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A brighter way

How to add venture capital to a portfolio whilst considering risk

In partnership with Hardman & Co, this guide highlights the growing role of early-stage, unlisted businesses and – taking into account the associated risks – explains how venture capital offers access to high-growth private market opportunities.

Written in partnership with



HARDMAN & CO.



Early-stage, unlisted businesses are playing an increasingly significant role in certain client portfolios. As a vital segment of the broader private markets, venture capital provides access to innovative, high-growth companies. Learn why this matters and how private market investments could benefit your clients.

The big shift to private markets

Once the preserve of large institutions, investments in early-stage unlisted businesses are now becoming an important part of some client portfolios. The growing interest reflects a broader change in sentiment towards democratising access to private markets, making them more accessible and inclusive to a wider range of investors.

Investors are hungry for higher returns, greater diversification beyond portfolios weighted toward listed equity and bonds, and opportunities to back exciting companies with significant growth potential. You only need to look at the growth in crowdfunding platforms to see evidence of this.¹

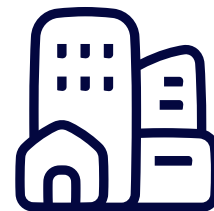
At the same time, pension funds are under increasing pressure to direct more capital towards private markets and the UK economy – as set out in the Mansion House Accord from May 2025.

With this in mind, it follows that financial advisers have become proactive, and are increasingly advising clients on this area of investing.

This guide covers:

- The case for venture capital in client portfolios.
- Allocating to venture capital while being mindful of a client's overall risk appetite.
- Ways to access investments in early-stage businesses with high growth potential.

¹Mordor Intelligence, Crowdfunding Market (2025–2030), 2025.





Why early-stage businesses can outperform incumbents

While investors in early-stage businesses face greater risk due to higher failure rates compared to more mature businesses, they also benefit from substantial upside potential. By investing in venture capital, clients gain exposure to these businesses which, given their stage in the growth cycle, have the potential to generate outsized returns relative to more traditional asset classes.

Macroeconomic factors, can be a significant driver of growth and success for early-stage companies. Surprisingly, even uncertain economic environments can create opportunities for early-stage companies. Their agility allows them to pivot quickly, responding to changing market demands, and capitalise on gaps left by bigger and slower competitors. This flexibility can be a key advantage in volatile environments.

Most recently, inflation and tighter capital markets have pushed many tech firms to cut costs and prioritise profitability.

What to expect from an early-stage portfolio

Investors looking to access venture capital often buy shares directly in early-stage companies. With this approach, returns are typically only realised when these companies are either sold to another company or list on a stock exchange. Naturally this takes time, and investors are usually unable to access their investment prior to realisation. Investors must therefore generally commit to a **five to ten-year investment horizon** and be comfortable with having limited or no access to their funds during that period.

By their nature, early-stage companies also have a high rate of failure so it is important that investors are appropriately diversified in their exposure to companies and that they understand how their investment values may fluctuate.

“Macro effects can work either way for venture capital companies. A positive economy can make it easier for a business to scale after product-market is found. Recessions can force companies to look harder at how they do things and look for cost savings. For example, the pandemic saw an accelerated uptake of many digital products but devastated some travel start-ups.”

Dr Brian Moretta, Head of Tax Enhanced Services at Hardman & Co

Investors should expect varied performance from portfolio to portfolio of early-stage companies. Returns are likely to be driven disproportionately by certain companies, while others lose all value.

For illustration purposes, consider a strongly performing portfolio of ten early-stage companies, which over the course of roughly five to ten years returns as follows:

- Two companies provide a 10x return.
- Two provide a 3x return.
- Two return capital invested.
- Four companies are written off to zero, for a complete loss of capital.

Bear in mind that this scenario is provided for illustrative purposes, to show the nature of potential returns in a portfolio of early-stage companies. A portfolio could return more or less, potentially falling to nil, and would be affected by fees and charges.



Allocation based on risk appetite

Clients with the appropriate objectives and risk profile may be comfortable taking on more risk with a portion of their assets. Adding investments in early-stage businesses to an existing portfolio allows a client to target higher returns, but also adds risk to the portfolio.

