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Sofia Harrschar and Tomasz Szubartowski - 01 March 2024

The market for Venture Capital (VC) experienced a challenging year. Rising interest rates and general uncertainty around valuations made it hard for funds to raise capital. In addition, the market is strongly segmented and therefore often not attractive for large investors. Despite these obstacles, there are ways to utilise the potential that is hidden here – with the help of experienced partners.

Opening a new asset class

Asset owners' interest in Private Capital has been growing steadily over recent years.
Private Equity and Private Debt have become standard building blocks of the portfolios of asset owners such as pension funds, family offices, insurance companies or foundations.

To enhance access to the opportunities of the VC market is thus the logical next step. By implementing VC solutions, investors are able to further diversify their funds, realise interesting returns outside liquid markets and mitigate risks. Strategic investors like big corporates in the tech sector also use it as source to enhance their Research & Development by combining funding with practical cooperation.

The focus on VC as an asset class, however, is also a matter of societal involvement as start-up companies find it increasingly challenging to finance their growth ambitions.
Making VC investments more accessible is therefore essential for the much-needed digital and sustainable transformation of the economy.

The finance industry now faces the challenge to provide structures for making VC accessible to a broader investor base. For this, it is important to take into account the various preferences and risk appetites of investors.

Challenging times for a multifaceted market

In 2023, falling asset valuations and interest rate insecurities put a strain on VC markets. According to the Preqin Global Report 2024: Venture Capital, entry valuations over the past two years have gone down and the outlook for 2024 is only slightly better.
The analysts point out that asset managers found it twice as hard to achieve their fund-raising targets in 2023 than in 2022 as

fundamentals had become more decisive than a compelling growth story. This rather gloomy outlook might reduce funding availabilities for start-ups, which may lead to a higher number of insolvencies.

On top of this highly demanding market environment, the characteristics of VC funds make investments even more challenging: A VC fund is both, more focused and smaller Professional information for investment professionals than a traditional investment fund, with ticket sizes typically spanning from 10 to 250 million euros. As these tickets are too small for many investors, a lot of them use fund of funds solutions, which helps to cope with the frequently high volatility of VC funds and can offer a way for governments to participate as investors as well. Governments are highly interested in VC but typically need more diversity than an individual VC fund can offer.

Different ways to invest in Venture Capital

As start-ups in Europe find it increasingly difficult to raise new funding, governments are looking for new ways to promote their countries as hubs for start-ups and innovation. To make VC accessible for a broader group of investors, different structures have been put in place: In Luxembourg, the set-up of an SCSp can be used as a potential VC vehicle. France has also come up with the so-called Tibi Initiative a specialised start-up vehicle, whereas in Ireland the fund structure ILP is suited for VC investments.

In Germany, the Wachstumsfonds Deutschland (Growth Fund Germany), core initiative of the German government's Future Fund (Zukunftsfonds), has just recently reached its target capital of 1 billion Euro, the bulk of which came from asset owners in cooperation with KfW Capital, the investment arm of German business development bank KfW. For this pioneering initiative, Universal Investment Group designed a unique structure for later stage investors: It comprises two investment vehicles that accommodate the specific risk preferences of the various investor groups.

As a result, three investment opportunities are possible such as Pari passu shares, direct investment in subordinated and "leveraged" VC fund of funds investment and Indirect investment via a bearer bond with a preferred return. This structure could serve as a role model for other funds in Germany as well as across Europe.

Exploring a new market with the support of experts

VC as an investment can bring many benefits to an institutional portfolio, provided a number of considerations are taken into account: Investors need to build in-house capabilities or find an experienced partner. The value of working with a solid partner that has significant expertise in this area, as well as a long-term track record in other asset classes, particularly alternative investments, cannot be underestimated. To guide them through this complex terrain, investors should look for a Super ManCo and administration specialists with broad product and regulatory expertise, a deep understanding of an asset owner's perspective and a focus on practical, achievable solutions also in terms of valuation. These platforms provide investors with the required transparency for making profound decisions with their comprehensive reporting capabilities.

When structuring a VC investment, alignment is key, along with an efficient fee structure that takes into account the small size of the individual VC fund. The more illiquid the asset, the more important transparency and flexibility become. An integrated platform should be in place as a basis for close cooperation between all players.

Dr Sofia Harrschar *is Head of Alternative Investments & Structuring at* ***Universal Investment***.
Tomasz Szubartowski *is Head of Design & Client Consulting, Private Asset Services, at* ***UI efa***.