Growing demand from retail investors has made the democratisation of private markets an inevitability, says Moonfare’s Dr Steffen Pauls

At times of high inflation, investors need high-yield products – ones that are relatively insulated against the macroeconomic environment and can offer security against the potential for loss-making.

Private equity has historically yielded far above a 20 percent internal rate of return over a prolonged period: even in today’s rocky macroeconomic climate, McKinsey’s Global Private Markets Review 2022 found that PE reported a pooled IRR of 27 percent in 2021, making it the highest-performing private markets asset class. The report also noted that PE continues to outperform relative to most public market equivalent measures, thus driving unmatched global growth in private markets.

For this reason and many others, private investors are increasingly open to the idea of adding the asset class to their portfolios, explains Dr Steffen Pauls, founder, chairman and CEO of global PE investing platform Moonfare – one of the first firms founded in this space. Private Equity International spoke to Pauls to gain his insight on why democratisation is the topic du jour in 2023, and how fund managers can encourage individual investors to dip their toes into the asset class.

Q Why are GPs so focused on tapping retail investors?

Institutional investors have more and more capital to invest, but they are also becoming increasingly saturated in their private markets allocations, particularly in the US and Europe. As such, many general partners are turning to new sources of capital in order to reduce their reliance on traditional limited partners.

One of the largest pools of untapped capital comes from private investors: according to research conducted by consultancy Oliver Wyman, individual investors are predicted to allocate an additional $1.5 trillion to private markets by the year 2025.

Additionally, ever since the global financial crisis, private equity’s largest players have become more transparent and are now looking to welcome more diverse players into their operations as a result.

The members of our Moonfare community are corporate decision-makers, professionals and executives working in...
Fortune 500 companies, making them attractive constituents that PE firms increasingly want to get to know.

Is the macroeconomic environment adding momentum to this shift? If so, why?

There are numerous studies that show how, particularly in times of recession, private equity outperforms public markets – for example, research conducted by Fortune found that deals from top-quartile vintages raised around the global financial crisis generated a 61 percent IRR. In comparison, the S&P 500’s annual return in 2008 was -38 percent.

One key reason for this success is the active ownership, or superior governance, model. In times of more challenging macroeconomics, the likes of KKR, Blackstone and the Carlyle Group are buffered by large volumes of professional operational resources, which they can deploy in their portfolio companies. They have expertise in M&A to drive forward consolidation strategies, as well as in digitalisation, supply chains, purchasing and so on, giving them a huge competitive advantage in times of economic difficulty.

Additionally, these firms are more active owners of their assets compared with public companies, are able to employ highly sophisticated operational playbooks, and are typically in touch with their portfolio companies on a weekly basis.

Another key point is that private equity is, by definition, private; this means PE firms can take a longer-term perspective rather than being driven by the aggressive quarterly reporting we see in the public markets. As a result, GPs can take fundamental steps to develop their portfolio companies at a pace that suits them, with a typical investment horizon of five to seven years allowing plenty of time to drive forward meaningful, long-term change.

There was an interesting study conducted by McKinsey that analysed the performance of PE firms that have their own internal operational resources and compared it to those with no operational resources. It found that there was a difference of 8 percent in the rate of returns.

This is absolutely the time to invest in private equity: the industry is expecting 2023 and the years to come to be some of the best vintages since those in the wake of the global financial crisis. We saw periods of especially strong performance both in the aftermath of 9/11 and after the last financial crisis, and it is very likely that this level of success will be repeated this time around.

What kind of demand is Moonfare seeing from retail investors today?

The democratisation phenomenon is a global topic and is a trend that is set to dominate private equity for at least the next 10 to 15 years. When we started the company in Germany, we soon saw demand in the UK, which resulted in us opening an office there in 2018. Following that, we launched in Switzerland. Now, we are positioned in 24 countries across all the major continents.

Moonfare has been growing more than 100 percent every year since its inception. We are seeing strong demand from all sorts of customer segments, including lawyers, entrepreneurs, medical professionals and corporate senior executives. The company's influence has spread across all different types of investors because it makes perfect sense as an opportunity. Sophisticated professional investors are allocating 25 percent of their assets on average to private equity; for private individuals, that figure is just 2 percent. There is a huge need to increase the proportion of private equity in individuals’ asset allocations – this is exactly why more and more retail investors are seeking out democratised products, and why Moonfare has stepped up as a provider of these.

What are the biggest hurdles to retail investors taking their first steps in PE? How are platforms such as Moonfare helping to overcome those hurdles?

We identify four major hurdles. First, the typical minimum investment in private equity is €10 million, so it is only...
the preserve of very wealthy individuals or large institutions. Moonfare brings that down to investments of €50,000 and pools individual investors to create critical mass, opening up the asset class to a much wider group of potential retail investors.

The second challenge is that private equity is a famously complex product, so individual investors need someone to educate them on the asset class, curate possible investment opportunities, and identify the best funds out there. Thinking of private equity as an index with ‘good’ and ‘bad’ investments is not a good strategy, but you do need to be investing with the top-quartile funds.

Moonfare’s investment committee includes some of the most seasoned private equity executives in the industry: I have spent my whole career in private equity, as have many of my colleagues. We are able to do the curation job on behalf of our investors to select and find the best products and the best managers out there. We look at some 300 funds per year, and only 20 of those make it onto the platform; we are highly selective on behalf of our investors.

Another hurdle today is that if you want to invest offline, you need to go to a bank, wherein you will find yourself faced with cumbersome processes around know-your-customer and anti-money-laundering checks. We streamline that process and automate it through a fully digital system, so you can make your investment in as little as 15 minutes.

Finally, we are making an illiquid asset class liquid by developing a digital secondaries market. When you invest in private equity, you typically have a holding period of 10 years, meaning you are locked in. We have solved that issue and created our own secondaries market of 50,000 users. These users can, after a holding period of one year, put their stakes up for sale and liquidate their position. We believe we are the only PE firm doing this globally – providing liquidity for retail investors who are so often put off by the long hold periods of the asset class.

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**Q** What developments would you pick out from the past two years as being the most significant for enabling democratisation?

One theme that we see across the board is that politicians and regulators are starting to think more deeply about the democratisation of private equity. This includes the Financial Conduct Authority in the UK, the Federal Financial Supervisory Authority in Germany, and the Securities & Exchange Commission in the US.

Under the proposed ELTIF 2.0 regime, we will also be able to market funds of funds so people can invest in well-diversified portfolios. Moonfare is currently developing such a product with a large private equity partner; that will be a big theme moving forward.

**Q** Where do you expect to see the most progress on democratisation in the next few years?

The private equity industry is expected to grow by more than 8 percent year-on-year over the next five to seven years, and is expected to double in size within a decade. We also see private markets more broadly continuing to grow: over the past 20 years, the number of initial public offerings in the US has been going down, which means we see the public markets playing a less relevant role over time. That means investors will inevitably be drawn to private markets instead.

We see the industry growing substantially; at the same time, private individuals will increasingly gain access to private equity through platforms such as Moonfare. What’s more, all of this is happening in the digital age, fully automated by players that offer access in a convenient, digital and automated way. All three of these trends will only continue to accelerate over time.