



## FAMILIES AND VENTURE CAPITAL – A VENTURE INTO THE UNKNOWN OR A RETURN TO ITS ROOTS?

At Concentric, we have had ongoing discussions with family offices in relation to their venture exposure – and it has become apparent that families are struggling with this particular ‘asset class’. Most families would like exposure to venture capital but are unsure in what form, or what such engagement could look like.

Combined with some background facts on family offices, the purpose of this note is to surface some of Concentric’s key findings gathered as a result of discussions with 300+ family offices across the world. We also aim to use our findings to make predictions and to elaborate on key trends in family office venture capital investing.

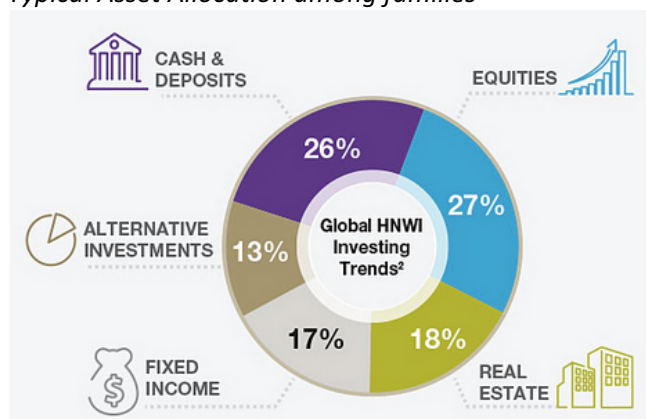
### 1. Role of venture capital within family offices.

#### The growth of family investment offices.

The boom in single-family investment offices is being fueled not only by the tremendous worldwide increase in private wealth, but by the desire of families to move away from complete reliance on outside advice and financial institutions when allocating their wealth.

Different ‘flavours’ of family investment offices exist today – some are ‘single family’ offices investing on behalf of one wealthy household and their descendants, while others might aggregate the wealth of ‘multi-family’ clients. These structures are typically set up to manage inter-generational wealth creation and management, with some more legally elaborate and structured than others which rely on the decision of (typically) one principal.

#### Typical Asset Allocation among families



Source: CapGemini, RBC Wealth Management

#### Families and venture capital – historic context.

Most wealthy families have generated their fortune by building operating businesses or by acting as entrepreneurs or venture capitalists, and actively investing in and managing riskier early-stage ventures. Thus, we would argue it’s fair to say that entrepreneurship is invariably at the heart of investing families.

Family offices have long had a sizeable direct allocation to the alternative asset class. These type of investments may:

- Fit well with a particular family’s industrial expertise;
- Provide ample opportunities for deployment of capital, either through funds or as a result of ongoing disintermediation – whether this happens directly or via syndicates on a deal-by-deal basis.

When it comes to venture capital, one could argue that wealthy families created the whole industry, both directly and indirectly. Some of the oldest venture firms were essentially developed as the direct investment arms of wealthy families – think Bessemer Ventures, originally an outgrowth of the Bessemer Trust established by the Phipps family, or Venrock which was originally an outgrowth of the Rockefeller family – though today both firms have outside LPs which constitute the majority of their capital. Greylock’s first fund was raised from a small handful of wealthy families based primarily in the Boston area.



As for Europe, some of the longest-established banking and investment families including Warburgs, Rothschilds and Wallenbergs have had direct and indirect exposure to venture investments for centuries, while in recent years family-led venture funds such as Frog Capital (Engelhorn family), Atomico (Skype founder), Creathor (Kohler family) and our very own Concentric have emerged.

Families and family businesses = entrepreneurs. Even as a family's wealth and size grows, a core role of the family office remains tied to investing – or, in other words, to supporting entrepreneurs. This further underlines the link between families and venture capital.

