Co-investment/direct investment – the reality

Pioneer is an investment firm that makes investments in European private companies within the Sustainability and Digital Economy sectors. The founders have over 60 years of private equity experience. The firm partners with family offices on a direct investment basis. It is widely known that family offices have an increasing appetite to make direct/co-investments. This form of investing is often over-simplified. This article highlights some key considerations for a family office wanting to be active in this space.

Define a strategy

Many family offices want to be in this space without a clear strategy. Co-invest or direct? How many investment s? What sectors/geographies/size? Do I have the skillset? What do I have to hire in? Do I really have value add and what is it? Define a strategy first!

What is co-investment?

Co-investment involves passive/semi-passive investing with others (usually the family office is not involved in key decision-making). Benefits over a fund are you chose where your capital goes and it is often a cheaper way of investing. The issue in this highly competitive world is how to access the best investments. Unlike previously, top funds do not need co-investors (currently €1 trillion of dry powder) = the best opportunities are offered to family offices that make large commitments to the fund. Therefore ask yourself, why is the fund picking this investment for you? If you instead co-invest with another family office, the key issues are who is doing the work that a fund usually does and how to get comfortable on alignment of interests. Even if you don't like funds, at least interests are defined. An exception can be small investments where clubbing is routine.

What is direct investment?

Direct investment is for family offices that have a strategy to be active and have a high level of control on the underlying investment, in essence for those who want to own companies. An investor can take part in/control key decision-making, in particular the exit. The issue with direct investing is the degree and length of commitment that is required which means a family office must have an internal investment team or outsource. Without this you cannot successfully source, execute and monitor even a few investments. The benefit of hiring a team is you can craft and control it, the challenge is attracting and retaining expensive talent = risk and ongoing cost. Outsourcing removes the challenges of hiring a team, leaving the dedication of thousands of hours per deal, per year, in the hands of specialists. For example, Pioneer funnels c350 opportunities per year down to 1 completed investment which requires mammoth research, air miles and manpower. Challenges are how to find the right partner with aligned interests and most importantly mutual trust.

The hot topic, economics!

Many family offices say they want to invest without paying anyone. As described above, the challenges on "free" co-investments are why are you being shown the deal, is it top quality and who is doing the work? On direct investments if you don't manage it yourself, why would a top class team work with you for free? There is often a misalignment of interests between funds and investors (e.g. managers getting rich on fees alone) but on direct investments it is possible to craft an economic partnership that works for both parties.

Conclusion

Family office direct/co-investing is a space we believe will continue to grow and evolve as it has many attractions and advantages. However, without a clear strategy it is fraught with risk. At the Campden Alternative Investment Conference on 19th February, Pioneer will discuss this topic in greater detail and provide a real life case study as to how this relationship works in practice. ■

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