What Ireland needs

More R&D led high potential start-ups and scale-ups, and investment in key sectors allowing innovation to drive our indigenous economy and our most promising companies to scale from Ireland.

IVCA
Irish Venture Capital & Private Equity Association

What IVCA Members Provide

Long-term financing for the most innovative, Irish firms that drive economic growth. We are responsible for funding SME's that contribute 40% of Ireland's SME spend on R&D

IVCA Pre-Budget Submission, 24th June 2024

Introduction

The Irish Venture Capital and Private Equity industry plays a pivotal role in driving innovation, economic growth, and job creation within the economy. As a critical source of funding for start-ups and small to medium-sized enterprises (SMEs), members of the IVCA provide the necessary financial support to transform innovative ideas into successful businesses.

The importance of a robust venture capital ecosystem cannot be overstated. Our members work with government agencies to foster a dynamic entrepreneurial environment, encourage research based technological advancements, and strengthen Ireland's position as a competitive player in the global innovation economy.

IVCA Perspective on Ireland's SME R&D Deficit and the indigenous economy

The impact of foreign direct investment (FDI) on the Irish economy is significant. However, the evolving international tax landscape highlights the need for an increased focus on developing a robust and thriving domestic SME sector. Indigenous enterprises with global ambition and the entrepreneurs that found them face considerable challenges in accessing risk finance to scale their businesses.

While the impact of FDI on our economy has been positive, domestic enterprises have not performed as well. When Ireland is assessed in comparison to other small, advanced economies, we see that Ireland has one of the weakest innovation records among these economies, with low total and business R&D spending relative to GDP and a poor ranking on the Global Innovation Index. Research from the IVCA indicates that approximately 40% of domestic R&D spending by SME's comes from venture-backed companies. At any given time, there are around 100-150 venture-backed portfolio companies in Ireland. To ensure that the indigenous economy drives economic growth, it is crucial to significantly increase the number of R&D-intensive companies and the funding available for their growth and scaling.

Investment landscape and funds raised by SMEs

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. In the late 18th and early 19th century, Ireland did not experience a transformative industrial revolution, and did not create 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 very 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.

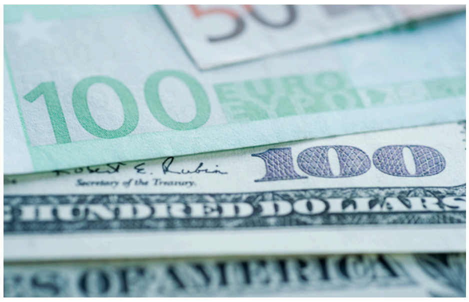
The ability for Irish funds to successfully fundraise matching private capital from Irish sources has been negatively impacted by our economic history and the consequent lack of sources of private matching capital.

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, and an **over reliance on international funding**, leaving us exposed to global fluctuations in capital allocation.

In the first quarter of 2024, **Venture capital funding into Irish SMEs fell by nearly a half (48%) to €258.5m**, compared to €502m in the same period last year. International funding into Irish SMEs in the first quarter fell by 57% to €184m from €425m last year.

The Irish ecosystem for getting companies off the ground, including government and state bodies such as Enterprise Ireland and ISIF, is largely working well. The big challenge is our over dependence on unpredictable international investors in taking these start-ups to the next level of growth. 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. Mobilising sources of private capital to do this will be crucial.

In light if this, **we welcome Minister Michael McGrath's recent comments on the desirability of unlocking some of the €150 billion in domestic household deposits** into more productive use for both the economy and for savers.



Budget 2025 must focus on measures which increase funding to enhance a robust and thriving domestic SME sector.

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Three Steps to Unlocking a Wave of Investment in Irish SME's

Pension Funds & Venture Capital – 3 steps to unleashing a wave of investment to fund the jobs of tomorrow.

Throughout Europe, initiatives are underway to unlock a new wave of investment that has yet to be tapped.

