Venture Capital

Fuelling Innovation and Economic Growth

Dr. Regina Hodits

Spokesperson of the German Private Equity and Venture Capital Association

Managing Partner Wellington Partners

Vienna, 21 November 2018

Fuelling Innovation and Economic Growth: The importance of venture capital for the economy

Capital and Knowledge

The economic benefits of venture capital

> Venture capital is crucial for the funding of startups with debt financing firmly out of reach for most of them

> Venture capital is not just capital, but investors provide their knowledge and their expertise when it comes to starting a business

Innovation and Growth

The economic importance of venture capital

> It is in the investor's own interest to select the startups with the highest potential, ensuring the efficient allocation of resources

> Venture capital drives innovation and growth as well as productivity and competitiveness of the economy as a whole

Disruption

Venture capital can jump-start the superstars of the internet age

> The world's seven most valuable companies by market capitalization are all digital behemoths that received seed funding from venture capitalists

> Venture-backed companies have created new markets, services and products and transformed entire industries

Digitalization

Venture capital supports the economy's digital transformation

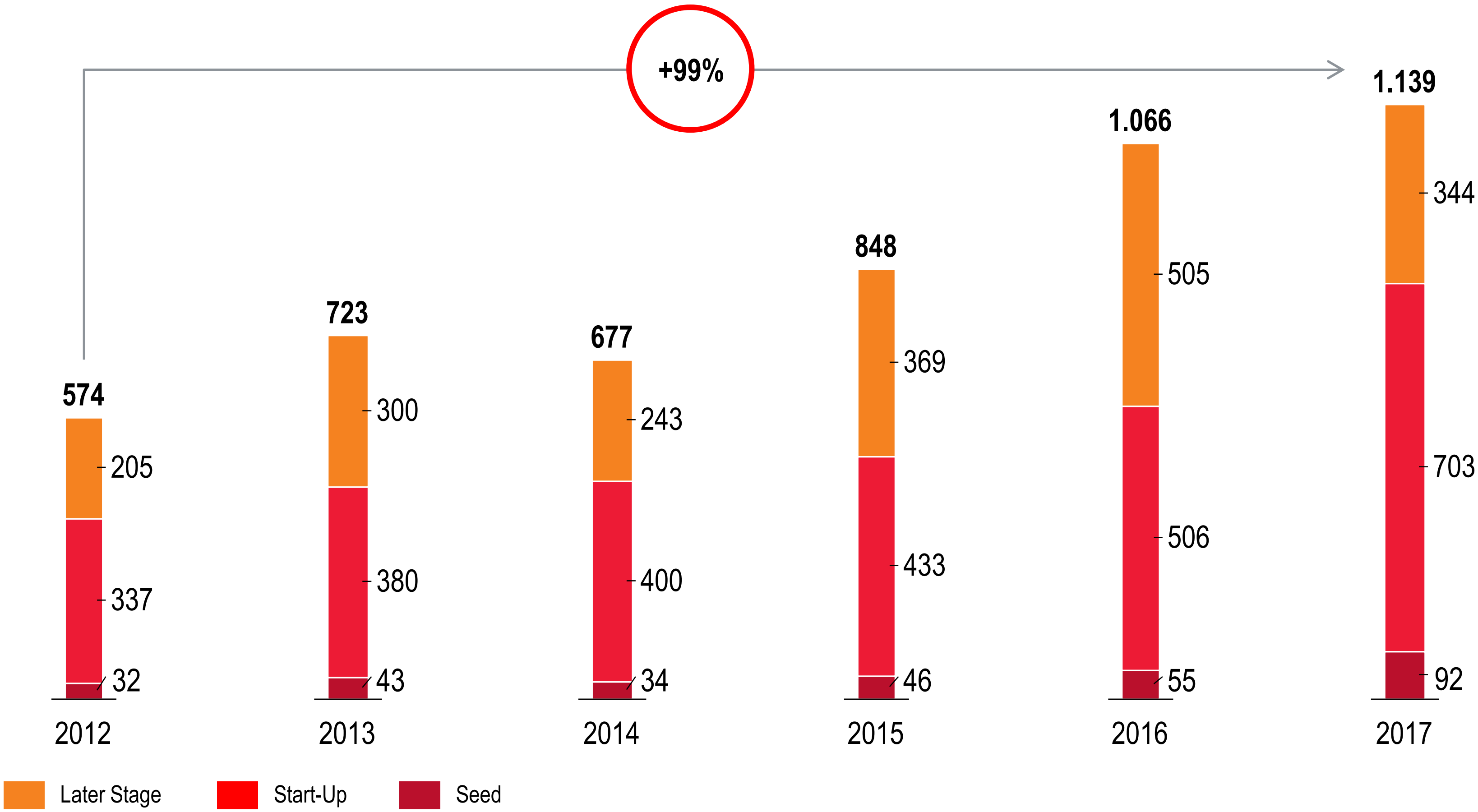
> Venture capital supports the development of innovative solutions for the industry, which is especially relevant to an industrial leader like Germany

