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Virtual Event Series

Institutional Investor Insights

Guest Speaker:

David Dana

Head of VC Investments
European Investment Fund

Hosts:

Kenny Estes
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DiffuseTap: Institutional Investor Insights

In our session featuring David Dana, Head of VC investments in Disruptive Tech and Innovation at the European Investment Fund (EIF), we covered emerging investment strategies in Europe and how the EIF is carrying them out.

If you want to make new friends from the Diffuse Fund Ecosystem VC ecosystem, email contact@diffuse.vc.

DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll DiffuseTap into brand-new sources of ideas) ... straight from your armchair like a boss.

Meet the Speaker: David Dana

David is a veteran investor and advisor with a strong background in tech and innovation, corporate finance, and private equity.

With over 10 years of experience in the EIF, a Fund of Funds supporting small to mid-cap companies, he connects the sharpest VCs with unique opportunities in the startup ecosystem, thereby helping small businesses launch industry-disruptive products.

About Diffuse

Diffuse is a fund ecosystem. We incubate and run select emerging funds. From investment thesis and process, fund structuring and fundraising to deal due diligence, deal flow management, and fund governance, we wear the COO and CFO hat as the fund's operating partner so that emerging managers can focus on delivering market-beating results.

If you want to spin up your own fund get in touch with us at contact@diffuse.vc. We would love to see how we can help.

KENNY ESTES: Today, we have David Dana. Now David, I've learned from experience that I'm terrible at introductions, so would you mind doing just a brief introduction on yourself and what you're up to?

DAVID DANA: Sure. Thanks for having me here today. So, my name is David Dana, I'm a French guy working for the European Investment Fund based out of Luxembourg, the tiny country in between France, Germany, and Belgium. I have been working with the European Investment Fund (EIF) for more than 10 years. Prior to that, I worked in corporate finance practice at PricewaterhouseCoopers (PWC), and I started my career in private equity for Société Générale Asset Management, a French Bank Group, making VC fund of fund investments mainly in France.

For those who might not know us, I think most of the people here might not know us at all, we are basically the largest LP in the European VC ecosystem. And we are a public institution, meaning our shareholders are the European Investment Bank (EIB), which is the investment arm of the European Union, the European Commission, and financial institutions from every single country out of the EU member states.

We were designed some 25 years ago with the objective of supporting innovation and job generation in Europe. And very early on, for various reasons, it was decided to do it in intermediated mode, meaning that we never, or almost never intervene directly towards companies or projects, but through financial intermediaries of two categories.

One is the traditional banks and financial institutions side. We have a whole department taking care of providing warranties, benefiting from our triple A rate as well as the one of the EIB, to provide advantageous conditions. And on the other side of the business line, we are acting as an LP following two different strategies. One, which is to back the lower mid-market, and the other one, in which I am directly involved in, is investing into VC firms across Europe.

So, over the last 25 plus years, we have been investing in more than 400 different VC funds. We have quite an extensive view of what is happening here. And on an annual basis, we are investing approximately 1.5 billion euros in new commitments.

KENNY: That is certainly a lot of experience. And David, I'll have you know that two weeks ago, we had more than 40 people attending for the first time. Last week we broke 50. And now we're at 60. So, I think people are pretty excited to hear from you today. So, thank you for donating some of your time here.

As you know, we do a fireside chat, we call it Tap Dance because we like puns. My partner in crime, Ayla Kremb and I kind of tag team questions. So, Ayla, do you want to kick it off?

AYLA KREMB: Yeah, happy to. So, the first question that's probably on everybody's mind is, what are you really looking for in emerging fund managers, or emerging funds? What are the markers that you're looking for?

DAVID: Sure. When addressing this question, it would be good to understand what we look at, generally speaking, when we are assessing and screening a fund investment proposal. And then when it comes to emerging managers, it's even more stringent. When we're investing into a firm, we are looking at what we call a "magic triangle", which means that we have a central demand, and then three main pillars. And we were looking for a balance between all of these aspects of a proposal.

So, at the heart of this triangle, you have the investment strategy. What does the team want to do in terms of what kind of companies they'll be looking at, including stage of development, sector focus, geographical focus, and so on. We want to see interesting value propositions. And then we will be looking at whether there is a proper balance between the intended strategy and the three particular pillars I was referring to.