#### **Appetite for venture capital amongst family offices.**

The vast majority of family offices we have spoken to over the past couple of years have a keen interest in investing into venture capital as an asset class. However, their experience has been mixed, and they remain unsure about how best to approach the venture capital asset class and related investment cycle. They are intrigued about the technology space – technology itself playing a key part in most of the industries in which they operate – and the strong technological grasp possessed by the younger generation of family office members means there is a keenness for exposure to this dynamic sector. The ability to generate significant financial returns in technology venture capital is an additional driving force behind the interest.

According to the Munich-based advisory company *Family Office Consulting GmbH*, one third of families have implemented a team and a strategy for venture capital. Moreover, today we see a higher degree of professionalism among larger family offices with assets of over €500m, as well as from multi-family offices.

#### **Approach to managing venture capital exposure in family investment offices.**

Having decided to gain exposure to the venture capital asset class, the question is: how should the family manage this?

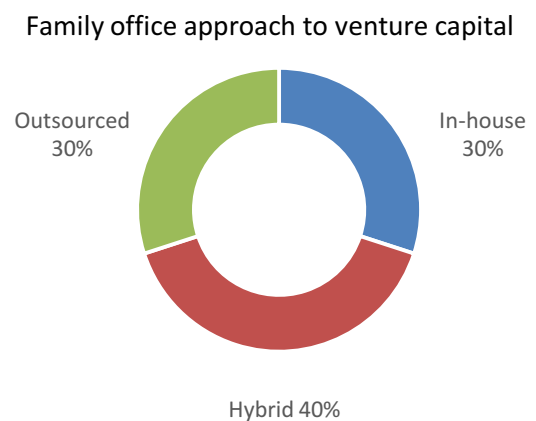
The most common ways of managing such exposure have been:

- *In-house* – all investment decisions are maintained internally, with families taking a deal-by-deal investment model approach;
- *Hybrid* – investment decisions are split between outsourced partners and the family office itself;
- *Outsourced* – investment decisions are fully outsourced, either via Fund of Funds or directly via preferred venture fund(s).

#### **Empirical evidence from Concentric' discussions.**

Through our discussions with 300+ family offices in multiple geographies, we found that circa 70% were actively investing or were evaluating exposure to venture capital.

Of these families, around 30% were set up with a team and a strategy to manage in-house investments, while another 30% outsourced the activities to third-party managers and the remaining 40% operated with a hybrid model:



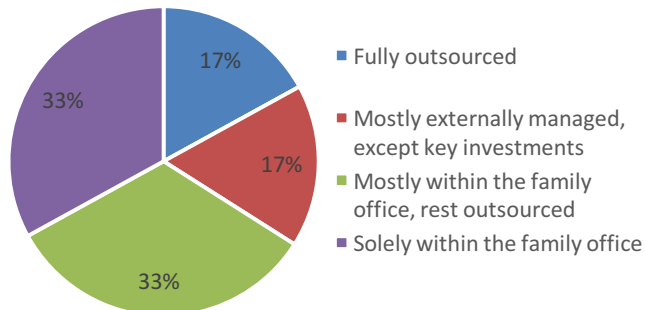
Source: Concentric

Looking back at our analysis, it proved somewhat challenging to classify families into strategy buckets.

The 'hybrid' group could also capture some in-house business building activities, while 'outsourced' encompasses a broad range of third-party professional managers including consulting firms, private wealth managers, multi-family offices and so on.



That said, our internal findings seemed to correspond to other independent studies, such as that by IMD/EVCA:



Source: IMD/EVCA

## 2. Investment approach to venture capital: in-house, outsourced or a hybrid model?

### How is venture capital different from other asset classes?

When dealing with venture capital as an asset class, you are dealing with eminent, visionary people (entrepreneurs), while venture-backed companies are incomplete and need assistance and mentoring – all the time.

This means that the job of managing venture assets in post-seed stages becomes a ‘lifestyle’ requiring total active focus, with little room for other activities. We believe that a more passive management style does not work in managing a portfolio of post-seed venture investments if you wish your portfolio to fulfil its potential with a minimal rate of company failures.

