White paper 2022

The Case for *Venture Capital* in 2022 and Beyond

Moonfare®

Steady momentum and healthier valuations

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Venture capital (VC) epitomised the blockbuster year that all private market assets had in 2021. Last year, exit numbers for VC investors hit record breaking new heights with $774.1 billion in VC-backed exit activity crushing 2020's previous record of $289 billion.[1]

The asset class has now cemented its place as one of the best ways to capitalise on both innovation and disruption and for the risk-willing investor, the rewards can be far greater when compared with other private market investments.[2]

These rewards have seen a host of newer and non-traditional[3] investors focus their attention on the asset class, which—among other reasons—helped global venture funding reach over $600 billion in 2021.[4]

But VC, by its very nature, is a risk, and investments in the space are facing downward pressure while the market more broadly is on a downturn. The Russia-Ukraine war, rising inflation and interest rates, turbulence in the global capital markets, and ongoing supply chain challenges, are contributing to a slowdown in investment activity.

But, while there are reasons to be cautious, the outlook for VC through 2022 and beyond still looks positive.

- The investment momentum in PE from 2021 looks set to continue - albeit at a slower pace
- Recent valuation resets should allow VCs to invest in a healthier environment
- Companies are continuing to stay private for longer, allowing investors to capture a larger share of the profits

Plus, for VC, macro-shocks are often catalysts that drive further innovation and expand investment opportunities. The pandemic is a good example of this. However, for investors to navigate these macro-shocks, it is paramount to build a diversified portfolio and ensure access to top-tier managers with proven ability to generate outperformance across cycles.

Our hope is that this whitepaper will showcase why now is such a good time to make VC a valued part of your portfolio and how investors can benefit from its inclusion.

"To navigate macro-shocks, it is paramount to build a diversified portfolio and ensure access to top-tier managers."

1. https://www.eisneramper.com/venture-capital-2021-record-year-fs-blog-0122
2. https://apinstitutional.invesco.com/dam/jcr:1f35880c-bdf9-42ea-8afe-ab69b85bc7a4/The%20Case%20for%20Venture%20Capital.pdf
3. https://pitchbook.com/news/articles/2021-record-year-us-venture-capital-six-charts
4. The State of Venture, Global 2021, CB Insights

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1. Venture Capital: *a brief explainer*

“Venture capital is a game of home runs. It’s about banking on high growth from a select few investments.”

VC firms often look for rapidly growing, innovative, tech-focused startups, providing them with funding and mentorship in return for a minority equity stake. This is how many of today’s most prominent tech companies first received major funding. For example, Airbnb raised $7.8 million in a 2010 series A round from VC investors including Greylock and Sequoia Capital.[5]

One common misconception about VC is that it’s the first port of call for startups when it comes to investment. In reality, they have often raised funds from friends and family, or via crowdfunding. Later stage seed funding may even come from angel investors. Only once a startup is established will a VC enter the arena in the hope of an eventual exit via a high-value sale or IPO that provides a large return on its investment. Take Airbnb: at the time of its IPO in 2020, Sequoia Capital’s stake on an initial $260 million investment was reportedly worth around $4.8 billion.[6]

Despite highly publicised success stories like Airbnb’s, VC-backed companies still have a relatively low success rate. A 2018 study by CB insights tracked more than 1,100 VC-backed US startups that raised seed funding between 2008-2010 and found that fewer than half managed to raise a second round of funding. Just 15% went on to raise a fourth round of investment. Overall, roughly two-thirds of the companies ended up either failing or self-sustaining. And while the latter may prove good for the company, it isn’t necessarily an ideal outcome for investors eyeing a big return.[7]

For a VC investment to be considered a genuine success, the fund needs to generate around three times the investment - and it’s thought only 5% of venture-backed startups achieve that.[8] This is why VC is such a game of home runs. It’s about banking on high growth from a select few investments that generate enough of a return to cover the losses from all the others. This is why a good manager is so important. Unlike angel investing, where investors must do time-intensive due diligence on even earlier-stage startups on their own, top VC managers know the market and how to build a portfolio that generates enough home runs to more than make up for the strike-outs.