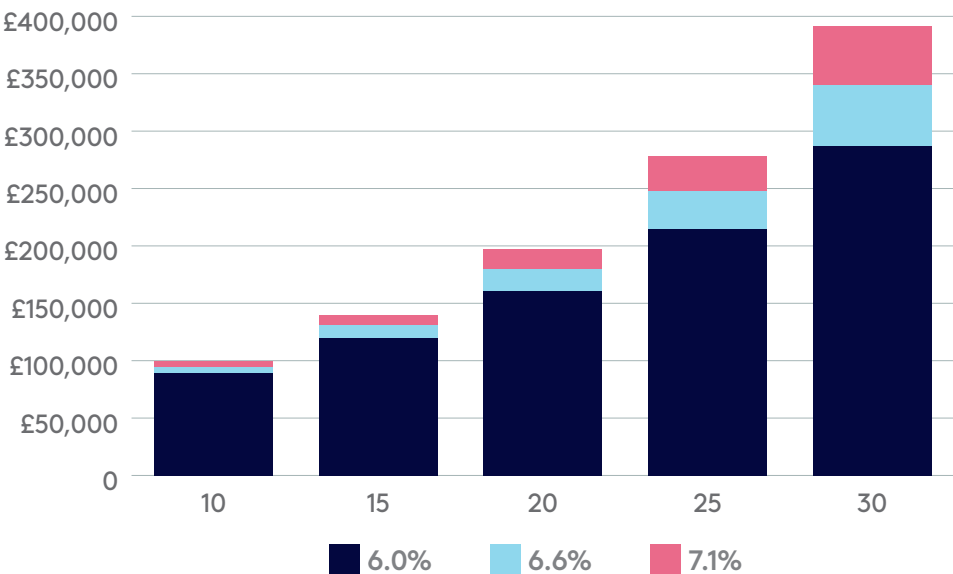
However, those that are new to venture capital often think investing in early-stage companies only means taking big risks. This view overlooks how venture capital can help diversify within a balanced portfolio. When considering a client's exposure to early-stage businesses, it's important to take a holistic view of a client's portfolio. We need to recognise that a portfolio can be made up of assets that have different risk profiles and different degrees of correlation, while the overall level of risk in the portfolio is at an appropriate level for the client.

Adding venture capital to a portfolio without increasing overall risk

Dr Moretta researched the effect of adding venture capital to client portfolios. Using market data and established research for venture capital, he applied Modern Portfolio Theory to determine optimal asset allocations.

Modern Portfolio Theory looks at risk through the lens of variance (the volatility of returns for each asset class) and uses this to establish the optimum allocation, producing the potential best return for a given level of risk across a portfolio*.

Fig 1: Effect of adding 0.6% or 1.1% to annual returns on a £50,000 investment



**Source: Hardman & Co Research
May 2025**

*Remember, Hardman & Co's research assesses risk in terms of variance. Other risks and considerations for suitability will need to be considered, for example liquidity and investment time horizon. Nothing in this document should be viewed as advice. Any suitability decisions should be based on a comprehensive review of your client's objectives, needs and attitude towards risk.

Effect of adding 0.6% or 1.1% to annual returns on a £50,000 investment

Dr Moretta’s research found that by adding relatively small exposures to venture capital, investors can improve potential annual returns by 0.6% to 1.1%** without changing overall portfolio risk.

While this might not sound like much, the impact of compound returns is significant. The chart in Fig 1, taken from the research shows the effect of adding 0.6% to 1.1% to a £50,000 investment returning 6% annually over 30 years.

Rebalancing a 60:40 portfolio when adding venture capital

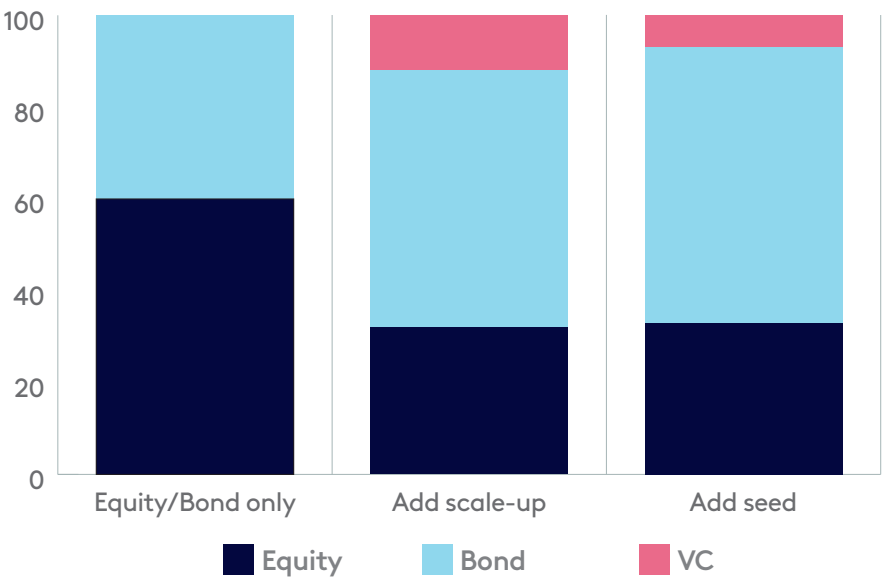
When a portfolio’s asset allocation changes the overall exposure to risk will often change too, however, careful rebalancing means that this can be avoided.

The chart in Fig 2 taken from Hardman & Co’s latest research shows how asset allocation might change from a 60:40 equity and bond portfolio when venture capital is introduced, where a client wishes to keep the same level of overall portfolio risk.

Allocations are shown for the addition of seed capital (where companies are in product development and finding their first customers) and scale-up capital (investing in slightly later stage companies with an established product and market).

Dr Moretta explains: “We are adding a riskier asset to the portfolio. It’s not simply a matter of leaving the rest of the portfolio unadjusted or even selling down equities to invest in venture capital. We have to reduce equities by even more and increase the bond proportion to keep the same overall risk.”

