Understanding the shifting dynamics in biotech funding

to better navigate the VC landscape

Maurits van den Nieuwboer
Principal Venture Finance Manager, FFUND

Siebe Warnars
Consultant Analyst, FFUND
VU University

WWW.FFUND.NL

Understanding the shifting dynamics in biotech funding to navigate the VC landscape

In 2022, many investments firms warned that the economic downturn would make fundraising a lot more difficult for start-ups for the foreseeable future. Y Combinator, the American technology start-up accelerator, advises start-ups to extend their start-up runway.

Instead of simply waiting out the storm, however, a much better strategy for start-ups in Life Sciences and Health is to fully prepare themselves to navigate the complex fundraising process. Fundraising is always a challenging activity for R&D intensive companies, especially when the risks associated with clinical validation are part of the development path. A sound financing strategy and strong business focus are therefore essential, no matter how the economic climate looks.

Over the past decade, healthcare-oriented investors have been raising record-breaking amounts of capital. Yet that doesn't mean that a larger percentage of start-ups actually received funding. The figures show that even in the best economic times, the success rate for fundraising through venture capital is less than five percent. And over the past decade the total number of successful early-stage financing rounds is even stagnating, while average deal sizes are increasing.

How we did our research

In order to gain a deeper understanding of the shifting dynamics in the biotech funding landscape, we set out to identify the drivers for the European venture capitalist (VC) funding landscape for early-stage biotech companies. This was done in collaboration with the VU University in Amsterdam, the Netherlands.

Together, we created a central database of all VC deals in Europe over the past ten years, focusing specifically on Seed and Series A, as these are the first opportunities for VCs to provide professional funding to novel biotech companies.

In this white paper we analyze exactly how the dynamics in the biotech funding landscape have changed, what this means for you as a life sciences entrepreneur, and how you can act accordingly.

Booming Life Science VC funding

2021 was another record-breaking year with over 123 deals in therapeutics in the EU alone, with a combined value exceeding US$ 5 billion (source: GlobalData).

Although this boom in VC funding could indicate high liquidity for funding biotech companies, this is not strictly the case. The total number of successful early-stage financing rounds is actually stagnating, while average deal sizes are increasing.

In the EU in 2014, there were a total of 71 early-stage funding rounds for the development of therapeutics. This included 30 seed investments accounting for US$ 194m and 41 Series A deals for US$ 541m, producing a total sum of US$ 735m. In 2020, however, 101 VC deals (37 seed & 64 series A) were made totaling US$ 789m and US$ 1.65b, respectively, producing a combined total of US$ 2.44b invested in early-stage financing that year. The number of deals increased by 42.3% between 2014 and 2020, while the total capital invested increased by 233%. We can only conclude, therefore, that more capital was invested in a smaller number of companies.

*Source: GlobalData).

Maurits Nieuwboer

Syndication of VCs

One factor that may explain this trend of more capital being invested in a smaller number of companies is the **asyndication of VCs.**

The question is to what extent multiple funds are working together on single deals. Since 2015, the average syndication in seed rounds has been steadily approaching that in series A, which has been consistently around three investors.

Parallel to this trend, the average amount of money being invested per investor has risen. This has caused a synergistic effect resulting in larger Seed and Series A investments. Interestingly, this increase in syndication and total investment by VCs has resulted in Seed rounds becoming markedly bigger and approaching the levels of Series A investments. Basically, the difference between the two seems to be fading. This indicates a trend that a funding gap may be emerging at the nascent and arguably most important financing step.

Availability of capital

Over the past decade, there has been a significant increase in the availability of capital to fund developing **small and medium-sized enterprices** (SMEs) in Europe. This can be attributed to several factors:

Record funding

Large VCs with a proven track record of generating returns have leveraged their expertise to raise record-breaking amounts of funding over the past few years.

Consistently low interest rates

Low interest rates have fuelled VC fundraising over the past few years by making VC funds with potential high-returns more attractive to limited partners (LPs).