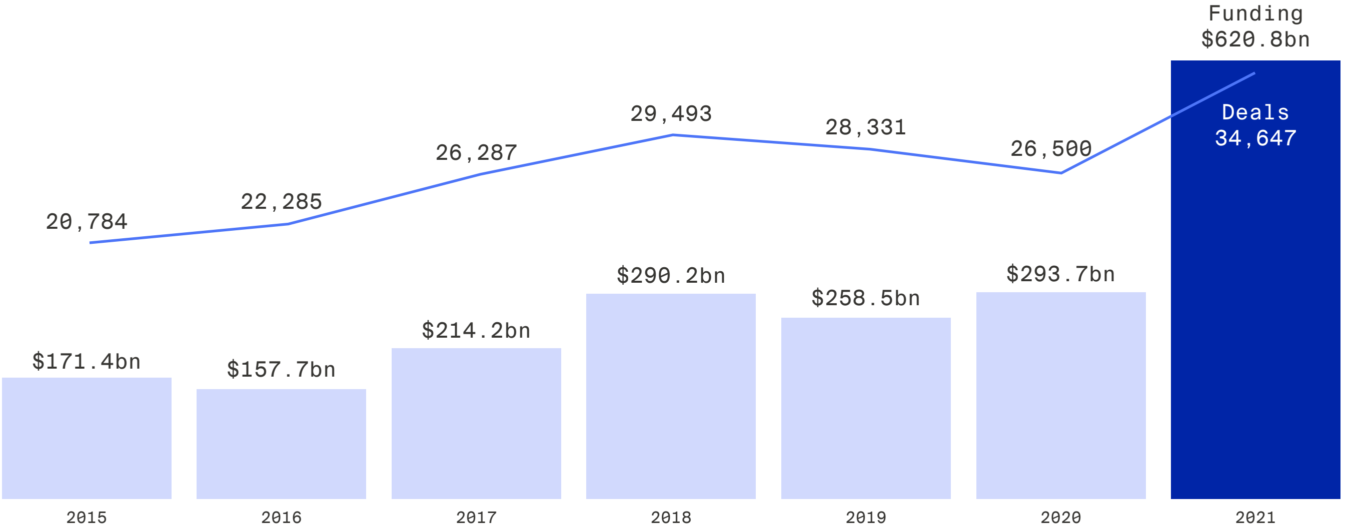
5. https://assets.airbnb.com/press/press-releases/Airbnb_PressRelease_11112010.pdf
6. https://www.theinformation.com/articles/airbnbs-biggest-ipo-winners
7. https://www.cbinsights.com/research/venture-capital-funnel-2/
8. https://techcrunch.com/2017/06/01/the-meeting-that-showed-me-the-truth-about-vcs/

2. 2021: a *record breaking year* for VC

In almost every way, 2021 was an incredible year for VC. Global venture funding hit a record breaking $621 billion in 2021, per CB Insights, more than double 2020's figure of $294 billion. While the valuations of VC assets under management (AUM) were up three-fold from just five years ago, rising from $547 billion in 2016 to $1.68 trillion in March 2021.[9]

Last year, 517 startups became 'unicorns'; that is, VC-backed companies worth $1 billion or more. This was up 69% from 2020. These new unicorns include sustainable home marketplace GoodLeap (valued at $12 billion), bitcoin and blockchain supporters Digital Currency Group ($10 billion) and crypto-exchange Gemini ($7.1 billion). And for the first time ever, there were over a thousand $100 million-plus global mega-rounds. These included five funding rounds that topped $2 billion such as electric manufacturers Cruise and Rivian and stock trading app Robinhood.[10]