And for that, the first thing we look at is the team. And by team, we mean, who are the team members who will be fully dedicated to investing, divesting, and monitoring investments. And we will be looking at the background of the team from an educational perspective. But obviously, this is not the most important for us. We will be looking more into what they've done in terms of operational experience, investment experience, and what added value they can bring to the companies.

Then the second aspect is market opportunity. Is there a deep enough market to absorb the capital that could be allocated to this fund? So, we will need to see a sufficiently large number of companies in the pipeline, and also some significant M&A activity. Because at the end, we are all here to generate returns. It's nice to invest, but if you cannot divest, the returns will be too insignificant.

And the third element is about what we call fund parameters, which are of two categories: terms and conditions and fund model. So, the management fees, team commitment, and the rather typical commercial topics. And the other one, which is a bit more theoretical, but extremely important for us, nonetheless, is a way to appreciate how the fund would be deployed. What would be the typical fund model based on size, and what is the minimum size to ensure the appropriate deployment of the investment strategy, as well as the viability of the management company?

So, this is what we look at when we're considering any single fund. Then, when it comes to emerging managers, we will not be looking exactly at the same elements. Because for instance, they might not have an investment track record, they might not already have a number of realizations that we have seen with more established teams.

So, we are looking at different topics. The most important one, especially here in Europe where we have quite some money available on the market for early-stage startups, we will be looking at what would make a new team unique. Because at the end, we are convinced that the good entrepreneurs with good projects will not be going to a single investor, but will benchmark all of them, and decide which ones they want to go for, i.e., the ones who bring something on top of the money. Because as I said, there is quite some money available.

So, the purpose would be to support VCs that would be capable of providing a particular added value, should it be by a different way of making investments and interacting with the founders, specific technical knowledge, particular relationships or network with authorities, or with any kind of entities that would be useful. So, this is a central point for us.

And especially as I said, having invested in more than 400 firms over the last 25 years, we are very, if not maybe too much, diversified. So, if it was just about investing into a team that would come and compete directly against the funds we already backed, it wouldn't make much sense. We are looking for investors that have a chance to be selected by the best entrepreneurs.

KENNY: That’s great. And you know, we don't have nearly half the experience that you do, but things like not only focusing on one specific value, having a tight thesis, really understanding the fund model and the different parameters — things like that are very important.

However, it does create a profit problem though, because you’re kind of looking for a needle in a haystack, right? You have to go through a lot of them before you find one that checks all of the three boxes on the Golden Triangle. So, Joe in the chat mentions Grosvenor Group, who he works with pretty closely on their fund of funds allocations, and they struggle just to find enough funds that actually check all of their boxes to get the money out the door.

Do you find that sometimes you’re in a place where it’s kind of like, there's just not enough investments to get you excited about? How does the age-old issue crop up on your end?

DAVID: I would say it's rather the contrary. When I started working for the EIF some 10 plus years ago, we were eight people making 400 million euros investment a year, which used to represent 40 to 45 percent of the overall European VC market. Now, at the end of 2020, we have 37 investment professionals making 1.5 billion worth of investments, which now represents approximately 15 percent of the European market.

So, we have grown in an exponential way, with a very high number of really highly performing teams. So, we are definitely not short of interesting proposals. If we had enough means both from a financial standpoint, but also from a human resources standpoint, to process the transactions, we could very well invest 2.5 billion a year with no shame towards the ones who would have been selected.

So, it’s really about being selective. Making an assessment of what makes sense. And from there, the most important for us is that we can always base our assessment on facts, meaning that we are known for being selective. And when I mentioned these 50 to 60 funds that we back every year, we review approximately 400 proposals a year. So, you have a bit of everything in terms of quality, and the average quality level is quite high now.

And thirdly, you have this quite well-known and well-developed European market in the UK, France, and Germany. But we see more and more coming from what we call peripheral EU, which is southern Europe and Eastern Europe. We've been making a number of investments in them, investing in Greece, Spain, Portugal, Poland, Estonia, or the kind of geographies where 10 years ago, there was basically nothing happening in terms of VC.

AYLA: Awesome. One of the things coming up in the chat is about geographical limitations. Of course, it's the European Investment Fund, not the everywhere investment fund. So, I'm assuming you're looking for two-thirds European based investment to the ethos of memory quads, right?

So, the question is around collaborations or opportunities that you see in, let's say, China, for example, or in the US. How do you deal with those opportunities, and can you diversify into those markets?

DAVID: Yes. So, coming back to this two-thirds reference you just mentioned, as I said, being a European institution, investing and managing EU taxpayer money, we really have some strong requirements in terms of EU exposure, and they're even more restrictive now because the EU has to be considered excluding the UK, following Brexit.

