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Investing in the Future

WHY MANY INVESTORS HAVE MISSED OUT ON A RECORD-BREAKING YEAR FOR VENTURE CAPITAL EXITS (AND WHAT THEY CAN DO TO AVOID THIS HAPPENING AGAIN)

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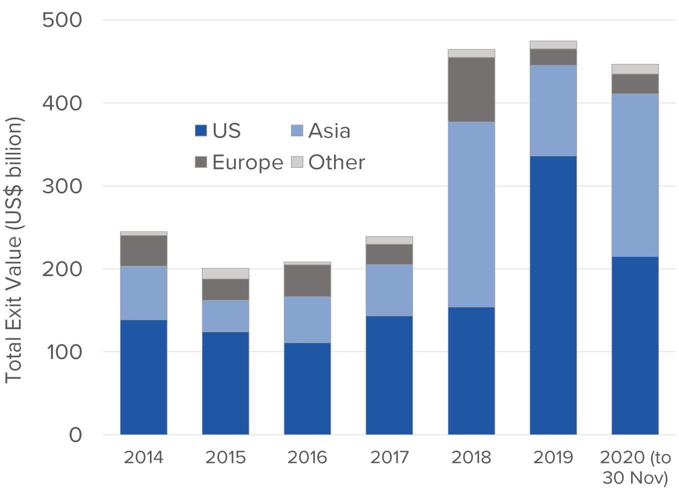
1. RECORD YEAR FOR VC LIQUIDITY

VC-backed companies are on track to generate record liquidity value in 2020, with total exit proceeds potentially exceeding half a trillion dollars. However, very few investors will benefit from this record-breaking year. The main beneficiaries will be those groups able to access the small cohort of top-tier venture funds that consistently back the leading companies. Many investors thinking about building their own venture fund portfolio face a major dilemma – do they compromise on manager quality due to lack of access or are they better off not investing in VC entirely. However, a viable third option also exists. Investors can use an experienced and focused fund-of-funds with proven access to the leading VC managers.

The exit markets have confounded all forecasts in 2020, with the second half of the year seeing a steady stream of companies achieving liquidity. With companies such as Airbnb and Doordash already listing in December, together with the recently announced $27.7 billion acquisition of Slack by Salesforce.com, 2020 is poised to be the strongest year ever for venture-backed IPOs and M&As, creating over half a trillion dollars of total exit value.

Global VC-Backed Exit Value



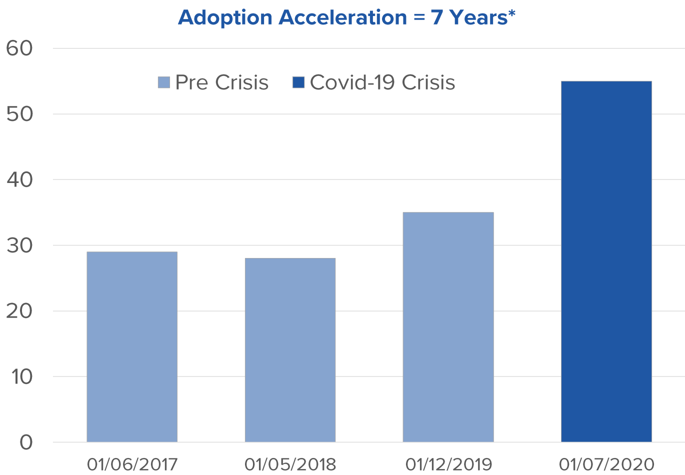
Source: Pitchbook. Exit value = post-money IPO value + announced M&A value

2. INCREASED EXIT SIZES AS COVID ACCELERATES ADOPTION

With leading companies staying private for longer, exit valuations today are substantially larger than in previous cycles. Snowflake is a good example of this phenomenon. The company, which develops cloud-based data solutions, was founded in 2012. It listed on the New York Stock Exchange in September 2020 at a post-money value of $33.2 billion and ended November with a market capitalisation of $91.0 billion.

In addition, during 2020 there has been a major acceleration in technology adoption by both individuals and businesses as they come to terms with COVID-19. Trends such as e-commerce, remote working, cloud services, etc. are not new, however adoption has seen multiple years of expected growth in just a few months. According to a recent survey by McKinsey & Company, the COVID pandemic drove a seven-year acceleration in the average share of global products and services that have become either partially or fully digitised.

Average Share of Global Products & Services Partially/Fully Digitised (%)



Source: How COVID-19 has pushed companies over the technology tipping point - and transformed business forever - McKinsey & Company, October 2020
* Years ahead of the average rate of adoption from 2017 to 2019

3. GAIN CONCENTRATED IN A SMALL GROUP OF LEADING VCS

Venture-backed technology companies have been one of the main beneficiaries of the changes in behaviour accelerated by COVID-19. However, the significant gains that have been generated by these companies have only been enjoyed by a relatively small group of investors. Over 66% of Snowflake, the largest VC-backed exit in 2020, was owned by just five venture capital firms prior to the company's IPO. This is a fairly common occurrence, with a highly concentrated group of VC firms consistently able to identify and access the new breed of global technology leaders.

4. HOW CAN INVESTORS GAIN EXPOSURE TO KEY COMPANIES?

The concentration of returns in a small number of venture firms presents a major challenge for investors. Many of the leading venture firms are notoriously difficult to access and, as a result, investors often take one of two options. Some decide they still want exposure to the VC industry and will look to back managers that are not access constrained. Given the significant difference in returns between the best-performing VC firms and the rest of the industry, this strategy can often result in disappointing performance. The other main alternative for investors is simply not to invest in the VC industry at all – without access, they simply can't justify an allocation.

However, a potential third option does exist – using a specialist funds-of-funds to guarantee access to the leading venture firms and thereby gaining early-stage exposure to the next generation of technology winners. The most experienced of these funds-of-funds have long-term relationships with the leading venture firms and understand how to provide investors with a cost-effective, highly proven solution. For institutions wanting to benefit from the significant value being generated by emerging technology companies but without the internal resources necessary to gain access to the leading VC managers, a fund-of-funds may prove to be the answer.

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