COVID-19 pandemic

Covid has brought much attention to the biotech sector and presented a window of opportunity for biotech VCs to raise funds. This increase in capital has resulted in the emergence of new VCs in Europe.

High-performing public markets

The biotech public markets have consistently outperformed the S&P 500 (a collection of the 500 largest US companies) in terms of generating returns, which has attracted investors to start investing in the development of biotechnological innovations.

Wider recognized value

Many private equity firms have recognized the value of investing in biotech and are attempting to buy their way into the early stage by acquiring VCs. This lower scarcity of capital and increase in competition drives up valuations and affects the ticket sizes.

Difficulty attracting funding

The increasing availability of capital to fund developing SMEs in Europe was initially considered a **promising development** for the sector.

A result of the higher investments and increased competition is that it has been driving up the valuation of biotech companies. This may not be viable in the long run, however, as a funding gap seems to be developing due to a shortage of VCs that can make smaller investments of between around EUR 2 and 5 million. This trend is already noticeable in the market.

The unwillingness of VCs to invest in 'smaller' tickets is increasing the difficulty for SMEs to attract funding and having fewer options for raising capital decreases the odds of successful development. The increased ticket sizes, which have resulted in inflated post-money valuations, also place Life Sciences companies in a more difficult position in follow-up rounds or during exits.

The unwillingness of VCs to invest in 'smaller' tickets is increasing the difficulty for SMEs to attract funding

Investment Strategy

There are different explanations for why a funding gap seems to be developing. On the one hand, a practical explanation is that deploying smaller tickets, particularly for larger VCs, is less efficient as the due-diligence process for each investment is the same, regardless of ticket size. On the other hand, VCs have also deliberately altered their investment strategy over the past years by increasing their ticket sizes through longer in-house financing.

The aim of this strategy is to de-risk the venture and to create value early on by providing more capital in earlier stages. This increases the exit opportunities and value of the company at the next inflection point, meaning that the VCs retain a bigger slice of pie. Larger investment rounds are being tranched more frequently, to alleviate the fund from potential risks and for the novel company to alleviate the need for constant fundraising, allowing focus on development.

