IVCA Pre-Budget Submission **2021**

Irish Venture Capital Association
Shankill Business Centre
Station Road, Shankill
Dublin 18, Ireland, D18 N1N2

t +353 1 276 4647
e secretary@ivca.ie
@IVCA_ie

www.ivca.ie

IVCA
Irish Venture Capital Association

Investment

In 2018 there were **227** funding rounds raising **€740m.**

Between 2016-2018
748 funding rounds
have raised **€2.6bn**

Employment

Since 2016 IVCA backed companies created **5,000** high calibre jobs.

Employment numbers have increased by **27%** per annum since 2016

Exports

Exports by IVCA backed companies grew by **16%** per annum since 2016.

In this period VC backed companies generated exports of **€1.8bn**

Research & Development

Expenditure on R&D by VC backed companies represents **35%** of all SMEs share of total spend on BERD*.

Expenditure on R&D by VC backed companies since 2016 was **€452m.**

In 2016 this represented 40% of all SMEs share of total spend on BERD*.

Irish Venture Capitalists

Invest in Future Growth Enterprises
Over **90%** of the funds were raised by SMEs in the High Technology sector.

Build/Scale Businesses
Over 50 companies in the portfolio have in excess of 90 employees.
Since 2016 the number of companies raising **€25m+** has doubled.

*Business Expenditure on Research and Development

The Irish Venture Capital Association (IVCA) is the representative organisation for venture capital and private equity firms in Ireland. Irish venture capital and private equity firms have invested €5bn in Irish SMEs since 2003 and, through syndication, have attracted a further €3bn in funding from international funds to Irish SMEs.

Research undertaken by DCU at regular intervals over the last fifteen years highlights the outsize impact venture capital backed firms have on the Irish economy. The last cohort studied, contributed 40% of the indigenous SME spend on research and development in 2016. These companies grow both sales and employment on average 15 times faster than those in the wider SME economy.

This contribution is more striking considering the number of venture backed portfolio companies in Ireland at any one time, this is on average just above 100. A crucial aim of our industry is to increase this number to power Irish economic development and an innovation driven economic recovery. This aim has consistently been held back by the lack of private capital in Ireland, and in recent years, low levels of seed funding.

The relatively recent nature of Ireland's prosperity, and the 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. There is a lack of domestic multinationals, which in other countries, typically deploy some of their assets in domestic venture capital funds or direct investment in startups. In 2018 corporate venture capital activity in the United States 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 by domestic private capital. The general trend of moving from defined benefit to defined contribution pension schemes has also meant those of a sufficient scale to have invested in the past (An Post, RTE, CIE, Eircom), find it more difficult to do so now. In practice the EIIS scheme has encouraged investment in asset backed medium sized companies and extraordinarily little funding has flowed to higher risk innovation driven enterprises. Lastly, Capital Gains Tax measures in Ireland are a significant disincentive to building a culture of serial entrepreneurship, diminishing another supply of private capital which exists in other jurisdictions.

The commitment in the Programme for Government – Our Shared Future to ***"Support the role that venture capital can play in driving growth in the indigenous economy, by ensuring a stable, long-term funding landscape"*** is very welcome and below we set out the short and medium term policy measures we would encourage in the budget and the National Economic Plan to encourage private capital away from passive assets to fund the future of Irish Industry and the productive assets that will rebuild and rebalance the economy for generations to come.

Alliance for an Innovation Driven Recovery

In advance of our pre-budget submission the IVCA have collaborated with a coalition of organisations that share an interest in developing Ireland’s high-growth tech ecosystem. Some of the short-term measures proposed here are also included in the Alliance Joint Submission.

About the Alliance for an Innovation Driven Recovery

Scale Ireland is the independent, not-for-profit representative body for Ireland’s high-growth tech startups.