The asset allocation of Irish pension funds according to Central Bank figures show that direct holdings of equities represent a small share (3%) of the balance sheets of Irish pension funds, the European average is 7% and the US is 11%. Most Irish pension funds invest in equities via equity-focused investment funds. There are €3.8 billion of equity holdings invested in approximately 2,300 distinct entities across a diverse range of countries outside of Ireland with the US 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. 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.

IVCA Recommendation

A policy intervention in Ireland to mobilise a small percentage of this pool of private capital to support Irish industry would have a long term and far-reaching impact on the availability of funding for Irish companies, including increasing the number of start-ups in Ireland and crucially ensuring their ability to remain Irish and scale here.

Mobilising Private Investment to Grow Irish Enterprises

Several successful initiatives in countries like Denmark, France, and the UK have effectively directed small levels of pension fund savings to local businesses. These models provide a roadmap that Ireland could follow. Based on the experience of other countries, we outline three options to unlock pension fund investment to support the Irish jobs of the future. In Budget 2025 we ask that some or all of these be enacted.

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› Continued | Three Steps to Unlocking a Wave of Investment in Irish SME's

Option 1 - France, Opt-in

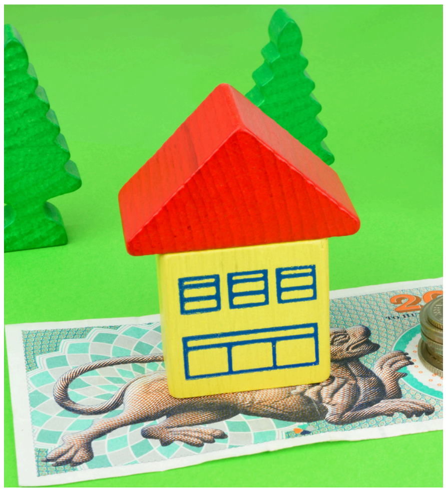
The French LME Law in 2008 mandated that Corporate Employee Savings Schemes must offer a Solidarity Investment Funds option. This resulted in significant growth in the amount of capital allocated to French funds from €200m to €6bn between 2002 and 2016.

Introducing an "opt-in" requirement in pension documents for new entrants into pension schemes, including auto-enrolment, would attract pension fund investment into indigenous enterprises. These schemes offer members an option to allocate a small proportion of their pension to a fund supporting Irish industry. This policy intervention would mobilise a small percentage of this pool of private capital to support Irish industry and would have a long term and far-reaching impact on the availability of funding for Irish companies. It would also necessitate the creation of a fund vehicle which could receive additional institutional investment.

Option 2 - Denmark

Vækstfonden is the Danish Sovereign Wealth Fund. In 2011, the Danish Government reached an agreement with a number of the largest pension funds in the country to establish Dansk Vækstkapital I which, among other things, gives new and smaller companies access to new risk capital. Vækstfonden is the secretariat for Dansk Vækstkapital. Pension funds were mandated to contribute to the fund based on the proportion of their assets under management. While 100% of the fund was invested in underlying assets, pension funds were only exposed to 50% of the fund. The other 50% had a guaranteed coupon rate applied, similar to a government bond. This was a useful way to get Danish pension funds familiar with the asset class.

Dansk Vækstkapital is a "fund of funds", which invests in funds run by professional private managers who, then, invest in companies within their respective competence area. Dansk Vækstkapital invests



in a wide range of funds, including venture funds and small and mid-cap funds. Around 40% of the fund's capital is in Venture and around 60% in Private Equity.

In 2015 Vaekstkapital II was set up and in 2019 Vaekstkapital III fund was established, and this is a continuation of the cooperation on risk capital that was initiated by the Government and the pension funds in 2011. While participation in the first fund was mandated by the Danish Government, successive funds have had optional and high levels of participation, with returns based on investment in 100% of the underlying assets of the fund.