Investment Approach

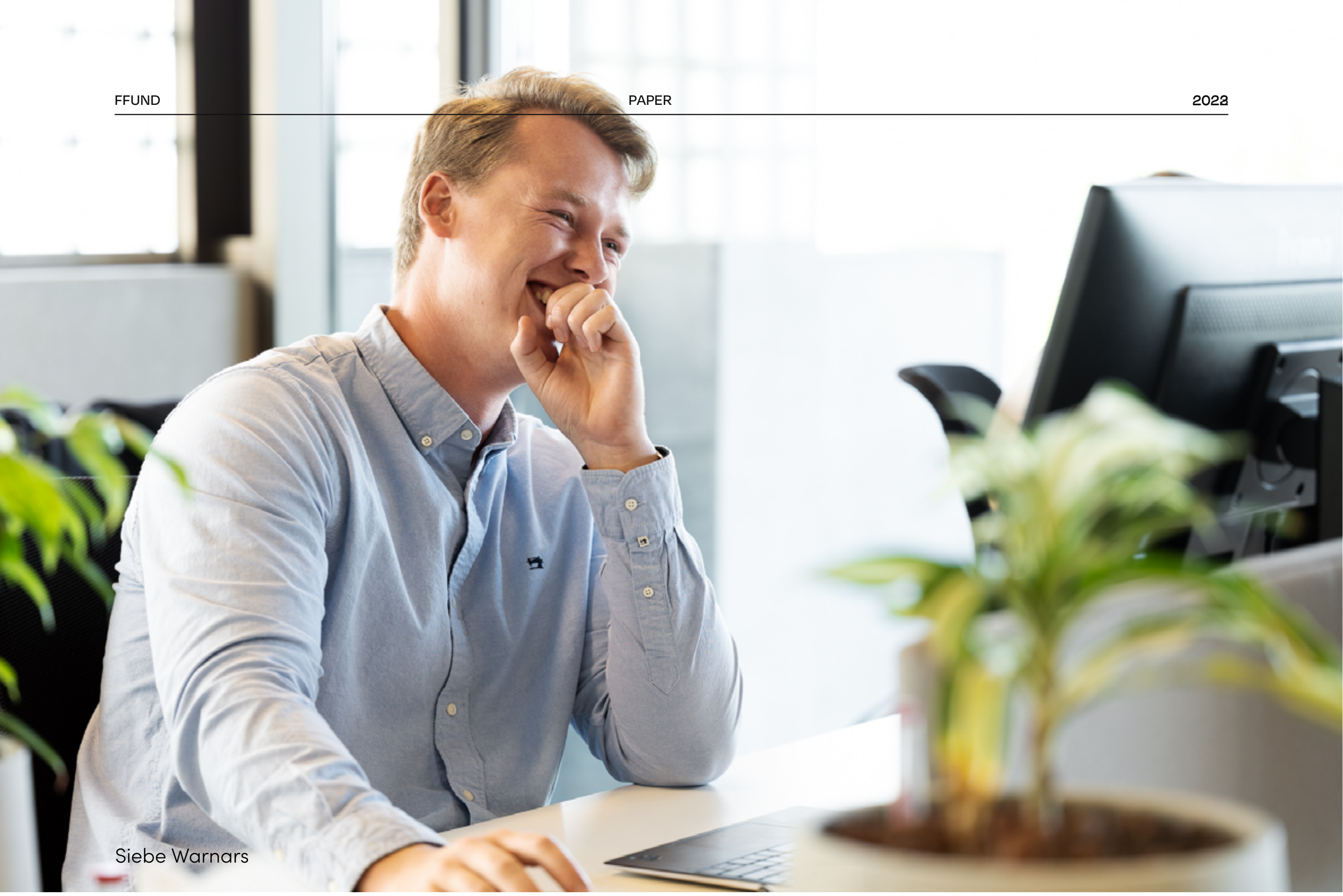
The VCs that have raised capital over the past 3-4 years are well-positioned, whereas funds that have almost no dry powder left are faced with strong headwinds. As a result, VCs are tightening their belts with regard to deploying capital in new ventures because of their vision on re-raising funds in the coming years. Hence, VCs are reserving more capital for follow-up investments in their portfolio companies as opposed to investing in new ventures.

The economic downturn will undoubtedly also make certain investors very careful, leading to reluctance to make new investments and instead a focus on investing in their existing portfolio. Yet there are plenty of investors who have raised substantial capital over the past years, which they are looking to reinvest and are open to interesting new propositions. For example, the number of deals in therapeutics up to the end of November 2022 already exceeded those in 2019 (97 vs. 94; source GlobalData).

What this means for Life Sciences entrepeneurs

The crucial question is what these developments mean for Life Science entrepreneurs starting out with a new business idea. In short, the economic downturn should not hold them back. It simply emphasizes the importance of standing out from the crowd by being entirely investor-ready with an optimized business plan, a sound financial development plan, a clear business case and IP strategy, and a well-justified valuation, all structured in an optimized data room.

Before approaching investors, entrepreneurs need to take a strategic decision on whether they are just looking to fund their next set of experiments, or looking further ahead. The latter can pay off, given the current changing dynamics and increasing ticket sizes. Moreover, it is critical to ensure that as an entrepreneur you approach the right investors or consortium of investors that fits your product development stage and business goals. This requires insight into the focus of investors and which are likely to have funds available.