> Applications like Internet of Things and artificial intelligence depend on innovative startups and venture capital

Source: IE.F, BVK, Roland Berger

Seed and startup funding for German companies saw stronger growth in recent years than later stage venture

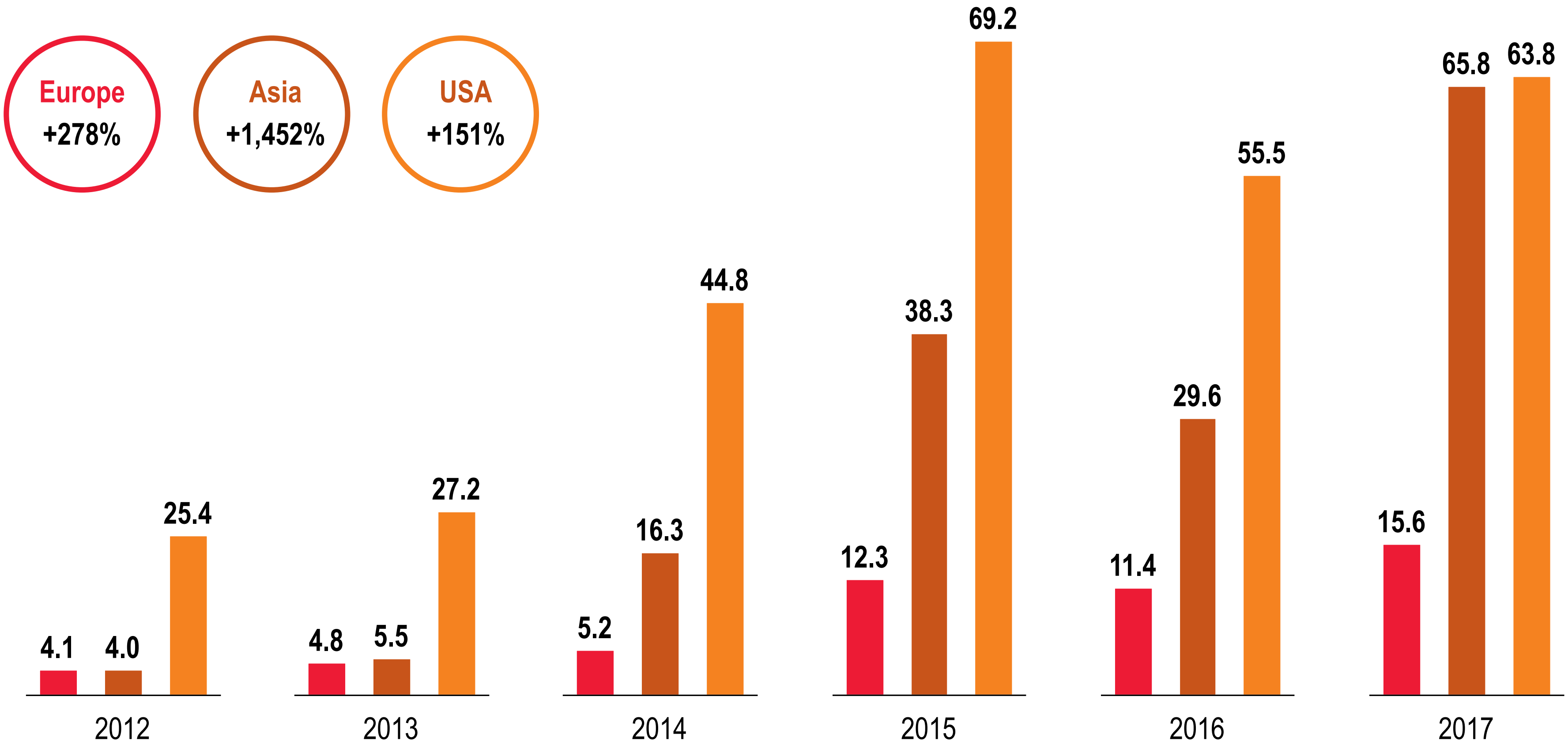
Venture capital investments in German companies by stage [EUR m]



