European Bank
for Reconstruction and Development

MEMORANDUM

To:	Directors and Alternate Directors	**Ref:**	CS/ARC/23-39 (Addendum 1)
From:	Secretary General	**Date:**	28 June 2023
Copy:	President / Executive Committee		

Subject: EVD: Evaluation of the Venture Capital Investment Programme I (VCIP) (2012-2019) - Management comments

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Attached for information is a document on the above.

Submission:	☒ Information ☒ Addendum
Timeline:	☒ Audit and Risk Committee: 6 July 2023
Approval Date:	☒Not applicable (information only)
Effective Date:	☒Not applicable (information only)
Next Reporting:	Not Applicable
Key Decision(s) or other content:	☒Not applicable (information only)
Budget Implications:	N/A
Legal Classification:	Other
Submission Basis:	In accordance with the Bank's Evaluation Policy (BDS12-324) approved by the Board on 16 January 2013
Public Disclosure	This document is not for disclosure under Section III.2 of the Access to Information Policy
Key Risks:	Not applicable
Strategic Context:	The SIP is a key corporate planning tool in EBRD used to operationalise Strategic Capital Framework (SCF) priorities.
Accountable:	VP Policy & Partnerships, Mark Bowman
Responsible:	MD, Impact and Partnerships, Ines Rocha
Questions to:	Natasha Khanjenkova, Anita Taci, Dirk Werner, Ervin Luga or Raghavan Narayanan.

Management comments

EvD evaluation of the Venture Capital Investment Programme (VCIP) I (2012-2019)

Executive Summary

Management welcomes the draft evaluation report on VCIP I. Management appreciates that EvD has internalized well messages shared via key informant interviews during the preparation of the report. This report correctly acknowledges the VCIP team's overall successful, catalytic approach and outcomes achieved from the programme approved in 2011, the streamlined processes in place for operational efficiency gains, and the innovative approach with the external advisory committee. The VCIP/TMT team is actively coordinating with other parts of the Bank in its follow-on efforts in VCIP II and VCIP III as noted in the report.

Management agrees broadly with the two EvD recommendations and looks forward to further discussions with EvD during the action plan preparation.

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1. **Recommendations**

Recommendation 1: *Consider developing an approach casting a broader net in terms of technology sectors to enhance the VCIP's impact on competitiveness and innovation.*

Agreed. Management will continue to explore opportunities in future VCIP initiatives (e.g. Fund IV) within the mandate approved by the Board. Management would like to clarify the following points in relation to the report findings on competitiveness and innovation, followed by further details.

- The VCIP operates at the highest end of the risk-taking spectrum of the Bank. It does so by adopting a portfolio approach and investment principles agreed with other units in the Bank, including Risk Management, and approved by the Board. According to these principles, the VCIP invests in Series A+ funding rounds, and does not normally engage in seed stage (i.e. higher technology risk). We believe the focus should remain the same.

- The framework mandate is sector agnostic, and we have invested in a number of end-verticals, broader than represented in the report (e.g. targeting education, healthcare, transport, communications). We are responding to opportunities in the market at a given time and that meet investment case selectivity criteria and co-investment requirements. For example, no executed investments in semiconductor / Cleantech is a function of limited investment cases in our markets at the time vs. a risk we did not take. The VCIP will continue to target investments across all sectors, as per the current mandate approved by the Board.

- Impact on innovation is closely linked to commercial success of investee companies.

a) VC asset class characteristics: Venture capital investments, by definition, are a distinct, high risk asset class

VCIP exposures are assessed internally based on a portfolio approach to allow the Bank to take risk into individual start-ups, which are classified as Very High Risk (PD 7.3 and LGD 100%), and Very High Potential Return. EBRD has increased exposure to this asset class by increasing the overall envelope dedicated to these investments through the approval of VCIP II (EUR 150mn), and most recently VCIP III (EUR 250mn). The Bank is not equipped to carry out ad-hoc venture stage equity investments outside the VCIP structure for a number of reasons, not least, exposing itself to “unhedged” risk position (if outside of diversified portfolio approach).

b) Investment strategy (Risk taking): VCIP investments are carried out within a given investment mandate, as approved by the Board

Risk/return is a function of the stage of the company, proprietary technology / business model, and specifics of the investment case, rather than the end-sector, which the Company’s value proposition addresses. Based on the investment principles agreed with internal units and approved by the Board, VCIP does not normally engage at seed stage for a number of reasons. Two are key: (i) there is an active investment community in the seed stage in our countries, including funds where the Bank is an LP – there is a gap in Series A+ stage; and (ii) significantly higher resources are required to invest the approved facilities in the seed stage given materially smaller size; therefore substantially larger number of investments required.

c) Investment strategy (Sector): VCIP is sector agnostic

The VCIP invests across all sectors. The portfolio composition should be assessed in the context of the market and innovation a decade ago; this was drastically different from today – ecommerce and marketplaces were a substantially innovative approach and solution in our countries. Even so, 2/3 of the investments from VCIP I were in verticals other than ecommerce / marketplace (e.g. healthcare, process automation, software development tools, transport MaaS, etc. As the market evolved, so did VCIP – see investments from later frameworks. Lack of investment in semi-conductors or Cleantech is a result of limited or absence of opportunities, not an investment strategy.

d) Impact: Commercial success of VCIP investments correlates with other objectives, including competitiveness and spillover effects of innovation.

Some transition indicators such as patents proved not to be a relevant / appropriate proxy for measuring success in the types of companies where VCIP invested. Software companies do not file for patents. Hardware and life-sciences companies tend to file for patents, but life-sciences is not in VCIP’s mandate. There were not many successful hardware start-ups in our region, and as a result, in VCIP II / III this transition objective was quantified in terms of another metric – a proxy for the Company’s investment into product development.

At the same time, the VCIP has supported innovation by (i) supporting successful companies that invest increasingly in R&D, and (ii) staff trained and developed in the most successful companies who move on and create new start-ups and invest in new innovative ideas.

The report makes salient points on the replication effects from Trendyol investment. Besides this example, the paper mentions that VCIP I did not finance truly innovative activities. Management notes that many of the VCIP portfolio companies have a global client base, especially in more developed markets (US, Western Europe).

EvD recommendation 2: *Enhance current structure and arrangements by reviewing the organisation and resourcing of the VCIP team (including possible out-of-the-box arrangements) so that the Bank achieves both its investment strategy and the internal synergies required for high additionality and impact.*

Agreed. Management Agrees broadly to reviewing internal arrangements, organising and resourcing of the VCIP, within the current structure. The report correctly acknowledges the benefit of dedicated structure / streamlined approval approach – a structure that works. In addition, we are open to increase interaction with other teams, an ongoing effort, and at the same time maintain that the Bank's venture capital investments should continue to be channelled via the VCIP framework, as currently approved by the Board. Further, Management notes that:

- VCIP will continue to replenish the team in line with market/client demand and plans to recruit additional staff this year including at the senior banker level.
- Management benefits from the AC (four members) and provide counsel as industry experts. This arrangement brings efficiency and relevant knowledge gains.
- Management looks to continue optimising resources and staffing. We plan to ensure that the staffing arrangements and process are fully leveraged in VCIP IV in the coming years. Management will continue to reinforce and build on what has worked successfully for VCIP (e.g. Advisory Committee).

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