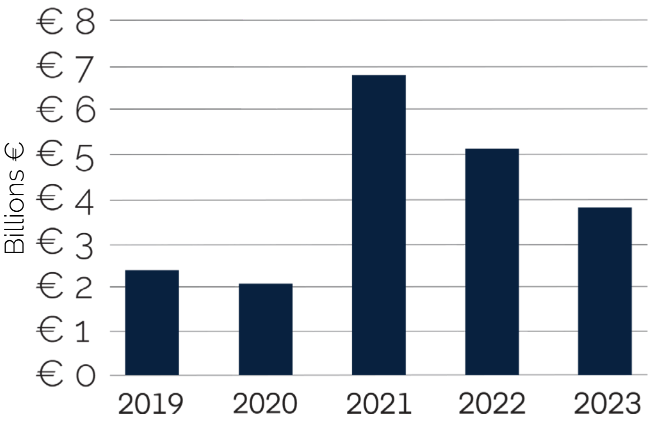
Director's Perspective

VENTURE CAPITAL FINANCING GAP:
TOWARDS A EUROPEAN SPACE INVESTMENT FUND?

In the transformative landscape of the space sector, venture capital has been a fundamental part of the fundraising ecosystem across the start-up's investment cycle. Accordingly, VC has been the largest source of private financing for the development of the European NewSpace ecosystem, accounting for roughly 76% of the total private financing for the development of Europe's NewSpace ecosystem since 2019.



VC Global Investment in NewSpace

Yet, by 2022, shifts in the macroeconomic landscape have concluded the period of low interest rates. The European Central Bank significantly raised the central borrowing rate from an initial 0.5% in July 2022 to a peak of 4.5% by February 2024. This surge in interest rates has led to a preference for safer investments, causing the venture capital and private equity sectors to face capital withdrawals and adopt a more conservative investment stance. Globally, according to **ESPI's Space Venture report, to be released in April**, the impact of interest rate shifts is evident with a 25% year-on-year decrease in investment and a 44% fall from its peak in 2021. While Europe may not have experienced this impact just yet, the number of deals indicating the space sector's activity, has reverted to pre-2021 levels. This transition indicates a period of introspection and recalibration for investors, who increasingly scrutinise the sustainability and long-term viability of their portfolios amid growing market volatilities and geopolitical uncertainties.

Venture capital, while a catalyst for breakthroughs and rapid scale-ups, inherently gravitates towards ventures with clear exit strategies within 5 to 7 years, often sidelining long-term or uncertain projects. Space projects, with their extended timelines, substantial initial capital requirements, and complex regulatory landscapes, frequently fall into this latter category. The gap between venture capitalists' profit goals and the long-term nature of space projects, compounded by less available high-risk capital in a **high-interest environment, threatens to slow the space sector's progress, at a time when scale-up is needed.**

Facing these challenges, it is essential to diversify and strengthen the funding landscape and develop new policy measures. Space financing should include various models to align innovative projects with the evolving preference for debt over equity in the capital market. As concluded in our latest report, **Bridging the Financing Gap in the European Space Sector: Alternative Funding Pathways in Tightening Markets**, **set key actions for Space Agencies and public actors in the European Space Sector:**

Diversify Financial Instruments: The introduction of Strategic Investment Funds (SIFs) and the leverage of Public-Private Partnership (PPP) models stand out as some of the most adequate ways to attract funding. These instruments, with their capacity for 'patient' capital, offer a lifeline to projects of strategic significance, allowing them the runway to mature and prove their market resilience.

Engage Strategic Corporate Investors: The inclusion of corporate venture arms in the investment mix introduces a layer of industry-specific insight and strategic alignment, enriching the ecosystem with partnerships that transcend mere financial transactions. These collaborations could unlock synergies between space technology developers and established industry players in different sectors of the economy, fostering innovation that resonates with market needs.

Standardise Investment Pathways: Integrating a model akin to the pharmaceutical industry's clinical trials, the space sector could standardise the evaluation of technological maturity against investment milestones, or example through the use of the Technology Readiness Level (TRL) scale. TRL-6 could mark an important milestone as a public partner within a PPP may pivot from its role of early-stage technology risk absorption to first anchor tenant. This method would not only streamline the investment process but also align stakeholder expectations, signaling commercial viability and thus facilitating sharper funding strategies.

PPP Unified Effort: The role of government sponsorship and procurement in providing 'patient' capital against clear policy goals is crucial. **A joint European Space Investment Fund**, inspired by models such as the U.S. Department of Defence's Office of Strategic Capital (OSC), could serve as a cornerstone for policy-guided strategic investments, marrying public objectives with private dynamism.

On our part, **ESPI commits to** advancing the space sector's financial ecosystem through **detailed policy and finance studies on mechanisms** like Public-Private Partnerships and Public Infrastructure Funds, **facilitating community building among space and financial stakeholders**, and **aligning investor ESG goals with space services' objectives and capabilities.** As the space sector enters a new phase, matching investment strategies with current market conditions and investor expectations is crucial. Budget constraints have intensified, with global military spending on space rising from \$42.6 billion to \$52.8 billion due to the Russian invasion of Ukraine, whereas civilian space budgets saw a modest increase from \$60.3 billion to \$64.8 billion between 2021 and 2022. This scenario underscores the need for a united and strategic approach to overcome the challenges posed by shifting capital market dynamics. By adopting these strategies, the European space sector can successfully tackle the current financial complexities, securing a dynamic and forward-looking future for space endeavours in response to European space policy objectives.

Yours sincerely,

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