Source: IE.F, BVK, Roland Berger

European venture capital is growing – but the US and Asia are way ahead of Europe

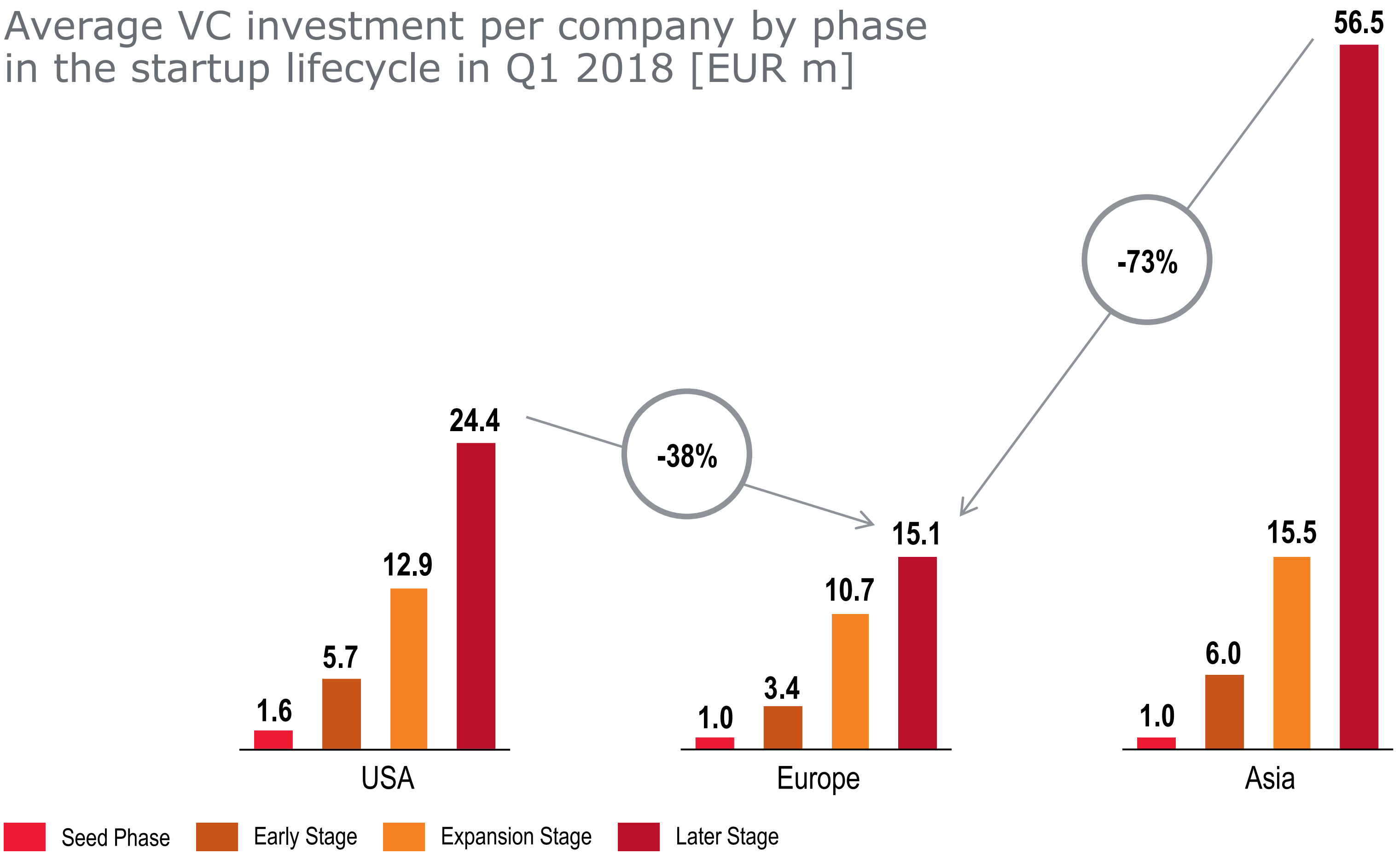
Venture capital investments by location of portfolio company [EUR bn]