HBAN is Ireland's largest network of business angels and syndicates with over 15 angel groups across Ireland and abroad. Euronext is the leading pan-European exchange, covering Belgium, France, Ireland, The Netherlands, Norway, Portugal, and the UK.

TechIreland is an independent not for profit on a mission to promote Irish and Ireland based innovation to the world through data, content, and community activities

We want to work with the Government to improve the policy environment for high-growth tech companies by committing to a process of structured engagement with the sector and prioritising targeted changes to EIIS to support access to private capital.

Taskforce

In recognition of the new suite of SME groups envisaged by the Programme for Government - Our Shared Future, the Alliance would like to actively participate in the creation of a High-Growth SME Task Force focusing on indigenous enterprises with exponential growth and export potential.

Funding Gap: COVID-19 & Proposed Short Term Measures

Recent Venture Pulse data from IVCA for the first half of 2020 (H1 2020) shows that while there has been an increase in the total amount invested, there has been a significant reduction in the number of early-stage deals.

The total amount invested was an impressive €545million in the first six months – with significant rounds raised by later stage companies and supported by VC's to extend their runway and survive the next 24 months. The vast bulk of the investment went into mature businesses that are scaling their exports and employment. This positions Ireland well for an innovation driven recovery; however, the earlier stage companies have not had the same experience. There has been a significant drop in the number of early-stage businesses – those tech startups that rely on early stage equity finance to get to their first Seed Round.

The number of investments less than €500k was down 40% and the number of investments between €500k and €1 million was down 60% on the same period in 2019. Experience from the last recession shows that in times of uncertainty many private individual investors become more cautious. Short term targeted tax-based incentives can balance investor risk and ensure that higher risk investments at seed and early stage are more attractive.

EIIS

A critical lever to address capital market problems exacerbated by COVID

In addition to the significantly reduced availability of private capital in the market, companies are facing ever lengthening sales and payment cycles, resulting in major cash flow challenges for early-stage companies.

These trends are resulting in the loss of high-skilled employment, and an increased reliance on Government liquidity support, and in some cases resulting in companies that would otherwise be viable failing.

By introducing temporary enhancements to EIIS the Government can increase both the amount of private investment in Irish tech companies and the number of people investing, allowing more early-stage companies to access growth capital, maintain and create employment, and to scale to economic benefit of Ireland Inc.

As the new government works to drive recovery, by making these changes to EIIS they could help replace existing government financial support for startups with investment by private capital; ultimately reducing the net cost to the exchequer.

1. **CGT exemption on all qualifying investments made during H2 2020 to end 2021**

Incentivise more investments in SMEs by providing an exemption from capital gains tax for all qualifying investments made during the period 1 July 2020 to 31 December 2021.

Problem: In an address to the Institute of International and European Affairs earlier this year, the Central Bank Deputy Governor warned that "Half of large corporations hold less than 8 percent of annual turnover in cash. Half of SMEs hold less cash and SMEs have less access to undrawn credit than their larger counterparts." Liquidity is a substantial issue for SMEs and COVID-19, has increased the risk of insolvency. The knock-on impact of reduced liquidity on the economy is an increase in unemployment, reduced consumer spending, reduced tax revenues and additional cost to the exchequer in the form of welfare payments. The pre-existing difficulty in accessing financing/ investment by SMEs has further reduced with the economy contracting. The appetite to invest in riskier assets, such as SMEs, has reduced accordingly.

Solution: We have previously seen the success of implementing a CGT exemption to intervene when the Irish property markets were stagnating. In 2011, a CGT exemption for property purchased during the period 7 December 2011 and 31 December 2014 resulted in a substantial increase in the amount of both domestic and international investors into the Irish property market.

We are therefore recommending that in addition to income tax relief (see below), a capital gains tax exemption is introduced and should apply to all qualifying EIIS investments made during the period 1 July 2020 to 31 December 2021 (the ***"Covid Emergency Period"***). The exemption would apply to disposals made after the expiry of the four-year investment period.

