European Venture Capital attracting increasingly more attention

Björn Waltmans, Managing Director of Alternative Investments at Wilshire, is still feeling positive about Venture Capital despite the economic downturn this year. In fact, more than ever, 'There are often good deals to be found in challenging times. The bargaining power has recently shifted from entrepreneur to investor.'

By *Harry Geels*

In general, why should Venture Capital (VC) be part of an investment portfolio?
'VC is actually about trying to capture the future unicorns and decacorns at their early stages, where typically between 10 and 25% of a new company's ownership is taken. The risks can be pretty high. A common rule of thumb is that for every ten startups, three or four will fail completely. Another three or four will either lose some money or just return the original investment. Just one or two will produce substantial returns and it is with these few firms that the high returns can be made. It is therefore important to build well-diversified portfolios with experienced managers. From a broader perspective: innovation and entrepreneurship are the kernels of an affluent society and VC is needed to get the promising innovations and entrepreneurs off the ground.'

Why is the European VC ecosystem interesting from an investment perspective?
'The European VC ecosystem is actually about five to ten years behind that of the United States. This means there is attractive relative pricing compared to the US. Technology has been the most dominant VC sector in the last few decades. The US used to have a strong position here but it's not the only country ringing the bell anymore. We have recently seen a substantial number of European technology firms successfully breaking through, such as the Dutch company Adyen. We believe that the European ecosystem is now at an inflection point. The market is getting more professional, and successful breakthroughs are attracting attention from investors. The good returns have also helped, of course. European VC has outperformed US VC in the last decade. Our EU VC Fund I launched in 2015 has tripled in value. Europe currently has some quite big and interesting startup hubs, like London, Berlin, Paris, Amsterdam, Barcelona and Stockholm. COVID-19 has helped in the sense that technology has become more important in our lives and has shown to be a resilient sector throughout the recent crises. We have run an analysis on which trends are structural and which are cyclical due to the COVID-19 crisis. Technology is a structural trend and our VC strategy is aligned with that.'

What makes VC investing different to investing in PE buyouts?
'Private equity in general is quite risky. I would say that if you are willing to take this risk, then why not invest in the most risky part of it and reap the concomitant higher returns? This is of course provided that you have been able to work with the best managers and create the right diversification, not only among managers but also in terms of stage, sector, and geography. VC has even outperformed PE buyouts, the highest returning subsegment of PE. The exact allocation depends of course on the type of investor. We see that certain corporates and government agencies want to be close to new technologies and tend to have relatively high VC allocations.'

How does venture in Europe compare to its peers in Asia?
'The Asian market is very large and if you can move quickly, you can make very nice returns there, because of, amongst other things, its relatively high economic growth and relatively inefficient markets. We have seen quite a few unicorns emerging there. There are, however, government policy and geopolitical risks, especially now in China. We are a little more reluctant to make deals there for the time being. But that can of course change in the future.'

PHOTO: ARCHIVE WILSHIRE

The global situation is less rosy now. Public VC, as measured by the Refinitiv Venture Capital Index, is down 50% this year. How do you see the current investment environment for VC?

‘There are obviously clear differences between private and public markets and that is as true for VC as for any other asset class. If an investor has the sufficient scale and wants to reap the potential outsized returns of VC, he will of course choose private markets. This year’s correction of 50% in the public markets is for a great part the result of the very high returns in 2021. Back then there was a fear of missing out in almost all asset classes, including VC. We think the air has run out of the market. Investors can now acquire stakes in interesting companies on more favorable conditions. Not every company is funded anymore, as we saw in 2021. Negotiating power currently lies more with investors and less with entrepreneurs. Last but not least, abstracting from the madness of the day, the underlying trend in disruptive technology is still very strong, so this will give the sector and its investors tailwinds for years to come.’

Why is Wilshire an attractive partner for European venture capital?

‘Wilshire is a global asset management firm where we provide benchmarks, consultancy and private market solutions, mostly in the form of advice. We have our own VC fund-of-funds, from which we can make both primary fund investments, as well as co-investments directly in the companies that are part of the underlying funds. Our clients can invest in our fund-of-funds, but can also invest directly in the individual funds that we have performed due diligence on. We’re also highly experienced in this, having been selecting and monitoring venture funds since the 1990s. Since then, we have also focused on other private markets asset classes. At the moment, we have € 30 billion assets under management in private markets globally, of which € 6 billion is in discretionary mandates and € 24 billion is under advice. In total, across all markets, we have $ 1,2 trillion under advice. Around € 1 billion is invested in VC. We started our European VC business in 2001 and we have since then built a solid track record through different economic cycles. For an investor it is important that fund managers are cycle tested and have gone through previous down cycles, because there are important lessons to be learned. Without giving too much away, one of the important lessons we have learned is that a manager should have at least three or four companies in the portfolio that have the potential to earn back or recoup the whole initial subscription amount of the fund – the less promising companies will then get a zero valuation in our models. In addition, we have a dedicated venture team, mostly consisting of partners in the firm. In Europe we have a very strong network which gives us access to nearly all of the top European VC managers. It’s important to know that for new investors it is not easy to get access to those managers. There is so much appetite for the asset class that they typically only allow existing relationships to invest. On a final note, I would like to mention that Wilshire manages its European business from Amsterdam, and our Wilshire EU VC Fund II is still open for subscription.’ ■

BIO

Björn Waltmans

Björn Waltmans is responsible for co-managing the European alternatives business and is a member of Wilshire’s private markets Manager Research and Investment Committees. Prior to joining Wilshire in 2011, Waltmans was an associate with Sequoia, a private equity, investment management and independent corporate finance advisory firm. He holds a MSc and BSc degree in Aerospace Engineering and a BSc degree in Economics and Business Economics.

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