Siebe Warnars

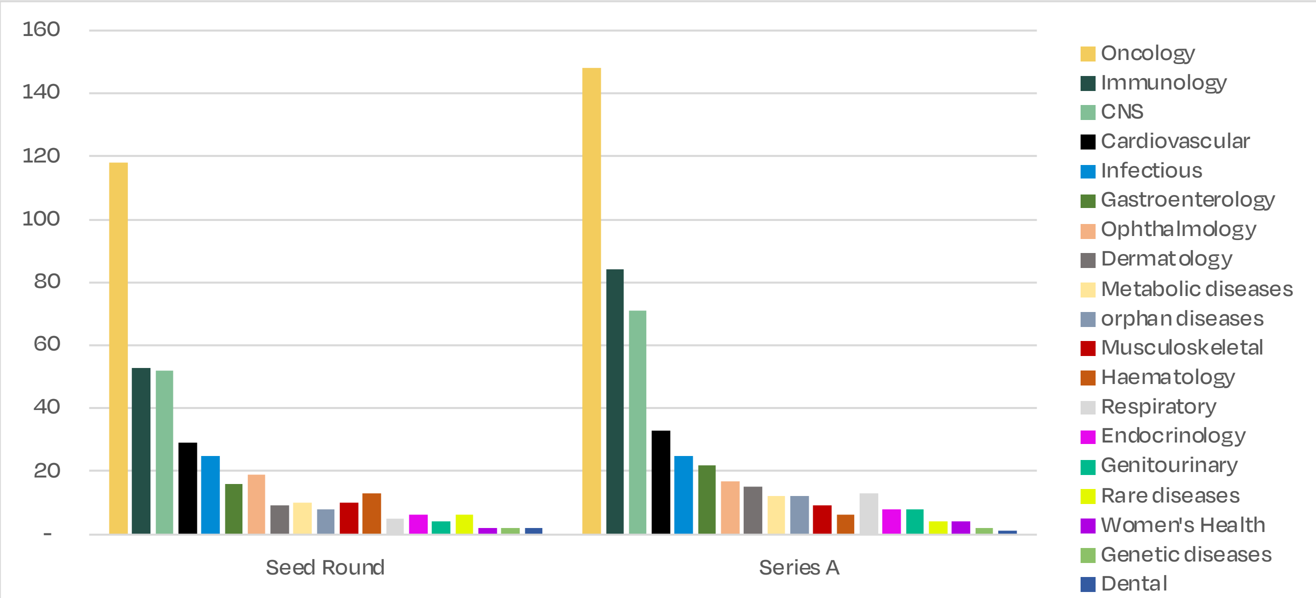
Strategic Venture Financing

FFUND has recently introduced its Strategic Venture Financing service that is developed as a fee-for-service model to help Life Sciences entrepreneurs save money, energy, and time, whilst **achieving their intended goals with better results.**

At FFUND, we take a critical look at your proposition, just as an investor would, and help you to become fully prepared. The Strategic Venture Financing service is based on a structured approach that runs in parallel with the scientific development work. As an integral part of an entrepreneur's management team, FFUND determines exactly what is required for the ongoing financial plan and the business plan for each development phase. That includes ensuring a strong match with investors and their funds.

