IVCA Pre Budget Submission 2024

Increasing the Resilience & Sustainability of the Indigenous Economy

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IVCA
Irish Venture Capital & Private Equity Association

Foreword

The Irish Venture Capital Association is the industry body for the venture capital and private equity ("VC/PE") industry in Ireland. The IVCA represents Irish-based VC/PE firms, as well as their investors and professional advisers.

White Paper on Enterprise Policy & Budget 2024: The IVCA welcome the significant work undertaken by the Government in preparing and publishing the first White Paper on Enterprise Policy in a decade. This document is highly ambitious for our domestic economy, and in this submission, we have been informed by the content and recommendations in the White Paper.

The preparatory work for the White Paper examined the performance of Ireland in the context of other small, advanced economies, and recommended that Ireland enact policies to strengthen its competitive advantage in domestic companies. It found that Ireland has one of the weakest innovation records of the small, advanced economy group: low total and business R&D spending as a share of GDP, and a weak overall ranking on the Global Innovation Index. IVCA economic impact research has shown that in the region of 40% of the domestic R&D spend is generated by venture backed companies. At any one time there are in the region of 100-150 venture backed portfolio companies in Ireland. Significantly increasing the number of R&D intensive companies and the funding available for them to grow and scale will ensure that the indigenous economy becomes the driver for our economic growth.

Sarah-Jane Larkin | Director General, IVCA

Economic History & Sources of Private Capital

We have many of the building blocks necessary to deliver on this ambition - a strong domestic funds industry, exceptional Government support through Enterprise Ireland and the Ireland Strategic Investment Fund but that's only a two-legged stool. If we want innovation intensive companies to succeed and be able to scale and grown in Ireland, then we must add the third leg and mobilise additional private capital.

Over the last 30 years Irish Government policy has enabled the creation of an active VC/PE market that leverages State investment and raises capital from institutional investors and invests it in Irish SMEs. Our members are long-term investors, investing in unlisted illiquid private companies, typically, for three to seven years, and are committed to building lasting and sustainable value in the businesses they invest in.

The ability for Irish funds to successfully fundraise matching private capital from Irish sources has been negatively impacted by our economic history and the consequent lack of sources of private matching capital. We believe that the best way to invest and scale Irish companies is to create larger domestic VC/PE funds who can support companies in the later stages of their growth journeys.

The relatively recent nature of Ireland's prosperity and its roots in an FDI orientated open economy have resulted in a lack of depth in the type of institutional and corporate investors often seen in other European countries. Ireland never experienced an industrial revolution creating domestic multinationals or intergenerational wealth. Ireland never colonised another country and extracted natural resources and wealth. Ireland has never created a state pension fund.

There are few domestic multinationals, which in other countries, typically deploy some assets in domestic venture capital funds or direct investment in start ups. Last year corporate venture capital activity in America represented 52% of total venture capital investment. Additionally, Ireland has significantly less well-developed family office and endowment fund structures than other European countries, and the small size or property focus of most domestic pension funds has limited investment in domestic private capital. The general trend of moving from defined benefit to defined contribution schemes has meant those of a sufficient scale to have invested in the past (An Post, RTE, CIE, Electric Ireland), find it more difficult to do so now. In addition, ownership changes at Eircom, Aer Lingus and Board Gais have also impacted negatively on allocations to domestic venture capital and private equity funds.

The absence of sources of matching private capital to leverage State investment has impacted on the size of Irish funds, and the levels of capital they can deploy. This has a direct impact on scaling finance available for Irish companies.

We can't outrun our economic history and because of it we lack many of the sources of private capital that exist in other countries. This has led to a situation where we are nurturing and growing companies to a level, and then finding ourselves in a situation where the best ones are cherry picked by overseas investors because of a lack of scaling finance.

Budget 2024

It is our view that this government has a central role to play as a catalyst in mobilising greater institutional investment in alternative assets. We would ask that you take leadership and drive the changes required to unlock the private capital necessary to enable Irish funds to access greater funding and provide it to the Irish companies they invest in.