An important part of being a good venture capital manager is an ability to constantly learn and adopt to ever-changing circumstances across a number of industries. One can learn directly from being ‘in the deal flow’, from speaking to new, exciting entrepreneurs and companies, from focusing on active management and not least from consequent exposure to issues in portfolio companies.

All of this requires undivided attention on a portfolio of venture investments.

### Accessing the venture capital asset class.

For any successful venture investor, the quality of the deal flow is key, and being in the flow is crucial in order to generate both the volume and quality of investment leads.

Enduring venture brands have an advantage in this respect; entrepreneurs and ‘deal sources’ have a preference for established brand names and tend to gravitate towards them.

We believe that the window of opportunity to build such a brand in Europe still exists, unlike in other parts of the world which already have more higher concentration of capital (Asia) and a deeper and more established ecosystem (US).

### Building a deal-by-deal investment portfolio.

As family offices look to add exposure to the high-growth technology sector and venture capital, they increasingly face challenges in the deal-by-deal investing model.

The peculiar nature of venture investments versus the more ‘traditional’ real estate or private equity deals, does not lend itself to a traditional family office direct asset allocation approach for a number of reasons:

- Number of investments required to create a balance portfolio and the relatively small individual deal sizes, means that a dedicated team/person would be required to focus on managing the dealflow thus magnifying the opportunity cost for family offices in time spent on this asset class;
- The requirement for specialisation – not just in one space but in a variety of niche sectors – with the venture investor’s education taking place primarily ‘on-the-job’ through working with, reviewing and meeting new companies;
- The critical need for a longer term, strong brand, consistent reputation and a professional team in order to secure access to the best deals over time.

Opportunistic approach to deal-by-deal transactions only makes sense for family offices with a high-risk profile, smaller investment amounts and a high degree of write-off expectations.



Furthermore, committing funds to one successful pooled capital vehicle is economically more attractive than investing deal-by-deal. Based purely on the algebra of returns, deal-by-deal carry is roughly double the portfolio carry, thus leading to lower returns for the principal.

### **Managing an in-house venture portfolio.**

Venture capital is very different from other investment asset classes, and for a family office looking to manage this entirely in-house, a plethora of skills would be required – many of which may prove difficult and/or expensive to develop internally.

Venture portfolio companies require an active management approach, given that they are constrained in terms of resources and skill set, and thus require constant assistance and support across numerous areas, from business development, product positioning and fundraising to HR, operational setup and more. This is why provision of capital is just a small portion of the value proposition, with the most prolific venture investors providing significant added value on top of pure capital – something which naturally requires full-time focus from a dedicated multi-faceted team.

Most family offices are not set up to undertake venture investing in that way – more often than not, venture capital is not core to a family investment office's overall asset allocation and thus the venture portfolio does not get the focus and value add input it deserves or requires. Moreover, if the family office investment team is spread across multiple asset classes, they will not be able to allocate the required time and devotion to source the best deals. Given the inherent lack of economic alignment and carry in a family office setting, it could also prove challenging to recruit and motivate a top venture management team.

Families who have done it successfully have typically assembled an experienced in-house team, entirely backed by the family. Over time, through patient deployment of capital and reinforcement of the investment team, the initial capital has been augmented by other capital partners and has built leading venture fund brands (examples of such teams can be found earlier in this paper).

### **Outsourcing venture capital investments.**

Following Concentric' discussions with families, we see core reasons why a family office should consider investing indirectly into venture capital:

- *Staff constraint* – some family offices simply aren't big enough to have dedicated in-house venture employees (the definition of 'big enough' varies widely but, generally speaking, family offices which manage less than €500m in assets will often benefit going the indirect route);
- *Deal access* – some family offices may have staff but lack the robust network of relationships in the venture ecosystem;
- *Being a specialised assets class* – with venture capital, you need a dedicated and focused team of professionals who can work with, mentor and assist portfolio companies as they grow and move through phases of development.