Source: IE.F, BVK, Roland Berger

Particularly at a later stage, European companies get on average less VC investment than their US and Asian counterparts

Average VC investment per company by phase in the startup lifecycle in Q1 2018 [EUR m]



Source: IE.F, BVK, Roland Berger

The study identifies the key barriers to venture capital investments in Germany …

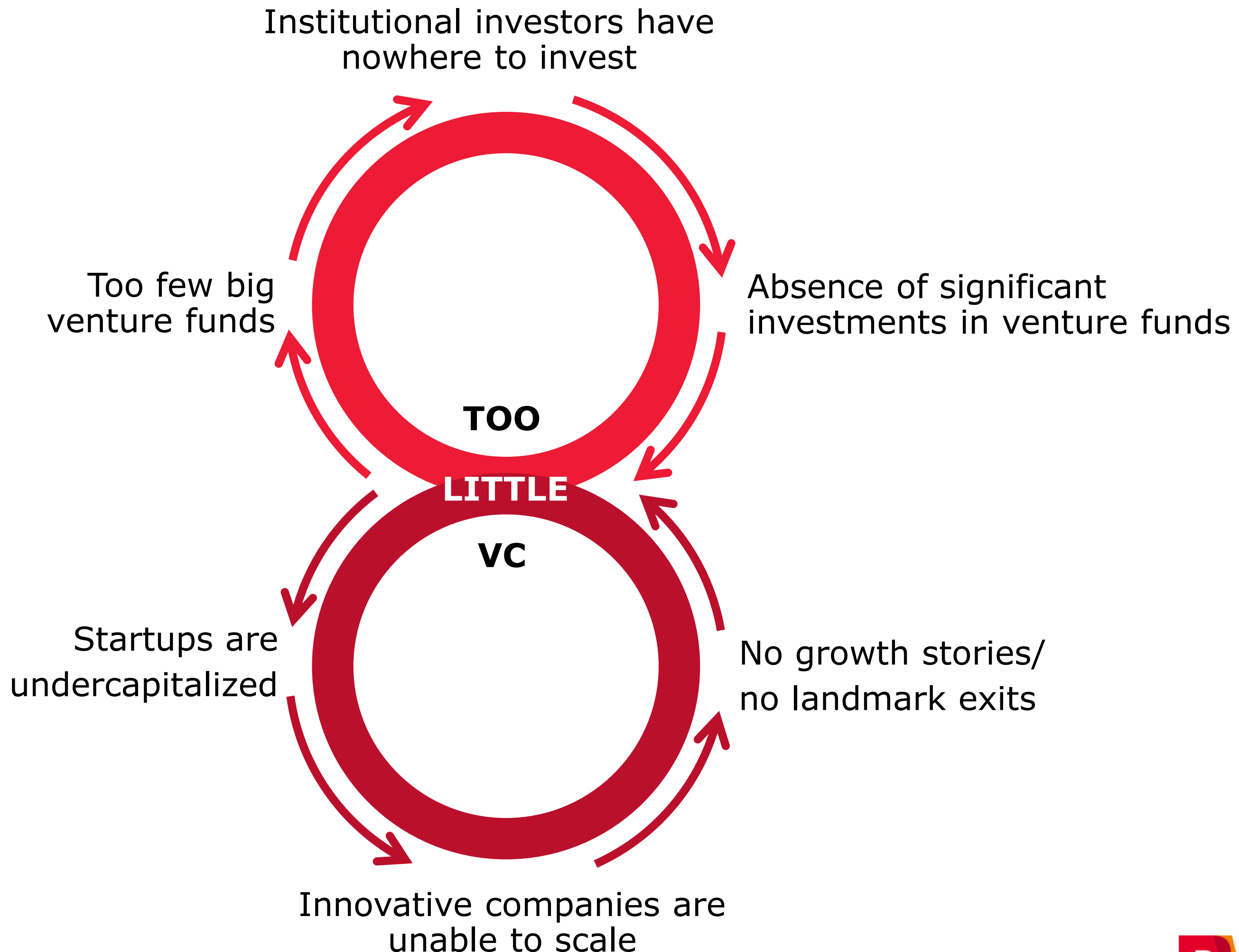
Too few big venture capital funds	> Not enough large-volume venture funds in Germany > German funds are therefore not capable of building global market leaders
Too little institutional investment	> Institutional investors invest only minimally in venture capital > Small volumes and perceived risk are key aspects that scare them off
Absence of significant investments in venture funds	> The smaller size of German venture funds makes this asset class less attractive to institutional investors
Startups are undercapitalized	> Since there is not enough venture capital circulating, startups find themselves undercapitalized > In particular the growth stage is missing larger venture funds providing substantial amounts of capital to startups
Innovative companies are unable to scale	> Though our innovative new startups may be able to grow and scale innovative business models, they fail to reach their full potential and are eclipsed by international rivals due to a lack of capital
Not enough landmark startups	> We miss success stories of exited startups which generated returns for their investors > We have no landmark startups to encourage additional capital to be pumped into other promising startups

