a range of Seed/Start-up Funds that are characterised as follows:

- The Fund should be established as a Limited Partnership with a fixed life of ten years;
- The Fund size should be a minimum of €25m;
- The Fund should invest in Irish SMEs;
- The General Partner (GP) or manager should be regulated by the Central Bank of Ireland;
- The GP or manager should employ professional venture capitalists who can demonstrate relevant fund management experience and relevant expertise in building company capability;
- The GP or manager should demonstrate an ability to raise additional funds within the private sector that will at least match a commitment from Enterprise Ireland and an ability to syndicate deals domestically and internationally;

- The GP or manager should manage the fund on an economic basis so that sufficient fees are generated to sustain the Fund on a stand-alone basis. Any uneconomic or subsidised model will hamper the stated objective of “achieving a more robust, commercially viable and sustainable sector”.

Since 2007 professional seed fund management has been pivotal as the cornerstone investor in start-ups, in providing pricing, infrastructure and corporate governance to angel/private investors.