Innovative financing of innovation: The European Venture Capital

KEN Presentation
Istanbul
31.05.2012
Humaneye

Focuses on
strategy & design / performance / fundraising

Serves
technology innovation ecosystem: corporates, start-ups and their investors

Roles
Lead Advisor, Swiss Federal Commission for Technology and Innovation (CTI)
Advisor EU Commission/DG R&D and Innovation
Senior Advisor, Go4Venture (finance boutique), International Venture Club
Former NED at Irish National Digital Research Center (NDRC)
Former CEO of European TechTour
Innovation, financing and venture capital

Innovation is seen as a source of economic growth, of employment and of productivity in the EU... but who has been innovating and financing innovation?

- **Large corporates** retreated from R&D and focus on incremental innovation
  - cost reduction
  - failed to exploit breakthrough (Xerox PARC, Bell Labs)
  - preserve current lines of business > start-ups are innovating (spin offs)

- **Public & governmental** did outfit focus on innovation support
  - direct financing not yet the rule (regulations, cash strapped, past record of failures)
  - indirect financing framework still in process (« European SBA », patchy national regulations ...)
  - tax breaks (FCPI, VCTs, wealth tax break) are expensive and unproven

- **Venture capital** appeared as the solution
  - focus on start-ups and backed disruptive innovations
  - strong alignment of interests between entrepreneurs and entrepreneurs and financers
  - value creators (academic and operational data)
A half-debunked myth: "Silicon Valley VC model to finance innovation"

- **Silicon Valley venture capital finances**
  - biotech, IT and cleantech essentially
  - late stage companies with specific needs in terms of equity and support

- **Silicon Valley venture capital has a bias**
  - towards disruptive innovation, with a high risk/return profile and a limited holding period
  - against fundamental research, unusual risk/return profiles and uncertain holding periods

- **Silicon Valley venture capital barely finances**
  - company creation (seed investment > angel investors, « super angels », crowdfunding)
  - company and laboratory spin-offs (European specificity)

2001 was a turning point in that respect as
- the modern assumed template of venture capital (Silicon Valley) is in crisis since then (« broken model »)
- Europe started to adopt the US model at the wrong time and without assessment of the applicability of the model to the European background
The bad news: Venture performance generally disappointing.

Source: NESTA Report – Preqin + other data
The better news: “After 20 years playing catch-up to the US”...

- European VC-backed pre-and post-IPO performance now matches or exceeds that of US counterparts - Best European VC funds demonstrate top US quartile performance

- Europe has seen some $15 billion in venture-backed liquidity events during the past 2 years: 50% of US, yet occurring with only one fifth of the venture funding

- Proportionally, Europe VC is now producing higher exit multiples than U.S. VC, as well as higher capital efficiency

- Capital efficiency, lower entry valuations, high-quality dealflow, buyer’s market in Europe

- Germany has 4 VC firms (> € 100M) vs 230 VC firms in the US (4xbigger economy)

- € 8,2B invested in EU in 2011 (close to 2001 level): +55% in 1 year

Source: PMEFinance, Earlybird + other sources
The better news: LPs see the opportunity

Source: Preqin
Is a European VC model emerging?

On a legal and regulatory ground, European venture capital is
- dominated by the limited partnership (LP) structure
- the SICAR & SIF are increasingly popular, as they are regulated and benefit from the « European passport » but expensive and burdensome
- national specificities: VCT in the UK, FCPI in France, which are retail vehicles for venture capital investments

Sources of financing of European venture capital are
- banks (Basel II & III, Volcker Rule), insurances (Solvency II), pension funds (UK only) and funds of funds (switching to co-investment) although diminishing
- private (family offices, high net worth individuals, retail) but insufficient
- public funding, notably EIF (from 8% in 2008 to 57% in 2011)

The main VC markets in Europe are the UK, France and Scandinavian countries

There are very few pan-European venture capital funds, most of the investment teams have a national and sometimes local reach
Potential solutions for a European VC model

VC will remain of limited use if there is no structural change

• Funds do not seem adapted anymore:
  • From inception to IPO: 9.4 years on average (term of a LP is 10 years)
  • IPOs are a minor exit path and the main source of profits in the US

Solution

• Longer terms for funds >> difficult to negotiate with investors (IRR)
• Secondary market for VC investments >> yet to emerge for non Internet co.
• Disintermediation >> know-how of retail investors? Of business angels? Of family offices?
• Extension of tax breaks (expansion of VCTs and FCPIs) >> costs and evaluation of impact still not clear
What works?

The answer
- Positioning: R&D outsourcer for large groups worldwide
- Financing: from early-stage to patenting, then reincorporation in the US
- Interactions: stronger collaboration with corporates
- Exit: through (micro-)IPO (Nasdaq) or trade sales

Conclusions
- Financing is not the problem > determining the source, position and destination of the innovation is paramount
- VC is part of solution, but not the only one

Opportunity
- 18/19th of October 2012 – International Venture Club in Istanbul
IVC Roundtables Istanbul

- 60-80 Corporate Venture, Venture Capital and Institutional Investors + VIP’s from Europe and Turkey
- Gathering in Istanbul on October 18th, 2012 for afternoon programme + gala dinner
- Workshops and presentations aimed at networking international and Turkish investors & funders
- Fosters investment collaborations, best practice sharing & cross-border connecting of investment ecosystems.
- Followed by Turkey Venture Forum (next day) within Eureka framework
- Gathering 40-50 Turkish and European innovative SMEs

info@iventureclub.com
Active in the community (investors)
Active ... (ecosystem)
The six types of start-ups

6 different types of entrepreneurs/start-ups do coexist

- **Lifestyle**: Work to live their passion
- **Small business**: Work to feed their family
- **Scalable business**: Born to be big
- **Buyable business**: Born to flip
- **Large company startups**: Innovate or evaporate
- **Social startups**: Drive to make a difference, a better world

Each of these requires a different ecosystem, educational tools, incubators, economic incentives and risk capital

Source: Steve Blank
In an era when microfinance for small-scale entrepreneurs has become mainstream, the reallocation of resources to support high-potential entrepreneurs may seem elitist and inequitable. But especially if resources are limited, programs should try to focus first on ambitious, oriented entrepreneurs who address large potential markets.