Source: IE.F, BVK, Roland Berger

… closely interlinked and mutually reinforcing in the form of two vicious circles

Vicious circle of **insufficient capital creation**

Vicious circle of **insufficient scaling**



Source: IE.F, BVK, Roland Berger

Six steps of how to turn Germany into a venture capital champion

1	Create major leverage for later stage investments	> Public larger-scale models for the later stage with a mechanism for leveraging between private and public funds > Coupling any government contribution to the decision by private investors
2	Establish a German "Fund for the Future"	> Set up a German fund of funds investing in venture capital funds > Reduce the risk for investors
3	Actively communicate success stories	> Publicize our champions and our landmark startups in the tech sphere
4	Have a legal framework in place that drives venture capital mobilization	> Reduce fiscal barriers (e.g. tax transparency of venture funds in law) and create tax incentives for venture investments > Establish one-stop shop for startup entrepreneurs
5	Enable people to share in venture capital growth	> Gradual modernization of our pension system and strengthening occupational pensions that people must share in the growth of the digital economy
6	Launch a "Science, Startups and Growth" excellence initiative	> Provide funding to universities and research institutes that bring their research to the market in the form of high-growth startups

Source: IE.F, BVK, Roland Berger

Why do we need a “Fund for the Future“?

Starting point

> Lack of venture capital, particularly for follow-on investments in the growth stage

> Too few big venture capital funds

> Absence of institutional investors (in particular insurances) investing in venture capital funds