The policy to introduce free education in 1967 is now seen as a milestone in Irish social and economic history. In this pre- budget submission, we outline a range of policy measures which could mobilise private capital to Irish funds and the companies they invest in. We believe that individually or collectively these proposals could be transformative for the indigenous high-growth tech start-up and scale-up sector in Ireland, and in strengthening the competitive advantage of the Irish economy.

Auto-enrolment - Increase Asset Allocation from Irish Pension Funds.
According to Central Bank figures the asset allocation of Irish pension funds show that there are €3.8 billion of equity holdings invested in c. 2,300 distinct entities across a diverse range of countries outside of Ireland with the United States accounting for almost half of holdings (47.7%). IVCA figures show that less than .01% of the equity holdings of Irish pension funds is allocated to Irish PE and VC funds.

IVCA members in receipt of State investment through Enterprise Ireland are required to invest in Irish companies. This State mandate should extend to pension funds directly in receipt of Irish state funding or indirectly through tax reliefs.

The creation of an auto enrolment pension scheme is an important step to safeguarding the economic security of Irish citizens. It is important that the design of the scheme does not limit the additional economic benefits to the domestic economy that the deployment of significant sums of State money could produce.

The IVCA believe that any auto enrolment scheme should ensure that a portion of this pension saving supported by the state should be used to finance the Irish jobs of the future.

A small increase in domestic venture and private equity allocation would have a significant positive impact on the availability of capital for high-growth innovative businesses. To achieve this the IVCA recommends introducing an “opt-in” requirement on new payments into pension schemes to attract pension fund investment into indigenous enterprises. This would require that schemes offer members an option to allocate a small proportion of their pension to a fund supporting Irish industry. The intent would be to emulate the successful implementation of the French LME Law in 2008 which mandated that Corporate Employee Savings Schemes must offer a Solidarity Investment Funds option. This resulted in significant growth in the amount of capital allocated from €200m to over €9bn between 2002 and 2018.

On the 10th of July 2023, the UK government announced that it had secured an agreement from nine UK pension funds to invest at least 5% of their default funds into the nation’s startups and fast-growing companies by 2030. This move has been hailed as an important step towards mobilising more capital for UK innovation. The agreement, known as the Mansion House Compact, was announced during a speech by the chancellor, Jeremy Hunt, and relates to defined contribution pension schemes. The UK government projects that this and other reforms could unlock an additional £75bn to be invested into fast-growing companies in the UK by 2030.

Implementation of similar policies in Ireland would mobilise pension savings to support Irish industry and would have a long term and far-reaching impact on the availability of funding for Irish companies.

Proposed Creation of a Sovereign Wealth Fund

The IVCA very much welcomes the May 2023 scoping paper in respect of the possible creation of an Irish Sovereign Wealth Fund (ISWF). The association is very much in favour of such a creation. The IVCA would encourage the Minister and his officials, when setting the investment objectives of the ISWF, to consider a sizeable allocation to Irish venture capital and private equity funds and the companies they finance. Even if management of these funds falls within existing state structures, such as the National Treasury Management Agency (NTMA) or Enterprise Ireland (EI), it should be possible to ringfence the allocation made. Both the NTMA and EI have proven track records and are established fund of fund managers domestically and internationally. A partial allocation to domestic venture capital and private equity managers, of the forecasted surplus from ‘transient tax’, should be directed at scaling early and later stage Irish based SMEs. This strategy would be consistent with the ISIF’s double bottom line objective but also adds a third pillar, in that it will help to broaden the domestic tax base and reduce the dependency on internal FDI.