We are advocating the exemption is time bound to balance the cost to the Exchequer with the current market failing to invest in riskier assets, such as SMEs, where access to liquidity is imperative for the business' survival. The reality is many investors in SMEs do not actually realise gains on their investments. However, the lucky few do.

Impact: By providing a CGT exemption on gains made on the ultimate realisation of EIIS investments made in the Covid Emergency Period the Government could provide an added incentive which may encourage otherwise reluctant investors to put their capital at risk and may drive an innovation driven economic recovery.

2. **Standardise investment period to four years for all qualifying investments**

Incentivise larger investments in SMEs by reducing the investment period from seven years to four years for investments of greater than €250,000 per annum.

Problem: Finance Act 2019 amended the annual limit an investor can make from €150,000 per annum to €250,000 and €500,000. Where an investment of greater than €250,000 is made, the investor must retain the qualifying shares for seven years. The increase to the annual limits is welcome.

However, with the economy currently contracting, there is limited appetite among private investors to lock in a very substantial investment for a seven-year period. Where an SME is fortunate to attract an investor capable of considering an investment greater than €250,000 in a year, the seven-year retention period is a substantial barrier to actual investment.

Solution: To incentivise investors to make investments greater than €250,000, we are recommending that the investment period for all qualifying investments up to €500,000 is four years. It should be noted that as an alternative to investing €500,000 which attracts a seven-year retention period, investors can make an annual investment of €250,000 per annum for two years. As the investment amount is €250,000, the qualifying investment period is four years. As such, the investor can obtain the same quantum of relief of €500,000 over a two-year period but reduce the total investment period from seven years to five years. However, in the current economic environment and with the shortage of liquidity in the marketplace for SMEs, it is critically important that businesses can obtain the maximum funding upfront.

Impact: As such, reducing the investment period from seven years to four years for investments up to €500,000 will incentivise the investor to make a greater upfront investment. The additional cost to the exchequer should be negligible on the basis it is simply bringing forward the relief to the investor by one year.

3. **Enhanced relief for investing in micro companies**

Introduce greater incentives for 'Early-stage Innovative Companies' – extend relief to apply to USC and PRSI for qualifying investments in micro companies.

Problem: Providing funding to businesses that are high-risk, high-potential, innovation-driven and early-stage is inherently riskier than investment in more established asset-backed enterprises. As the economy contracts, limited private sector funding is available and the appetite for riskier investment has substantially diminished. The EII scheme therefore needs to recognise that not all businesses that qualify for the scheme are equally attractive investment prospects to investors. To encourage investors to bear the additional risk of investing in high-risk startups and early-stage businesses, additional relief for the investor is required, and could be accommodated readily by EIIS.

Solution: Our recommendation is that the EIIS relief should be extended to provide a deduction for USC and PRSI purposes where the qualifying investment is in a "micro company".

The Taxes Consolidation Act already recognises that the investor profile for micro companies is substantially different to other SMEs eligible to participate in the EII scheme. It is proposed that the extended relief should be available to investors in micro-enterprise, within the meaning of Annex 1 of the General Block Exemption Regulation. A micro-enterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed €2 million.

Impact: By limiting the application of the extended relief to micro companies, it should strike the appropriate balance of Exchequer cost and ensure that such relief is focused on smaller, higher risk, higher potential enterprises that otherwise are less attractive to investors.

4. Allow other investment vehicles to qualify for tax relief on EIIS investments

Extend the type of investment vehicles that qualify for relief on EII investments to include private equity and venture capital partnerships.

Problem: Under the terms of the EIIS legislation, the Revenue Commissioners can designate a fund a "designated investment fund" which can, once authorised, be used as a collective investment vehicle which can invest in qualifying EIIS companies, the investors in which secure EIIS relief. Currently a fund will only be designated where certain conditions apply, including that the fund is established under irrevocable trusts for the sole purpose of investing in qualifying companies. This is essentially restricting the type of private equity funds that can invest in qualifying EIIS investments, thus cutting off an important potential supply of investors in funds designed to invest in early stage companies.