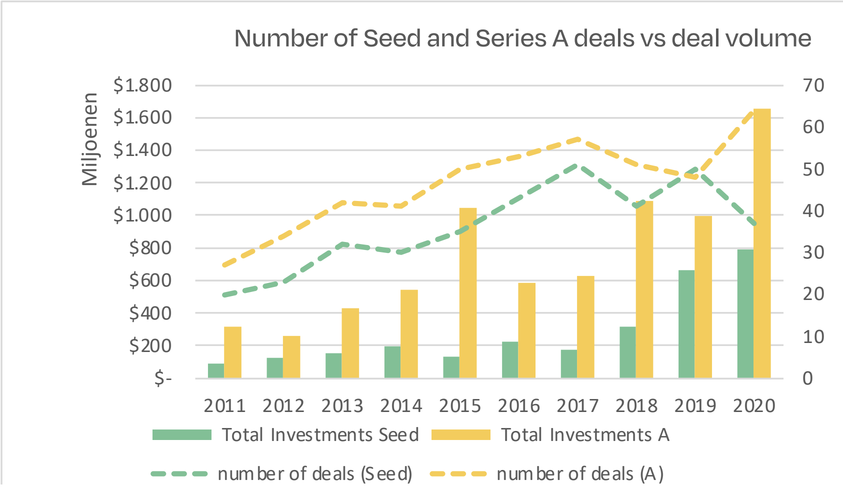
Annex

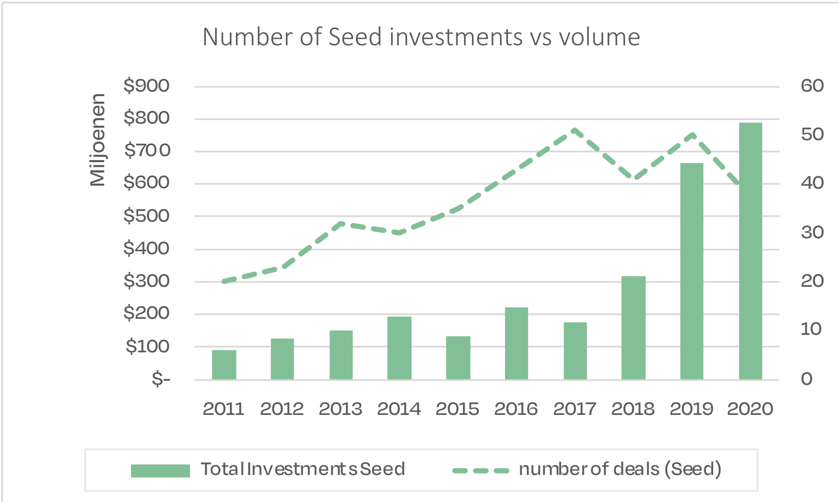
Total number of VC deals between 2010 and 2020 categorized per therapeutic area

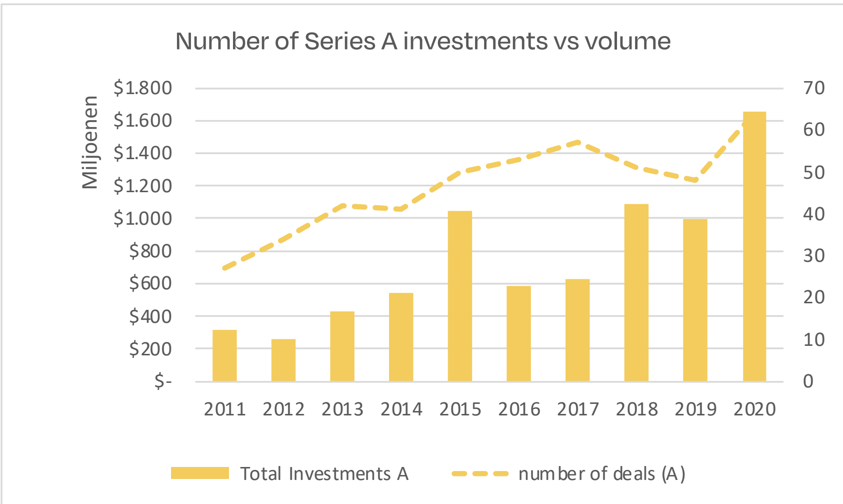


Annex

Total capital invested in Seed rounds compared to the number of seed rounds in therapeutics

