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Tapping the growing GCC venture capital opportunity

The GCC's venture capital (VC) market has grown rapidly in recent years, particularly in Saudi Arabia and the UAE, its two largest markets. Investors such as high-net-worth individuals (HNWIs), family offices, corporations, and sovereign wealth funds (SWFs) increasingly regard VC as an attractive asset class. However, many first-time investors lack a clear entry strategy, which can create unnecessary portfolio risk. Instead, all types of investors should approach VC opportunities in a manner that aligns with their respective aims and capabilities.

The rapid growth in regional VC stems partly from the need to fill the investment vacuum created by the withering of the GCC private equity (PE) market, which followed the Abraaj Capital incident and loss of trust in regional PE firms. Government measures are also a significant factor: Saudi Arabia, for example, is upgrading its digital infrastructure to support tech companies and encourage innovation. It has ambitious targets, particularly in fintech, with the aim of over 500 startups operational by 2030. Similarly, the UAE's "We the UAE 2031" promotes the digital economy and positions the country as a financial services and digital payments hub, and an innovation center.

Also fueling VC growth has been investment by SWFs and government-affiliated entities. Examples from Saudi Arabia include Jada (controlled by the Public Investment Fund) and SVC (a subsidiary of the Small & Medium Enterprises Bank under the National Development Fund). These investments have focused on removing value chain bottlenecks, seed funding new technology, and economic growth. They either directly invest in startups or support small PE and VC. The sheer scale of SWFs and government affiliates means that they can have impact swiftly.

Family offices and HNWIs, however, have not yet properly engaged with VC, although they regard it as an attractive asset class to maximize financial returns. The difficulty is not the lack of opportunities—most investors are continually approached by brokers, entrepreneurs, and investment banks. Rather, they lack a proper strategy, tending to evaluate options one by one, sequentially and reactively.

"There is no lack of opportunities to invest in VC. However, many investors can create unnecessary portfolio risk without a clear entry strategy.

Instead, family offices and HNWIs initially can invest in one carefully selected VC fund as a limited partner. That provides them with opportunities, and the ability to start with small commitments and track their performance.

- **A good first step is a VC fund that is diversified across industries.** In selecting their initial fund, investors should look at those with a solid track record in sectors of interest. If the experience is positive, family offices and HNWIs can invest in multiple VC funds, diversifying and increasing exposure to other asset classes.

- **Another subsequent step for family offices and HNWIs is to negotiate co-investment rights—the ability to deploy additional capital directly into a portfolio company at subsequent capital rounds.** The arrangement can be beneficial for all parties: VC fund managers know in advance that they have secured additional capital for their most promising companies and investors gain priority access to winners and reduce downside.

Unlike family offices and HNWIs whose primary purpose could be financial returns, large corporations undertaking corporate venture capital (CVC) should go further. They should focus on building strategic value. That could include next-gen technology, driving product and service innovation and new business models that can stifle competition. Otherwise, corporates have the fiduciary duty not to shift their risk/return profile, and indeed are better off returning capital to their shareholders and avoiding agency costs. To ensure CVC is a potent tool in their arsenal, corporates should have a clear vision of the purpose of their investing and ensure that investments build on each other.

Initially, corporations can deploy capital in specialized VC funds as a limited partner—typically one or two at the outset. As the corporation builds capabilities and insights, it can create a dedicated “venture builder” unit, mandated to make direct investments into startups and growth-stage companies (and not necessarily in the form of co-investment with a VC fund). These units should have autonomy in their investment decision-making, with proper risk assessment and governance. Importantly, remuneration packages should make sense for an investment environment, which may differ from the corporation’s existing incentive structure.

Some corporate investors are diversifying risk by syndicating new ventures among market players, even those traditionally viewed as competitors. A case in point are regional banks that have invested in neo banks such as fintechs that offer financial services and that can challenge incumbent banks.

The GCC’s VC market is poised for continued growth. To take advantage, and contribute to the region’s growing and diversifying economy, all types of investors need a VC investment strategy that fits their ambitions and capabilities.

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