An example of the French Opt-in Model Applied to Ireland

As part of your pension savings plan, you can choose to allocate a portion of your contributions to be invested in Ireland through Venture Capital and Private Equity funds that support early and growth stage Irish companies and associated jobs.

Irish Industry Fund ('Le Chéile Fund') Allocation:

1 % of Contributions: _______ 3 % of Contributions: _______ 5 % of Contributions: _______

***Acknowledgement:** By opting in, I understand that a portion of my contributions will be in-vested in Irish companies as per the fund's guidelines. I acknowledge and support the allocation to Le Chéile Fund*

***Default Option:** If no allocation is specified, my contributions will follow the standard investment options selected by the plan administrator.*

I hereby authorise the allocation of my pension contributions to the Le Chéile fund.
***Employee Signature:** ____*

› Continued | Three Steps to Unlocking a Wave of Investment in Irish SME's

Option 3 - UK

In July last year the UK Chancellor of the Exchequer announced the "Mansion House Compact" and this was signed on the day of the speech by nine defined contribution (DC) pension providers, committing to allocate a minimum of 5% of defined contribution funds to unlisted equities by 2030, with the aim of unlocking over £50 billion of new capital by the end of the decade. Following this, the Chancellor of the Exchequer announced in his 2023 Budget the abolition of the Lifetime Allowance for pension savers from 6th April 2024.

It is likely that the thresholds were moved in order to secure commitment from pension fund providers to invest in UK Venture Capital and Private Equity.

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These options could be implemented jointly or separately to unlock a wave of investment to Irish SME's and ensure that Irish pension savings are used to invest in the Irish jobs of the future. It is likely that if we do not enact these measures in this budget, we will be overtaken by measures in the proposed Capital Markets Union and this opportunity may be lost.

The Capital Markets Union and Irish Venture Capital

The Capital Markets Union is designed to improve access to finance for Europe's most ambitious companies, and aims to make it easier for businesses, especially SMEs and start-ups, to access venture capital and private equity by creating a more integrated and efficient capital market.

The CMU is working to reduce regulatory barriers and create a more consistent regulatory environment across EU member states, making it easier for venture capital firms to invest across borders.

While the CMU offers numerous benefits, it may also pose some risks, particularly to countries like Ireland with small-sized funds. It is possible that if the European venture capital industry becomes a pan European one, this may have a negative impact on Ireland. As the venture capital market is more mature in some EU countries, particularly in relation to private funding, than in others, this may lead to disparities in access to funding. Countries like Ireland, with smaller funds and no private sources of capital might struggle to compete with larger, more established funds that can leverage economies of scale.

Today around 50% of equity funding in Ireland comes from Irish funds, the rest from overseas sources, which ebb and flow with global economic cycles. Greater integration may also lead to increased exposure to market volatility. Small funds may be more vulnerable to such fluctuations due to their limited capacity to absorb losses. In light of European developments related to the Capital Markets Union, we think this is the time to enact measures to mobilise private capital to Irish Venture Capital and Private Equity funds to allow them to grow, fund scaling businesses, and to take advantage of the changes the CMU will bring.

If we do not establish a vehicle to channel Irish pension savings to Irish companies, this source of funding may not be available in the future for Irish businesses, and our economic development will be reliant on investment decisions taken outside of Ireland. Ireland missed out on the first industrial revolution. If we do not enact measures to mobilise private capital to our most innovative companies, and increase the quantum of capital available, we may miss out on the second.