> Missing incentives for this kind of investments

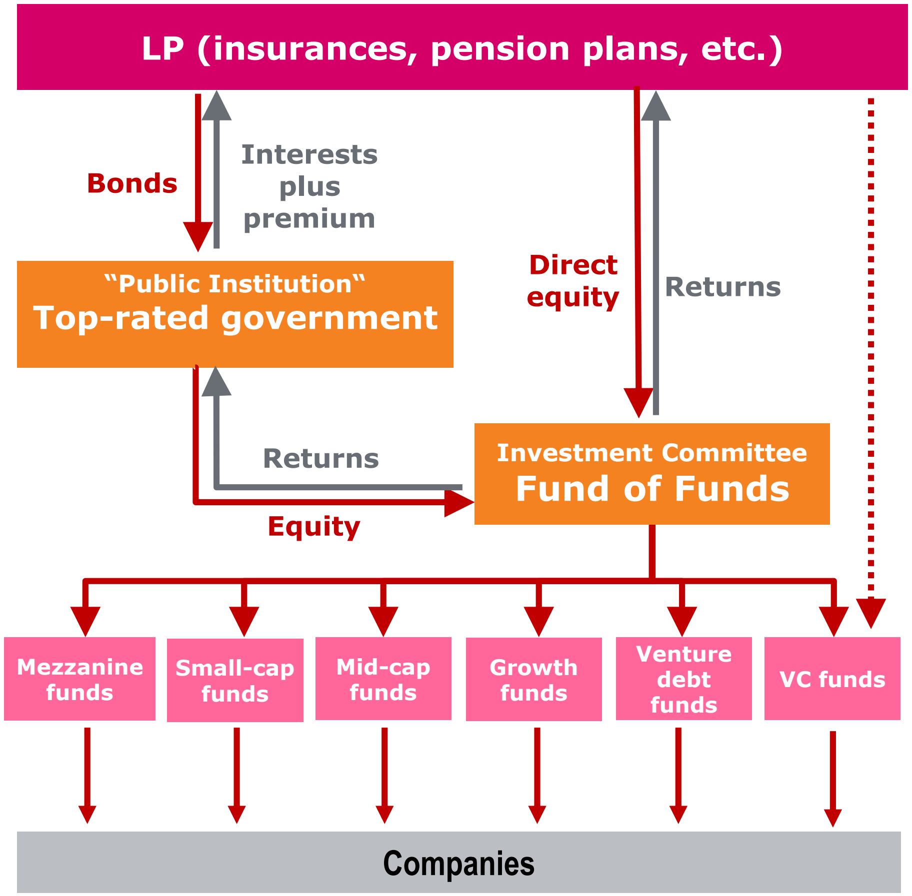
> Historical experiences (e.g. new economy bubble) vs. maturation of German venture capital market (e.g. increasing expertise, cycle experience)

> Lasting low interest level requires alternative asset strategies

Solution

> Set up of a new platform for institutional investors: Fund for the Future

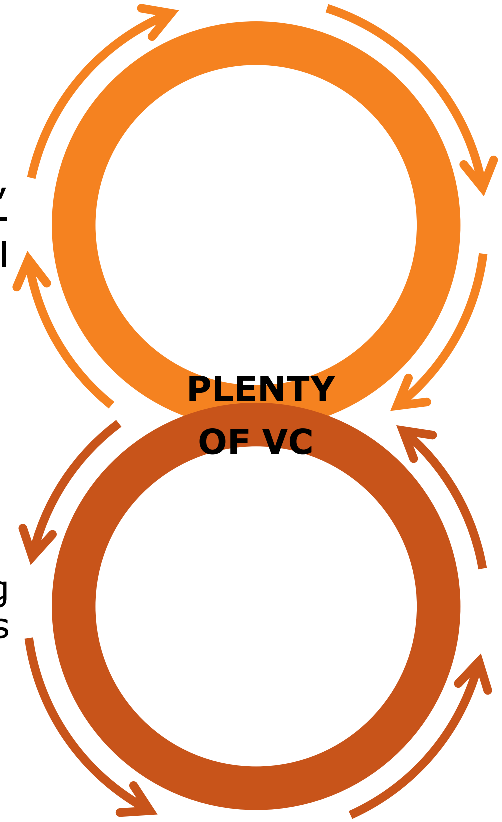
"Fund for the Future" in detail



- Model: Fund of Funds "Dansk Vækstkapital", ~€ 700 million
- FoF capital refinanced according to a ratio to be defined (e.g. 3:1) from a bond (Pillar I) via a public institution (e.g. KfW) and FoF direct commitment (Pillar II)
- Investors invest in risk-free (government) bond with an interest premium and directly in the FoF
- Public institution transfers bond capital to FoF, takes default risk and receives part of the fund returns
- Defined share (e.g. 20 %) flows into venture capital funds (on target fund level)
- Experienced FoF management
- Investment committee and FoF management decide on target funds

The proposed steps towards more venture capital in Germany can be mutually reinforcing

Virtuous cycle of **capital creation**



Virtuous cycle of **scaling**

Source: IE.F, BVK, Roland Berger

Thank you!

Dr. Regina Hodits
Spokesperson of the Board

Bundesverband Deutscher Kapitalbeteiligungsgesellschaften –
German Private Equity and Venture Capital Association e.V. (BVK)
Reinhardtstraße 29b
10117 Berlin, Germany
Phone: +49 30 306982-0
Fax: +49 30 306982-20
E-mail: bvk@bvkap.de
www.bvkap.de