Fig. 01 Global venture funding reached record-breaking heights in 2021



Source: CB Insights 2021

9. The State of Venture, Global 2021, CB Insights

Venture Capital 2021: a deeper look

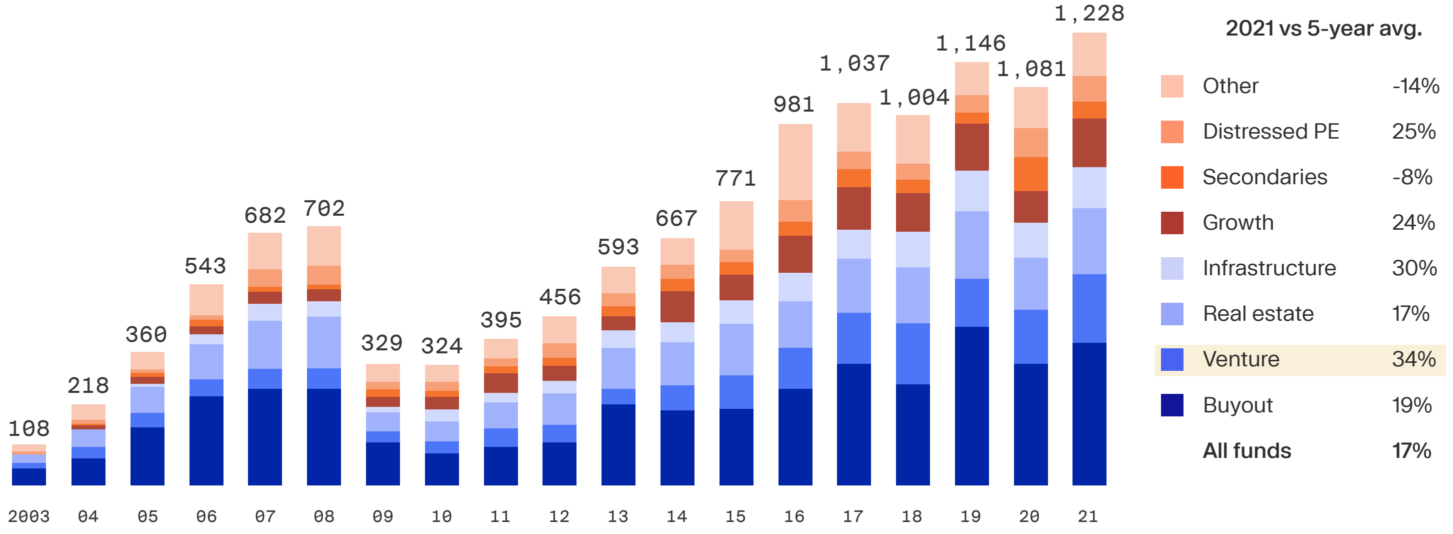
There are a number of reasons why venture markets in general saw record-breaking levels of growth last year. Increased liquidity worldwide, boosted by trillions of central bank stimuli pumped into the economy as an antidote to global lockdowns, benefited private investors immensely. This liquidity has been also bolstered by the arrival of high net worth individuals (HNWIs) into private markets, while a quiet start to 2021 left investors with record levels of dry powder to invest over the second half of the year.[11]

Unmatched fundraising

VC was a huge part of record-breaking fundraising in private markets.[12] Along with growth and infrastructure, it grew faster relative to its five-year average and Q4 of 2021 closed the year with an all-time high of $176 billion in funding – the sixth straight quarter of growth.[13]

Fig. 02 Private market investors flocked to venture capital funds in 2021

Global private capital raised, by fund type ($bn)



Notes: Buyout category includes buyout, balanced, coinvestment, and coinvestment multimanager funds; includes funds with final close and represents the year in which funds held their final close; excludes SoftBank Vision Fund

Source: Preqin 2022

10. https://news.crunchbase.com/startups/biggest-vc-startup-funding-deals-2021-cruise-rivian-robinhood/
11. https://www.pwc.com/us/en/industries/financial-services/library/private-equity-deals-outlook.html
12. https://www.bain.com/insights/private-equity-market-in-2021-global-private-equity-report-2022/
13. The State of Venture, Global 2021, CB Insights

Exits hit new heights

2021 was a strong year for VC exits too. The total value of VC-backed companies' exits reached a new high of $410 billion in the first three quarters of 2021. According to Preqin, 70% of exits were for financial services, healthcare, and information technology (IT) companies, mirroring the three sectors' fundraising success.[14]

IPOs are now the most prominent form of exit. In the first three quarters of 2021 alone, the proportion of start-ups that exited via IPO jumped to 28%, from just 14% in 2016[15]. This included six IPOs with valuations in the tens of billions of dollars, with number one being electric car manufacturer Rivian's November IPO. Valued at $66.5 billion, it launched at $78 a share, raising nearly $12 billion, with the company's VC backers including D1 Capital Partners and several corporate VC arms.[16] On the other hand, the largest trade sale of a VC-backed company in 2021 was for computer software company Nuance Communications, bought by Microsoft for $19.7 billion.[17]

