Q&A: BVCA’s VC committee chair on the current outlook for venture capital

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Andrew Williamson, chair of the British Private Equity & Venture Capital Association’s (BVCA) venture capital committee and managing partner of Cambridge Innovation Capital (CIC), talks to Unquote about the state of the UK venture market and the outlook for 2023.

Ero Partsakoulaki: Even following the reversal of a large part of the UK government's "mini budget", regulations regarding investments are still in play; would you agree with the wider market sentiment that several of these reforms are good news for private investors?

Andrew Williamson: What we heard in the budget will have a positive impact in the medium term on UK entrepreneurship, innovation, and economic growth. Some of the regulatory reforms it discussed are policy initiatives that the BVCA has been advocating for several years. I would highlight two initiatives: the regulation around Defined Contribution (DC) pensions; and the extension of the Enterprise Investment Scheme (EIS).

One of the handicaps, frankly, that the UK venture capital and private equity innovation ecosystem has had for decades compared to our peers in Europe − but certainly our peers in the US − is that these pension funds have been unable to invest in traditional private equity capital funds because of structural reasons, particularly the fee cap. So there's very little UK DC pension money invested in UK funds. This means that tens of billions of cash is sitting on the sidelines, when it could be used to grow next generation UK champion businesses and provide great returns for UK pension funds' beneficiaries. The Chancellor confirmed plans to remove performance fees from the charge cap applying to default funds of DC pension schemes, introduced in 2015. That's great news – it's a win for both the entrepreneurs and the start-ups that will have access to more capital, as well as for the pensioners who will benefit from higher returns.

Similarly, the extension of EIS's sunset clause is very positive and my peers in this space are already seeing the benefits. This scheme encourages early-stage investments in high-growth, margin-intensive UK businesses by providing a tax advantaged status for investors. These tax benefits, which bring millions of pounds a year into a sector where it's often challenging to attract capital, were due to expire in 2025. The uncertainty as to whether the EIS tax relief would be restricted could see investors exiting funds in a volatile ecosystem, and it was starting to impact business. Therefore, the extension of the so-called "sunset clause" is one of the couple of regulatory improvements that I think would be very positive, so we're quite bullish from that perspective.

EP: Overall, how do you expect the current economic uncertainties to affect investments? Do you see investors shifting to more traditional sectors?

AW: In down markets, there's often a flight to quality, which is what I saw when I was in venture in 2008. Quality means different things in different sectors. Some venture-backed businesses are burning cash and so founders naturally worry about where the next financing rounds are going to come from. What we're seeing in the market is larger financing rounds that will fund businesses for longer. We're seeing larger investor syndicates and club deals, meaning that three or four VC firms are backing a company together in the knowledge that if the markets continue to be difficult, they can fund the business themselves. So, there's no refinancing risk. Cambridge Innovation capital is mostly going into knowledge-intensive businesses, such as big tech and biotech. Sectors with long macro trends around next generation therapeutics, semiconductors and AI, for instance, are expected to disrupt capital markets over the next five or ten years. Therefore, most investors in these sectors know that short-term fluctuations over the next 12 to 18 months don't really have a significant impact, and as long as the business is well financed, you need to focus on the medium to long term.

Deep tech is thriving, particularly in the UK. The UK is now embracing the EU's and the US's wide recognition that fundamental science and technology innovation drive productivity, economic growth, and wealth creation. The UK government talks about the "science superpower agenda" and its goal to position the UK as a leader in science-based innovation and the economic growth that it drives. I think that's fabulous, and I'm delighted to see it as I think we're going to see the level of investment in those innovation sectors grow quite rapidly.

EP: Do you believe that the pound's low trading levels against the US dollar could increase competition with US investors entering the UK market?

AW: I think there's a couple of things going on. One is that there's a VC macro trend of more and more US involvement in European markets, which has been around over the last five years. 10 years ago, US venture funds weren't interested in European markets as the large domestic market had good dealflow, and the fragmentation of the European market, which had onerous employment laws, among other issues, just wasn't welcoming. That has changed quite dramatically over the last five years, and it has nothing to do with exchange rates. I think it has more to do with the growth of the European venture scene, the quality of the entrepreneurs here who are building startups that attract US investments. I think that's a trend that's likely to continue. This might mean that domestic and European funds are seeing more competition for deals with these US funds coming in, but equally, it means there's more capital available and I think that's really positive.

With respect to the exchange rate, I think that what everybody wants in business is just stability. So nobody is particularly excited about the current market, other than possibly high-frequency hedge fund traders. Generally speaking, when you're buying a venture-backed business, it's more about the upside potential. So the exchange rate may trigger a few acquisitions where US investors might buy a business in the UK that they might not have bought six months ago, for less, but I don't think it's going to really make a difference.

EP: What is your estimate for 2023 when it comes to the outlook for startups? Is there enough dry powder enough to support businesses?

AW: There is a lot of dry powder if we take a look at the funds raised in 2021 and early 2022, and the amount of capital that has been deployed in the last six to 12 months. It's clear there is a lot of capital on the sidelines, a lot more than there was, say, in 2008. So, the recent slowdown in activity is not because investors are short of capital. It's that they're waiting to see markets and valuations stabilise before re-entering the market with new investments. My prediction for next year would be that, once the Fed signals that we've reached peak inflation, public market valuations will stabilise, increasing stability in the private markets as well. It's difficult to predict exactly when that is going to happen, but I would say six months, not two years.

EP: Do you expect the European and UK venture secondaries market is to grow in 2023 as a lack of attractive exit options has increased the need for liquidity?

AW: Generally speaking, the European venture market is much more nascent that the US market, it's still maturing. Secondaries are naturally sort of a class of security that lags behind primaries. You can't do any secondaries until you've done some primaries and they've got to a certain stage. I would say we're just starting – the secondary market in Europe, and certainly in the in UK, is still in growth pace, and we're seeing new entrants coming to the market, with more activity happening. That's going to be an interesting space for a while, particularly if the IPO market stays closed – if funds can't get liquidity through IPOs, secondaries are an obvious way to do that. I think we have a fairly liquid and robust secondary market in the UK.