Fig 2: New portfolio allocations when keeping risk constant and adding venture capital



Source: Hardman & Co Research
May 2025

**This return figure doesn’t consider the impact of any tax reliefs that may be available when investing in venture capital.

Applying this in practice

While the theory behind portfolio rebalancing makes sense, it's not typically well understood in practice. This creates an opportunity for advisers to add real value by helping clients manage asset allocation more effectively.

Since this research was first published in 2021, interest rates and bond yields have risen significantly. Encouragingly, the recommended allocations remain very similar, showing that the model is robust. The upside for investors is that the rebalancing now feels more attractive – earning 4%-5% on bonds is far more appealing than the 2% yields available previously. As a result, expected overall returns have improved.

This analysis doesn't account for tax reliefs, which can further enhance returns. Conversely, venture capital funds typically have higher fees than traditional equity or bond funds. However, with long enough holding periods, the tax benefits can outweigh the higher costs – making this a more attractive option for suitable investors.

It's worth noting that short-term volatility often appears lower than for quoted equities. Venture capital assets may not react to external market shocks in the same way as quoted equities. For instance, during the early months of the COVID-19 pandemic, when listed markets saw sharp swings, unquoted valuations stayed relatively stable. While this can help with short-term portfolio stability, it may cause an imbalance after sharp market movements and investors can end up overexposed to private assets without an easy way to rebalance, due to their illiquid nature.

A simple example:

Imagine a 20% drop in quoted equities. In the rebalanced portfolios shown earlier, equities made up around 32% of the portfolio. That means the overall portfolio falls by 6.4% ($20\% \times 32\%$). The venture capital and bond allocations – unchanged in value in this scenario – now make up a larger share of the total. In the scale-up portfolio, this pushes bond's weighting from 56% to 60%, and venture capital from 12% to 13%.

For investors still adding to their portfolios (the accumulation phase), this isn't a major concern. New contributions can be directed to equities and bonds to restore the target mix. But for those drawing down from their portfolios (the decumulation phase), rebalancing is harder. In these cases, it may be wise to slightly reduce the initial allocation to venture capital – say by 1% or 2% – to give a buffer in case quoted markets fall sharply.



How clients can access venture capital

With the inclusion of venture capital in a diversified portfolio, you can potentially raise expected returns while being mindful of an investor's overall risk appetite.

Direct access to early-stage companies for clients outside of family office levels of wealth can be difficult. However, the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) are an attractive and accessible route to diversifying client portfolios with investments in smaller companies. These investment structures make it possible for clients to invest in private companies and claim tax reliefs to compensate for some of the risk they take.

It's worth reiterating that the potential impact of tax reliefs is excluded from the analysis in this document, making these types of investments even more compelling within a long-term investment portfolio.

“There are limited options for retail clients to invest in venture capital. The main options are those available through the tax-advantaged schemes of EIS and VCTs.”

Dr Brian Moretta, Head of Tax Enhanced Services
at Hardman & Co

EIS

Investors in an EIS portfolio own shares directly in a number of early-stage companies, targeting high growth over the long term. Investors can claim generous tax reliefs because of the risks involved. Investors can claim 30% upfront tax relief up to £1 million invested each tax year.

Importantly there is also relief on both the upside and downside, whereby gains are tax-free and loss relief can be claimed when a qualifying company returns less than invested even if the portfolio is profitable overall. In order to maintain the reliefs, investors have to hold shares for at least three years and the underlying company must remain EIS-qualifying for three years.

VCTs

VCTs are listed companies that invest in a diversified portfolio of early-stage companies. Investors benefit from the VCT owning small stakes in a large number of companies, typically across different sectors. VCT investors can claim 20% upfront income tax relief up to the first £200,000 invested each tax year, provided shares are held for at least five years. The dividends paid by a VCT can generate a tax-free income.

Acknowledgements

This document draws on the research of Hardman & Co.

Dr Brian Moretta

Brian Moretta is Head of Tax Enhanced Services at Hardman & Co. He is an actuary turned fund manager, who then moved into equity research, and has analysed many EIS funds, VCTs and companies, both listed and unquoted.

Hardman & Co

Hardman & Co is a rapidly growing, innovative corporate research and consultancy business, based in London, serving the needs of both public and private companies.



Key risks



- These are high-risk investments. The value of VCT and EIS investments, and any income from them, can fall as well as rise. Investors may not get back the full amount they invest.
- The shares of small unlisted businesses are high risk, their price may be volatile, and they are harder to sell than listed shares.
- Tax treatment depends on individual circumstances and tax rules could change in the future.
- Tax relief depends on the portfolio companies and Venture Capital Trusts / Enterprise Investment Schemes maintaining their qualifying status.

We do not offer investment or tax advice. EIS and VCT qualifying investments are not suitable for everyone. Personal opinions may change and should not be seen as advice or recommendation.

Any recommendation should be based on a holistic review of your client's financial situation, objectives and needs. Issued by Octopus Investments Limited, which is authorised and regulated by the Financial Conduct Authority. Registered office: 33 Holborn, London EC1N 2HT. Registered in England and Wales No. 03942880. We record telephone calls. Issued August 2026. CAM015042.



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