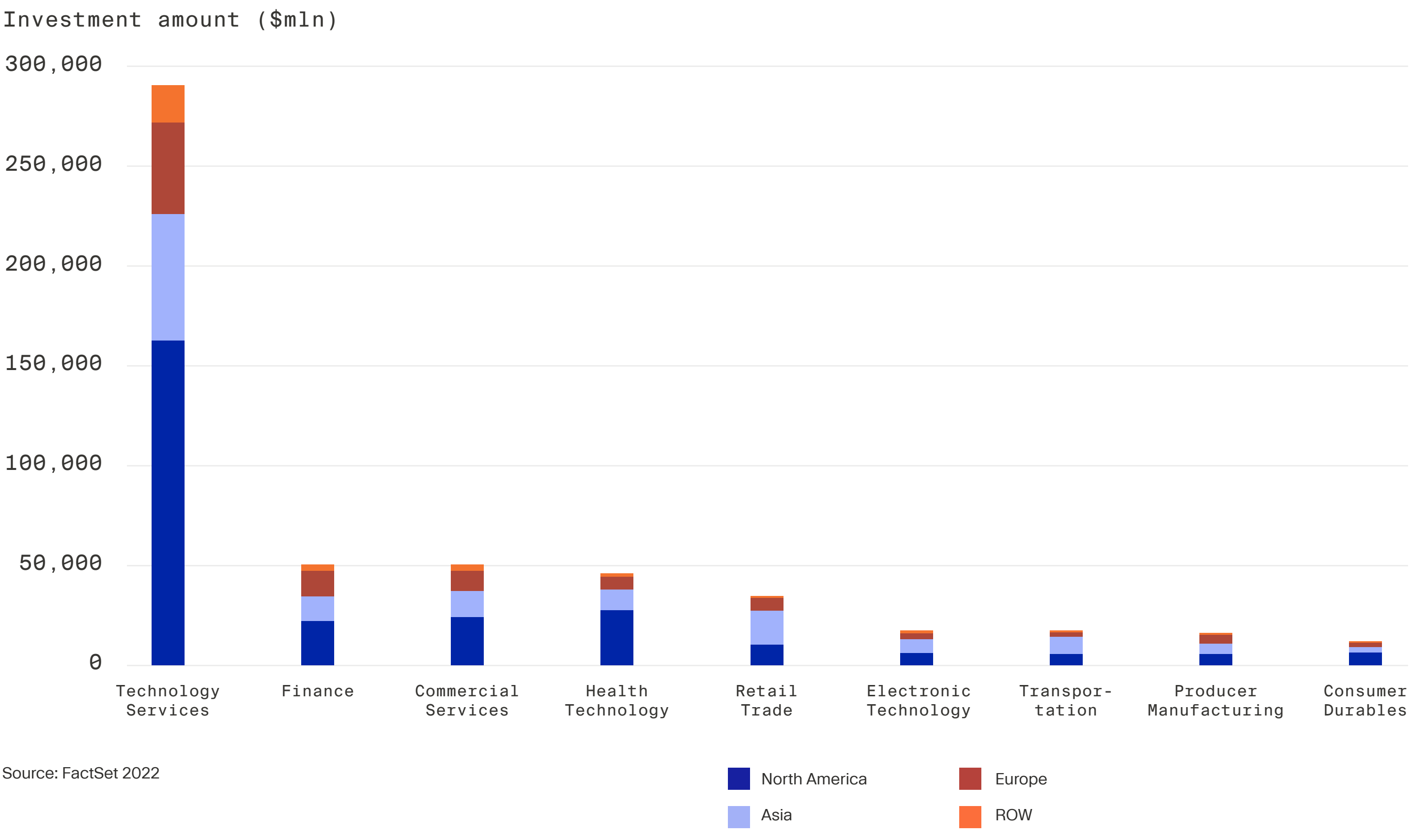
Tech thrives among sectors

Global VC investment into technology startups hit a record level of $675 billion in 2021, double the previous all-time high of $340.6B in 2020.[18]

Although technology was already a focal point for many VC investors, the pandemic accelerated digitalisation even faster which encouraged even more funding to come in. This includes companies such as edtech startup Newsela, which provides online textbooks. The company opened up its services for free during the pandemic, giving it a huge boost. It became a unicorn in 2021 following a $100 million series D.[19]

Fig. 03 Technology is a clear focal point for VC investors

Top venture capital sectors globally, in 2021



Source: FactSet 2022

14. 2022 Preqin Global Venture Capital Report, Preqin
15. 2022 Preqin Global Venture Capital Report, Preqin
16. https://www.investopedia.com/rivian-ipo-what-happened-and-why-it-matters-5209505
17. https://news.microsoft.com/2021/04/12/microsoft-accelerates-industry-cloud-strategy-for-healthcare-with-the-acquisition-of-nuance/
18. https://www.adgully.com/global-tech-vc-investment-in-startups-hits-record-high-of-675b-in-2021-113161.html
19. https://techcrunch.com/2021/02/25/newsela-the-replacement-for-textbooks-raises-100m-and-becomes-a-unicorn

Pandemic puts focus on healthcare investing

VC investments into healthcare in the US and Europe exceeded $80 billion, beating 2020's record by more than 30%. This follows a trend which has seen investment into healthcare companies double every two years since 2017, from $16 billion to $34 billion to over $80 billion last year.[20]