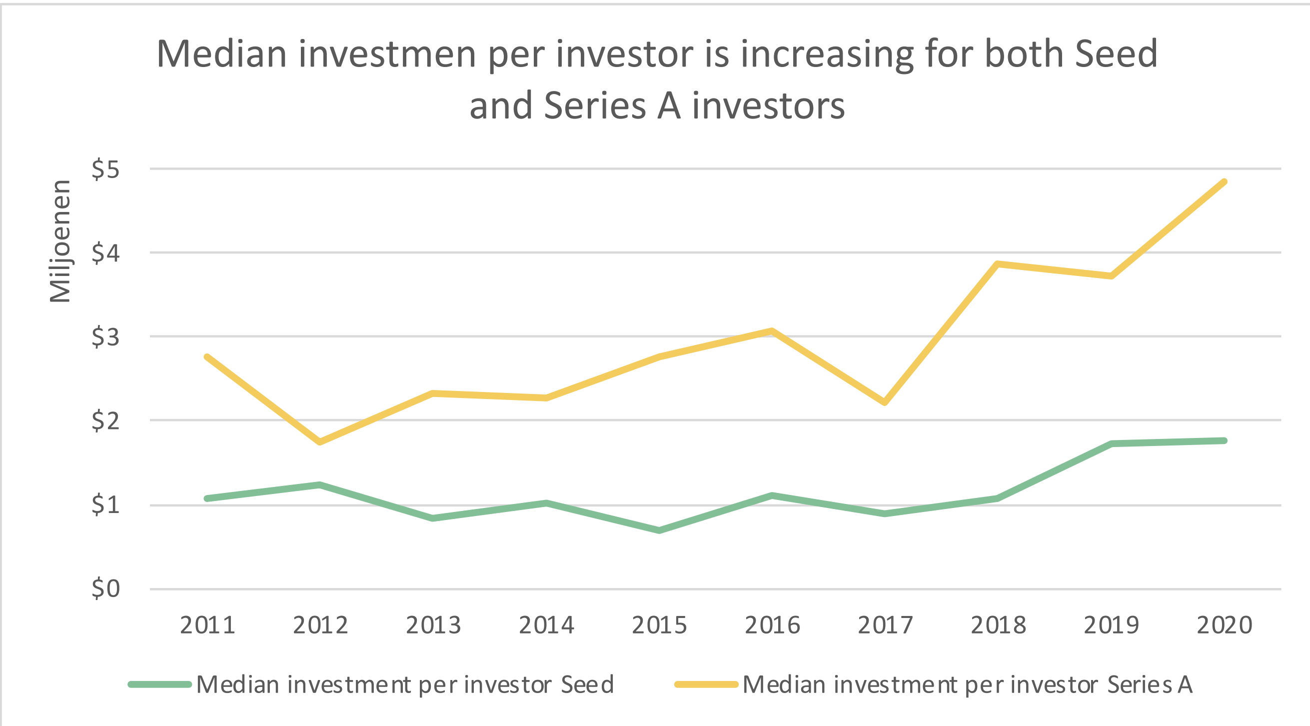


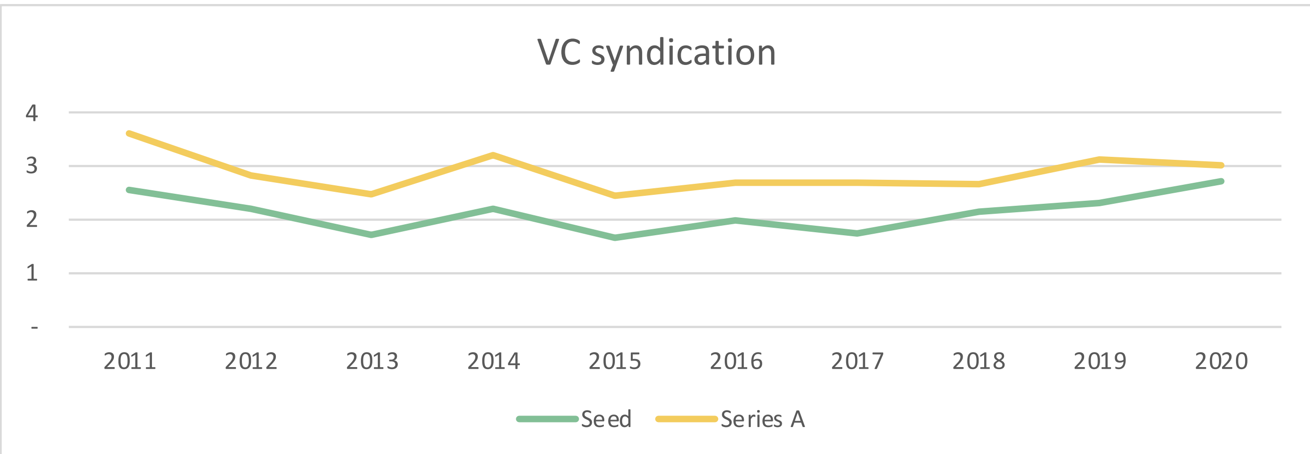




Annex