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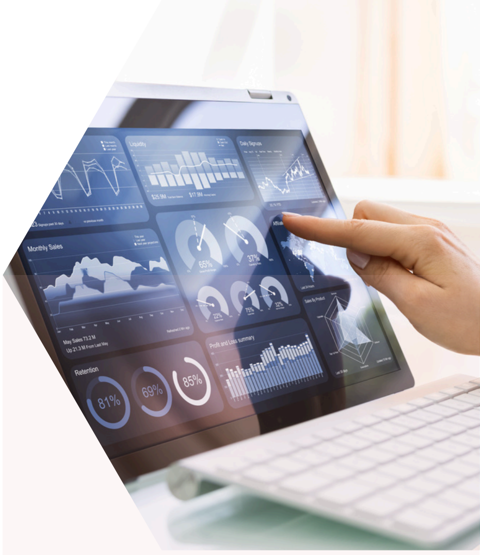
Employment & Investment Incentive Scheme [EIIS]

A number of amendments to the Employment and Investment Incentive (EII) were included in the Finance (No. 2) Act 2023. These updates to the EIIS rules, intended to align with EU State aid changes, have created uncertainty for investors and diminished the capital available and the appeal of the EIIS incentive for start-ups. The revised GBER stipulates maximum relief rates of 20 percent, 30 percent, 35 percent, and 50 percent. The applicable rate for a particular investment depends on the eligibility criteria of the company seeking investment and whether the investment is made directly by the investor into the company or indirectly.



Investments made through Designated Investment Funds (DIFs) are treated as direct investments by the individual investor in the company seeking to raise finance and thus attract the following maximum relief rates under the GBER:

- 50 percent for a company that has not been operating in any market and is engaged in an initial round of fundraising.
- 35 percent for a company that has been operating in any market for less than 10 years following its incorporation or less than 7 years after its first commercial sale and is engaged in an initial round of fundraising.
- 20 percent for a company seeking to raise finance to expand into a new economic activity or, having previously raised risk finance investment, seeking further finance where the need for follow-on risk finance is provided for in the business plan.

While the intent of these changes in applicable rates was to assist companies in raising risk finance, particularly in the earlier stages of their lifecycle, the lack of clarity on the tax relief percentages for EIIS Funds has led to a more cautious approach from investors. This specifically pertains to EIIS funds that encompass multiple investments falling under various tax relief brackets of 50%, 35%, and 20%. Predicting the exact or approximate blended tax relief amount is highly challenging for fund managers, as investments are made in the year following the EIIS fundraise. Consequently, this uncertainty creates challenges for EIIS fund managers and presents potential investors with an approximate, uncertain qualifying tax relief percentage when considering investing in an EIIS Fund. Funds investing in a portfolio of companies, which qualify for a mix of 50%, 35%, and 20% relief, cannot provide potential investors with sufficient certainty regarding the expected blended rate of tax relief prior to their investment.

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Members of the IVCA who operate designated investment funds are reporting a 30% - 50% decrease in the Euro value of investor applications to EIIS Funds since these changes were made. This has affected the volume of available funds. The reduction in investment is particularly concerning given the importance of these funds in supporting start-ups and SMEs that rely heavily on this type of financing to scale their operations.

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IVCA Recommendation

We would strongly urge that an analysis of the effects of the Finance Act 2023 changes on EIIS funding should be completed prior to budget 2025. If it is found that investment levels are adversely affected, the measure should be swiftly amended.

Given that the changes were as a result of GBER rules, consideration should be given to developing a notified scheme for EIIS to ensure that as well as complying with state aid rules there can be more certainty on the qualifying tax relief for investors.

Objective	Proposal	Impact
Pensions: Unleash a wave of investment, allowing innovation to drive our indigenous economy and our most promising companies to scale from Ireland.	**1.** Introduce a mandatory 'opt in' on policy documents for all new entrants to pension schemes to specify investment in Irish companies **2.** Mobilise existing pension savings by following the recent Danish or UK examples	Rewrite the legacy of Ireland's economic history and ensure our SME's are well capitalised. Fund indigenous companies capable of being employers of scale in the future.
EIIS: Maintain and increase EIIS investment levels	Monitor and analyse the impact of recent changes to EIIS on Designated Investment Funds and the levels of capital invested. Consider a notified scheme.	Ensure more certainty on the qualifying tax relief for investors. Continue to evolve Ireland's investment culture from property to productive assets and jobs.

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.

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