The IVCA also sees the creation of a sovereign wealth fund as a vehicle that can be used to provide side car co-investment by the private sector. Using the same investment infrastructure, could allow private sector PAYE workers (invest alongside a sovereign wealth fund) for their future by allocating a small percentage of their pre-tax income to a parallel investment fund. For example, in 2001, the French government passed legislation the ‘Fabius’ law of 19/02/2001, whereby pension funds, are required to invest between 5 and 10% of their assets in accredited ‘solidarity-based enterprises of social utility’ organisations. This rule, which is specific to solidarity-based employee savings funds, has in practice been applied by fund managers to all other solidarity based collective investment undertakings (CIUs) (mutual funds (FCPs), open-end investment companies (SICAVs), to promote standardised management rules and to present products that are easier to understand for all investors. The effect of such legislation promotes the domestic economy and has had the effect of mobilising private sector investment.

Using existing infrastructure to manage an ISWF and parallel private sector investment has the benefit of using an existing route to efficient capital deployment, urgently required to diversify the countries tax base, but can also provide a level of comfort in respect of the achievability of returns.

FDI Fund: Last year corporate venture capital activity in the United States represented 52% of total venture capital investment. This is a significant source of capital, lacking in Ireland.

The composition of the Irish economy has resulted in an important and vibrant multinational sector. However, we lack a large pool of domestic multinationals, which in other countries, typically deploy some assets in domestic venture capital funds or direct investment in start ups.

Consideration should be given to developing, in conjunction with the multinational (domestic and overseas) base in Ireland, a fund to invest in R&D intensive Irish start-ups. Mechanisms to allow investment in such a fund to count towards the 25% credit on qualifying R&D expenditures should be explored.

Such funds could be targeted at specific sectors, and regional clusters where Ireland has built up expertise or those selected as part of the ongoing Innovators Initiative.

Promote Investing in Irish Funds; At the inception of the Enterprise Ireland Seed and Venture scheme and the domestic equity funding industry it sought to create a role existed within Enterprise Ireland. This role promoted the benefits of investing in Irish venture capital fuds to Irish banks, other financial institutions, high net worth individuals and semi state pension funds. This role existed to mobilise private capital to match the State allocation, with considerable success. Given the decreasing sources of private Irish capital today, and the positive trajectory of Irish funds over the last number of years, it is worth considering whether a similar position today could impact on the capital available.

Conclusion

We believe that every great entrepreneurial management team should be able to obtain the finance it needs in Ireland to develop their ideas into major global businesses. We believe that the measure outlined in this submission would both increase the number of start-ups in Ireland and crucially ensure their ability to remain Irish and scale here.

Today, over 50% of funding for Irish companies comes from overseas sources. Overseas investment is welcome and validates the quality of Irish companies and the investment opportunities being created in the knowledge-intensive sector. However, it is a concern that Ireland lacks a domestic scaleup investment capability in these knowledge-intensive sectors. For our domestic economy to thrive it needs to become world-class at both creating knowledge-intensive companies and scaling them up. Relying on foreign investment to scale up Irish companies exposes Ireland to geopolitical risk and fluctuations in global capital allocations. It also increases the risk of domestic enterprises nurtured locally, re-locating or re-domiciling overseas.

Firstly, companies in receipt of international funding often build out in the market close to their investors, reducing their footprint in Ireland. Secondly, this funding is quick to recede when the global economy contracts. Thirdly, recent global events have threatened the liberal economic order and new concerns about the wisdom of being so reliant on flows of overseas capital are emerging. AI, blockchain, Fintech, Cybersecurity and other deeptech innovations will provide the technologies and companies that propel our economic future. Today there is a growing recognition throughout Europe of the need for tech sovereignty and the fear that if we are unable to fund our own leaders in these technologies, we are risk having our economic future dictated by interests outside Ireland.

Greater participation by the private sector in local funding will both diversify and de risk the funding for Irish business from potential cyclical allocations of capital from international investors and increase the likelihood that domestic capital providers can continue their funding journey for scaling Irish companies for longer. In turn that will increase the likelihood of those businesses generating greater value added for the long term in Ireland.

IVCA Members

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