Solution: To broaden the scope of investors eligible to claim EII relief, and thus increase the supply of funds to early stage companies, we are recommending that other investment vehicles, such as private equity and venture capital partnerships, should qualify for tax relief on EIIS investments.

Impact: This will increase the range of collective investment structures which can access EII tax relief and will generate much needed funding to specially designated SME funds at this time.

5. **Increase certainty for companies that they are eligible for EIIS**

   Confirmation that a company is eligible for EIIS investment should be final if the information provided is correct and complete.

   Problem: The need for certainty is essential in the operation of any tax relief. Currently investors do not have certainty that investee companies will be able to secure and or retain EIIS status as they are subject to audit in subsequent years.

   Solution: To provide companies with certainty, we are recommending that the Revenue Commissioners provides confirmation to companies that are eligible within 60 days of receiving all information required.

   Impact: This would result in only one stage in the Revenue approval process and would increase confidence of investors.

6. **Simplify EIIS Structures and allow Convertible Loan Notes (CLN)**

   Problem: The situation often arises that angel investors to avail of EIIS tax relief must invest by way of ordinary shares, but other investors want to invest by way of CLN for commercial reasons. Having two different instruments in a seed investment complicates the negotiations, the deal structure, and the cost and adds time to get a funding round closed.

   Solution: Convertible Loan Notes should be allowed under EIIS

   Impact: Seed round investments will be completed more quickly.

Long Term – Unlocking Institutional Investment

We believe an incentive mechanism needs to be found to unlock far greater asset allocation from domestic pension funds into private capital funds. This will ensure that existing state investment in the sector goes significantly further.

How to Unlock Private Capital to Finance Growth in Innovative Firms

Venture Capital increases the quality of innovation and has a far-reaching impact on competitiveness. Spin off effects on job creation, patent applications and economic growth have been well documented both internationally and locally in the IVCA Economic Impact Studies. Consequently, it is unsurprising that policy initiatives have been undertaken in other countries such as Denmark, the UK and Norway aimed at unlocking billions of private sector investment to finance growth in innovative firms.

Most Governments, the EU Commission and the EIF favour the creation of a fund of funds by the State, as a diversified vehicle to encourage private sector investment in venture capital. The IVCA has explored this concept in Ireland and we are certain that, with Government sponsorship, a successful fund of funds can be established in Ireland.

Auto-enrollment Pension Proposals and a Fund of Funds

Establishing a vehicle to unlock private investment and enable investment in pension funds is vital when we take account of the stated Government policy of establishing an auto enrollment pension scheme.

Historically the operation of a pension fund mandates that the long-term savings of today's workers to be invested in businesses, providing more jobs, and generating tomorrow's profits. The UK Government created the National Employment Savings Trust (NEST), as the default home for pension contributions under auto-enrolment, it currently holds, more than £3bn from nearly 7 million members and their employers. A recent analysis of the holdings in NEST's flagship fund shows that all the 10 largest holdings are in US and not UK based firms. An effort is now underway to correct this and ensure that a higher portion of holdings is allocated to UK based companies including high potential startups, which will create the UK jobs of the future.

IVCA members in receipt of State investment through Enterprise Ireland are required to invest in Irish companies. As part of the design of the proposed Irish Auto Enrolment scheme 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 Irish jobs of the future. An established Fund of Funds will be critical to achieving this aim.

Action

Now is the time for the Irish Government to make significant, cohesive, innovative, and far reaching policy decisions, which will increase the number of startups and ensure their ability to scale up in Ireland. IVCA members are immersed in the start up and indigenous SME ecosystem both in Ireland and throughout Europe and have valuable experience and insights. We look forward to the creation of a taskforce, where along with other Alliance members, we can work together to increase support for the sector and rebalance Irish economic development.