So, the typical requirement we have is two-thirds of the total invested amount, independently of how much we could potentially invest in a fund, to be invested in EU companies. And by EU, we mean companies which at the time of the initial investment are established and operating within one of the 27 EU countries.

For example, if you invest today 500K into an Italian company, and tomorrow this company relocates anywhere in the world, should it be EU or not, a follow-on investment will still qualify as EU. And then it will be part of the calculation. This requirement, by design, ensures that we are almost exclusively investing into EU firms.

Some of the mandates we are managing -because as I said, we are investing as a fund of funds, but we do not have a legal entity to make that- we are managing funding from the EIB, the European Commission, but also more than 35 other mandates, which all have their own particular requirements. And most of them being national, regional, are more precise in terms of geography, and are more restrictive.

When it comes to non-EU players, we are very keen on working with any fund for a couple of reasons. And the main one being that currently, when it comes to later-stage, we are lacking European managers that are capable of investing large tickets.

We have a few of them, but in most of the cases, if we look at the rounds of $100+ million over the last two to three years, more than 90 percent of those runs were led by non-European investors when it comes to European companies. This is something we are not good enough at.

Just to give you some examples of what we've done. One US-based investor that you may know, Paladin Capital based out of DC, which is focusing on cyber security. They saw a big opportunity in Europe, and thus we have been working with them for a while to set up a particular legal entity, because that would make them qualified for us to make an investment. And now, we are their current LP when it comes to European activity.

It's working well. We are very happy with that, and we're in talks with them for additional opportunities. We have, for instance, another mandate with the Silk Road Fund, which is one of the sovereign wealth funds of China. It was about introducing them to opportunities in VC funds in Europe, which either had a relevance for China, or were over performing.

And we have been recommending them a number of GPs, which resulted in approximately seven or $800 million being invested into them. So, we are very open to partner with anyone to the extent that it makes sense for the market, and it shows that we can get something in return for Europe.

We are very regularly reached out to by a number of non-European investors, corporates, or any other entity who actually has difficulties in accessing the European innovation market. And given our positioning, we are quite well positioned to support them, while helping the European VC market.

KENNY: Great. And I'll pick up parts of questions in the chat before we go to the breakout rooms, or Tap Dance, whatever we're calling them. So, since everything is virtual now, we've heard from other speakers previously that being in this new environment kind of de facto means that a lot of the investments are going to managers that they knew before the pandemic hit and are just kind of doubling down on those relationships, rather than fostering new ones.

Is that consistent with how you guys are investing at the moment? Or are you still actively nurturing new relationships via Zoom or whatever, and doing new deployments into new managers?

DAVID: Actually, about one year ago when the pandemic started, we were all a bit scared because being a European institution means that even though we have means to do what we do, we also have a lot of constraints. And it's a bit, I wouldn't say bureaucratic, but slow, in a way, to transition out from a fully on-site office workspace, with physical signatures on each and every document and such. We were a bit scared that first of all, our network will not support this, and then deals will take ages to happen.

But quite surprisingly, it worked well. And quite quickly, we decided that we might need to transition to an almost fully digital way of working. And I think this is the same for you as investors, for those who are VCs in the audience, considering an investment opportunity, with the team being one of the most important items, if not the most important aspect of the analysis, while not being able to meet them, if you cannot properly assess the dynamic and the chemistry among the founding partners, this is very difficult.

Even though online discussions and meetings are great and easy to do, when someone speaks, especially in smaller groups, the other ones tend to just listen and react afterwards. Whereas in real life, the interactions are more lively. This is what we are looking for.

But also, I cannot tell you the number of times where we were on due diligence and decided not to pursue opportunities because of the interactions, because of the reactions of the people in front of us when we asked certain questions. So, the lack of this is something that led us to initially decide to focus exclusively on the managers that we already knew.

But after a couple of weeks and months like that, we decided that it was not sustainable, for the simple reason that one of our objectives is that we are, of course, seeking for the best financial returns, but also, part of our objectives is policy driven. And by policy-driven, we mean developing underdeveloped areas, supporting new market segments, which by design comes more from emerging teams.

But we had to agree that despite these objectives, we still could not meet-in person. This is still the case now. Nevertheless, we had to continue our process. Overall, 20 to 30 percent of what we did last year was with first time teams, and it should continue this year.

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