On the flip-side, the outsourcing approach poses its own issues. Selecting funds is not always straightforward as the established funds are often closed to new investors, and many funds prefer an institutional investor base while the best performance is statistically generated by smaller/first time funds.

Making the 'wrong' venture fund selection will also be detrimental to portfolio returns; the fund's team should be able to set their mark on any investee company and manage to lead deals, rather than acting more passively and leading to distributed responsibility. Such a potential hands-off outsourcing may be exacerbated by inherent misalignment of interest in some larger funds between the GP and LPs, as outlined earlier.

### **The hybrid investment approach.**

As touched on previously in this note, one of the main constraints for a family office in connection with an effective venture capital strategy is the time resource constraint. In that respect, a hybrid investment model may be the best way forward. This approach involves deeper relationships with two to three complimentary venture fund teams, outsourcing deal flow generation and investment management as well as creating balanced diversification.



In parallel, this approach allows a family office to maintain a number of direct investments and to build their own investing brand – typically into areas and technologies associated with the sector or operational field in which the family has experience and knows well. Such activity could also be formed as an in-house company builder, where the family utilise their skills and resources to build new offerings in their sector of expertise.

This way, the family office can gain exposure to different strategies, investment stages, risk levels and so on – all in a proactively managed manner, but without the need to hire a full-fledged operating venture team. At the same time, the family office maintains its own direct investment strategy into a select few companies where they possess real expertise and competitive advantage.

The hybrid model makes most sense when there is an alignment between the LP/GP, and thus a focus on fund returns and ‘real’ GP participation, rather than enrichment through management fees.

### 3. Summary

Venture capital as an industry is becoming more professional and the EU venture market is maturing in terms of structure, ecosystem and quality of entrepreneurs. This evolution, coupled with the growth of family offices and increased focus on the technology sector, means there is also an increased debate around families’ involvement in venture capital.

Historically, family offices have not marketed themselves well towards entrepreneurs and technology companies, raising the incorrect perception that family offices provide ‘dumb’ money – a belief based partly on the fact that family offices have not been structured with venture capital investments in mind, nor have they always been able to consistently elaborate on what they can provide as ‘value add’.

Saying that, venture capital is very much on the agenda for most families that we have spoken to and 70% of them are actively building exposure to direct investments, including venture capital.

Going forward, the optimal approach to building venture exposure depends on the structure of a family office, the size of wealth under management and the skills that exist in-house. As we found during our discussions with family offices, and also documented by the Munich-based advisory *Family Office Consulting GmbH*, one requires a minimum of €20-30m venture capital allocation to be able to benefit from dedicated managers and their skills to build a professional venture capital franchise in-house.

By comparison, the hybrid model discussed in this paper allows a family office to both invest/build direct companies within their own area of specialisation, as well as to allocate €5-10m into two or three partner funds which will provide the required portfolio stage, geographic and sector exposure. This approach would provide a qualified deal flow that is managed actively by outsourced teams, with an investment office retaining ability to top-up on such deals as desired, thus maintaining a direct investment brand without much overhead.

Whatever strategy is adopted, it is important to remember that venture investing is very much a hands-on activity – not unlike building a business. In that respect, we consider it a very rewarding activity for family offices given their entrepreneurial roots, that nevertheless deserves due attention to and approach to structuring. We believe that when family offices get their venture capital approach right, due to their financial strength and extensive relationship networks they represent a significant and crucial force in the EU venture capital eco-system.

#### **About Concentric**

*Concentric is a technology investment partnership that invests in early-stage European software technology companies. We partner with founders who have built original and scalable products with a proven business-model and a product-market fit. We are substantially invested in the partnership with our entrepreneurs and look to support their growth by deploying both financial as well as human capital.*

[www.concentricteam.com](http://www.concentricteam.com)  
[info@concentricteam.com](mailto:info@concentricteam.com)