Contrarian investors embrace early-stage technology risk

With a contrarian investment strategy that targets early stage risk and emerging clean technology innovation, David Anthony's 21Ventures aims to provide an antidote to a struggling venture capital sector.

Investor Profile: Venture Capital
David Anthony, 21Ventures

Clean technology-focused venture investing is no more capital-intensive than other sectors, and the real challenge remains the increasing aversion to risk displayed by institutional investors, according to David Anthony, managing partner of early stage technology investment firm 21Ventures.

According to Anthony, the greatest barrier facing the growth of the global cleantech sector is the lack of available capital for early stage companies. He says, 'The biggest problem facing the industry is that there is no seed money. We have the appetite for it, though.'

He also admits that while it may be too early to tell which technology sub-sectors hold the big winners, he is confident that the clean energy industry as a whole offers a compelling opportunity for investors of all kinds.

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'There is a window of opportunity which will be there for the next two to three years, after which prices will correct, and I want to take advantage. It is too early to tell with a lot of these investments, but we believe the problems are so big it is worth taking the big bets,' Anthony adds.

Venture in crisis?

As a burgeoning industry in urgent need of development capital, cleantech has suffered from the dwindling pool of capital available to venture capitalists, as the institutional investors, known as limited partners (LP), display an increasing wariness to potential risk. This growing caution on the part of the LPs has seen allocations to the venture industry drop in recent years. As a result, venture capitalists will need to learn to do more with less, with a greater focus on company growth and profitability, Anthony says.

The number of venture investors is also set to drop as allocations to the sector shrink, Anthony says, with LPs also imposing unrealistic time restrictions on venture investors. 'There are limitations to venture capital and one of these is the constraints of having to put a set amount of money to work and harvest it in a specific time frame. It is a structural problem within venture capital. It does not scale well.'

Funds that cannot grasp their limits are in for a bleak future. 'Funds will go down and those with money will tighten their strategies,' he adds.

The aversion for risk shown by many LPs means that only a selection of venture capital firms will survive, with early stage capital set to be even scarcer. Emerging technology sectors such as cleantech, will inevitably suffer.

'Capital will go to there as a growing sector and there will be big winners, but there will be a smaller pot of venture capital than in the past,' he says. 'Cleantech investing – and indeed venture capital as a whole – needs to embrace a new model of cash-flow profitability. Investors need to work toward making their companies cash-flow positive. It is a totally different game.'

He adds, 'Companies need to show business plans with routes to getting cash-flow positive with the least amount of capital,' he says. 'Investors who can stay liquid can make a killing.'

Another hangover of the economic downturn is the still-weak IPO market, limiting potential exit routes investors. For Anthony, however, this is less of a concern than the immediate issue of ensuring sustainable company growth and development.

He says, 'I don't even think about exits. It is not something a technology investor should be considering in 2010.'

With an approach that combines a desire to take on genuinely innovative early stage opportunities with a pragmatic strategy of company-building, Anthony hopes to capitalise on the next generation of clean energy technology.

Why cleantech?

With drivers that include global warming, overpopulation and fuel depletion, the clean technology sector offered a compelling investment prospect, according to Anthony.

David Anthony, managing partner, 21Ventures

Within targeted sectors including solar, wind, storage, water, efficiency and agriculture, 21Ventures defines itself through its focus on early stage opportunities.

He says, 'Our strategy is to take on technology risk, going in early. We look for opportunities to provide the early money – whether the first $1m or $10m.'

With the firm's focus on innovation, Anthony is naturally protective of his deal flow and while he may be unwilling to invest alongside others on the initial round, he recognises the importance of partnering with experienced players to support companies through their next stage of growth.

'If our initial investment brings the company to commercial revenue or technology validation, then we will look for other investors to come in with us,' he says. 'We will not show anyone a deal we have not invested in. We may continue to invest, but we will not continue to be primary investor, because we feel others are better equipped for the B and C rounds in the venture ecosystem.'

Anthony concedes that the firm's strategy is a contrarian one, targeting seed and A rounds in a market where other venture investors prefer to avoid technology risk.

'We aim to find value in the worst of market conditions,' he says. 'Our fund is structured more like a pledge fund, as opposed to the traditional LP-based structure.'

The benefit of this fund structure means that Anthony is not subject to investment committees or over-cautious LPs keen to dictate and monitor the firm's investment strategy. The firm invests closely alongside US green investor David Gelbaum's Quercus Trust, focusing on novel technology companies, such as high altitude wind turbine developer Magenn Power.

He says, 'David Gelbaum and I are effectively the investment committee and we do not seek outside capital unless I get approval or we are signing up other investors to take on that risk.'

This autonomous investment approach offers a freedom that many investors will envy and Anthony welcomes the lack of competition at a stage where other venture capitalists are less likely to tread. With LPs becoming increasingly risk-averse, venture firms are as a result also unwilling to focus on investments in unproven technologies and early stage companies, Anthony says.

'The greatest problem facing the venture capital industry as a whole, and by extension, cleantech, is that institutional investors like endowments and pension funds have lost their appetite for risk. It is not the fault of the venture funds that they have zero appetite for risk. This stems from what their LPs are telling them.'

He adds 'This is one very big challenge for the industry, but a great advantage for our fund, is that this is not an issue we have to face. I have some luxury in that I can look to swing for the fences.'

Game-changers

Anthony prefers to focus on new innovations that may be neglected by the more mainstream investors. He says, 'The areas that I think are most exciting are in solar, such as light trapping technology, different wavelengths of light and the improved efficiency of solar cells.'

While on the one hand, an investment into an emergent technology may hold with it a higher level of risk than more proven areas, investments in small start-ups offer a cost-efficient means of accessing the sector, particularly in those segments which Anthony considers underinvested.

While confident that many of these newer technologies will eventually take hold, Anthony is less optimistic as to the growth environment provided by the US.

'One of my great concerns for cleantech is that the early adopters are not going to be Americans. Americans are not practical people – look at the cars we drive. Look at the homes we live in and the way we spend money,' he says, 'Within the sectors we look at, we see real opportunity in emerging markets which have the ability to see the potential and take it on.'

One area, which holds considerable appeal and import for the global energy industry, is energy storage. With new utility-scale alternative energy generation often hampered by inadequate storage solutions, it offers a significant barrier to the alternative energy sector's growth

'If someone can crack utility-scale storage, they are going to make a ton of money, but we do not see anyone with a cost-efficient solution currently,' he says. 'Storage is seeing so much money being thrown at it, but has still not been fully solved.' Another challenge for the growth of the renewable energy industry is the relative lack focused, regional development, with no established centres of excellence as in other sectors.

'If you go to Boston or Silicon Valley, you can find electrical engineers and software developers that are the best in their field, but not for cleantech. You almost have to live on a plane to properly target this sector,' Anthony says.

A lack of centralised, technology development hubs mean investors have to work that much harder. This is reflected in the global approach that investors often take to fully capture the opportunities on offer.

'We have investments in China, UK, Israel, and everywhere in the US from Boston to Silicon Valley to Southern California. I do not see that changing,' he adds.

investor profile