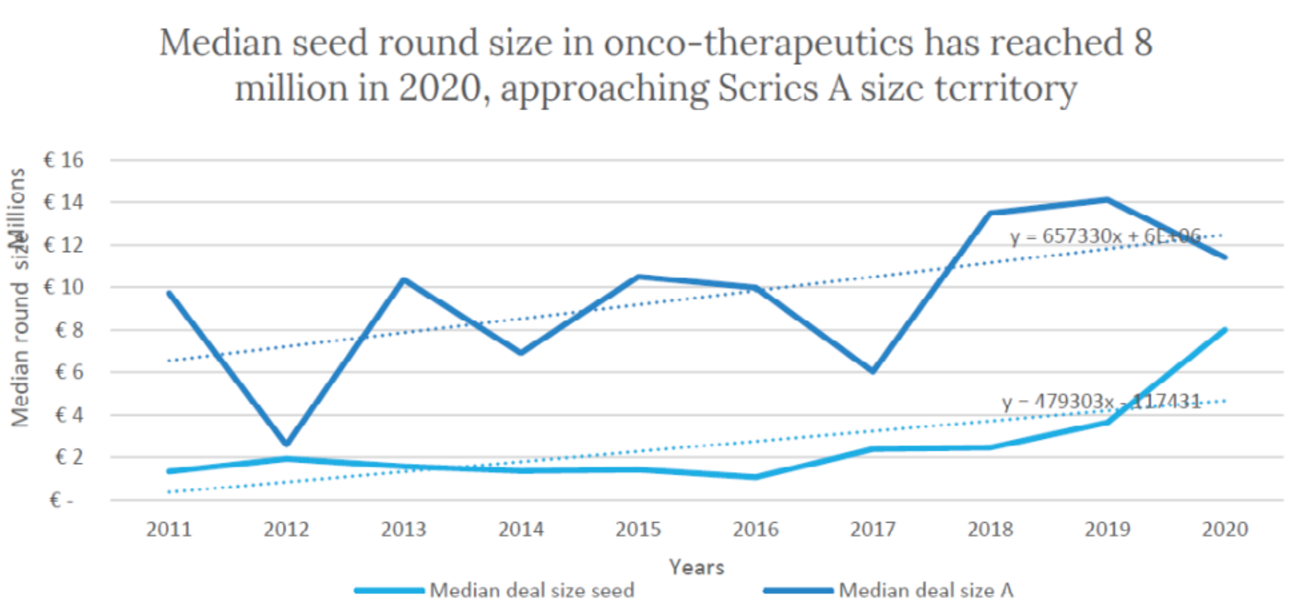
Average VC syndication in Seed and series A rounds between 2010-2020

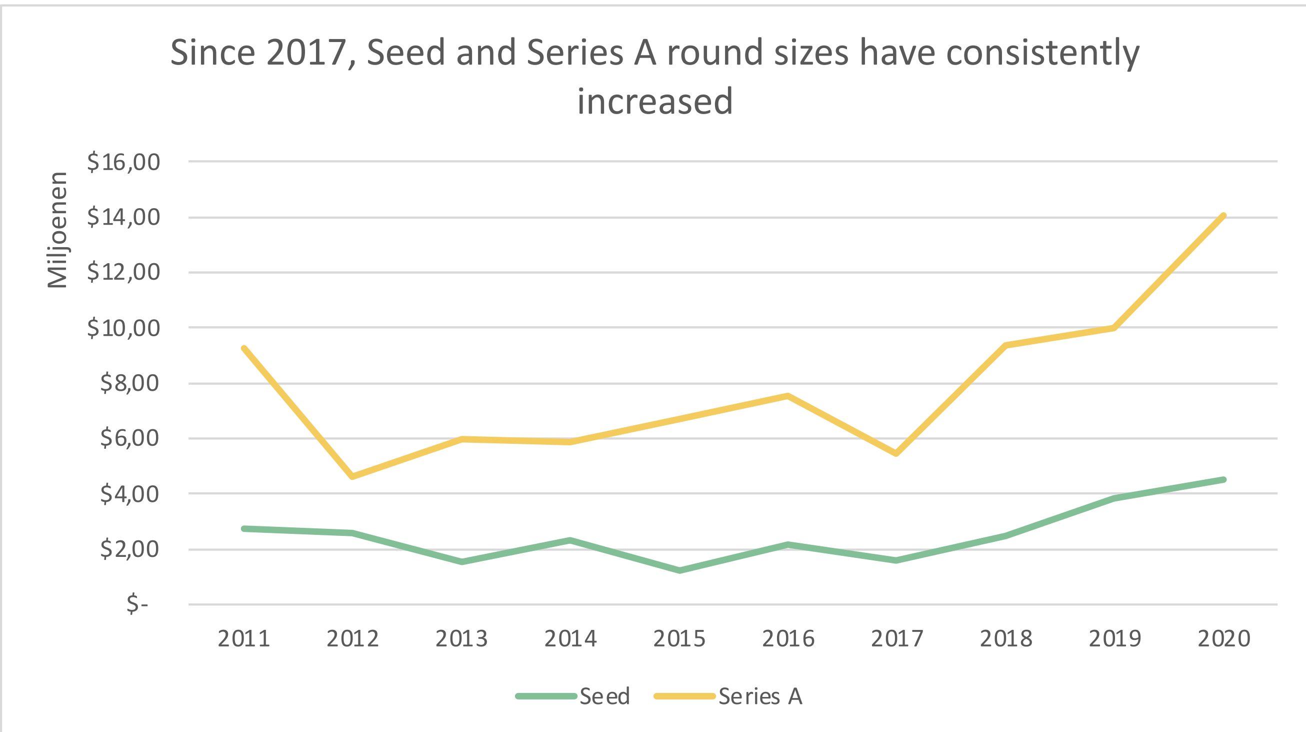




Annex

Median seed and series A round sizes in therapeutics over between 2010-2020





About FFUND

Our people have extensive experience in the field of life science start-ups and scale-ups. We are not only aware of the challenges and risks that occur in the process of bringing a product to market, but we have also experienced them first-hand. Our team consists of entrepreneurs, scientists, and business consultants who have combined to develop specialized services that are optimally aligned with the field's needs in order to accelerate the time to money and successful products for the healthcare system. Scientific research, launching start-ups, business development, securing funding, and closing licensing and exit deals have all been part of our own journey. In the past couple of years, FFUND has supported over 300 innovative parties, ranging from start-ups to scale-ups with products on the market, resulting in a 4-10x increase in the chances of securing grants and loans, and significantly speeding up the time to close investment rounds and deals. With our support, we ensure that you gain expertise, save time, and secure financing.

FFUND relieves innovative ventures of their strategic and hands-on financing challenges so the management team can focus on the core business activities, build strategic relations, and develop innovative products for the healthcare system. In doing so, FFUND helps companies fine-tune their business plan, including the product-market fit and (financial) development plan on the path to attracting financing. If you want to convince an investor to come aboard, you need the right arguments and data. You need proper showcases and a sound proposition that is backed up by the passionate commitment of the company leaders.

FFUND
FAST FORWARDING YOUR INNOVATION