Biopharma firms were the biggest benefactor and were involved in three of 2021's top ten largest series A raises across all sectors. Neumora Therapeutics ($500 million), Odyssey Therapeutics ($218 million) and Avistone Pharmaceuticals ($200 million) focus on brain diseases, cancer and inflammatory diseases and oncology, respectively.[21]

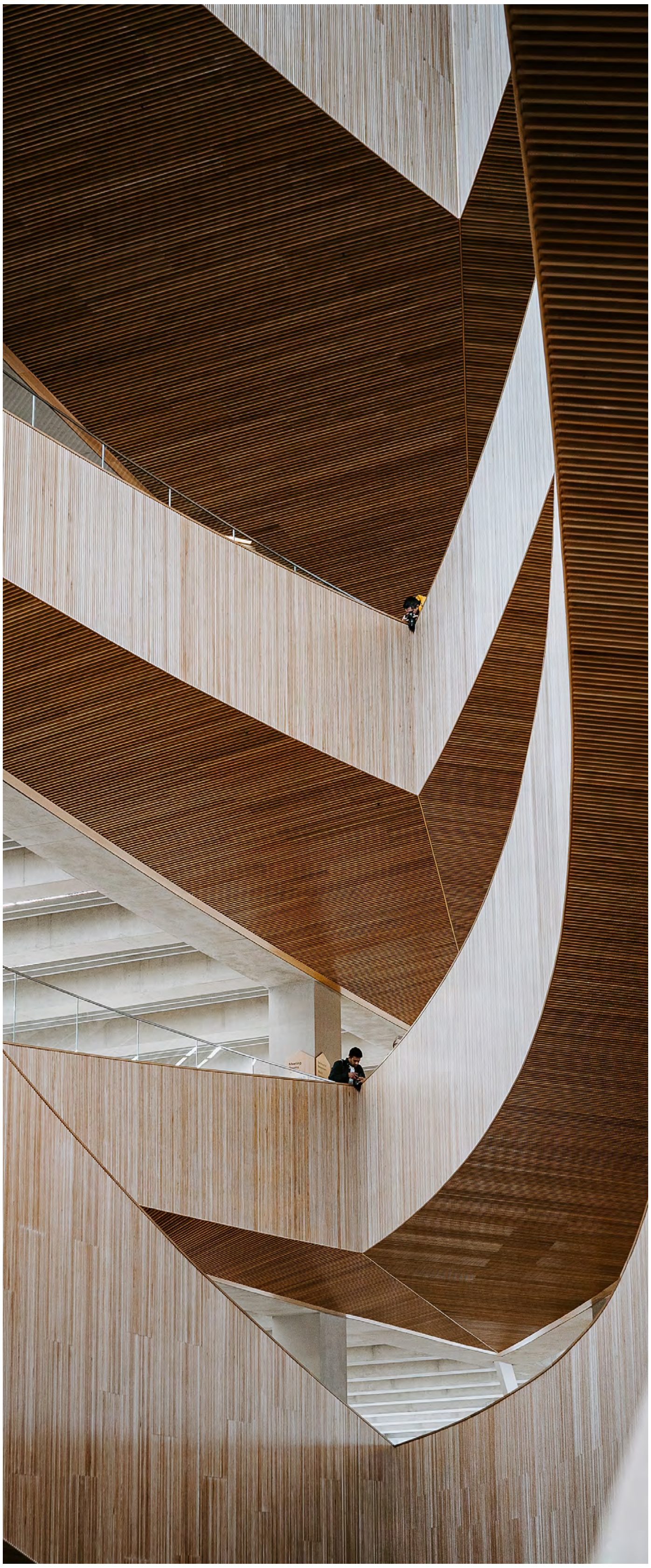
Fintech funding continues to fly

The pandemic's ability to accelerate digital transformation across industries was certainly seen in financial services. In 2021, fintech firms raised $132 billion in funding, accounting for 21% of all venture dollars. In addition, one in every four unicorns is in fintech — the most by far of any industry.[22]

Notable funding rounds included Dutch payments provider Mollie's $800 million series C which saw the company valued at $6.5 billion. By June 2021, the company was on track to double its number of processed payments from $10 billion in 2020 to over $20 billion, prompting Blackstone Growth, EQT Growth, General Atlantic and TCV to invest.[23] The company also saw a 51% increase in buy now, pay later transactions[24] (BNPL) as online shopping surged during the pandemic.[25]

VC opens up to new geographies

The pandemic further emphasised the increasingly international nature of the asset class. Suddenly, startups close to traditional investment hubs possessed less of an advantage as meetings transferred from in-person to online. With this, the number of cross border VC deals increased dramatically. For example, US VCs invested $78.5 billion into European and Israeli startups

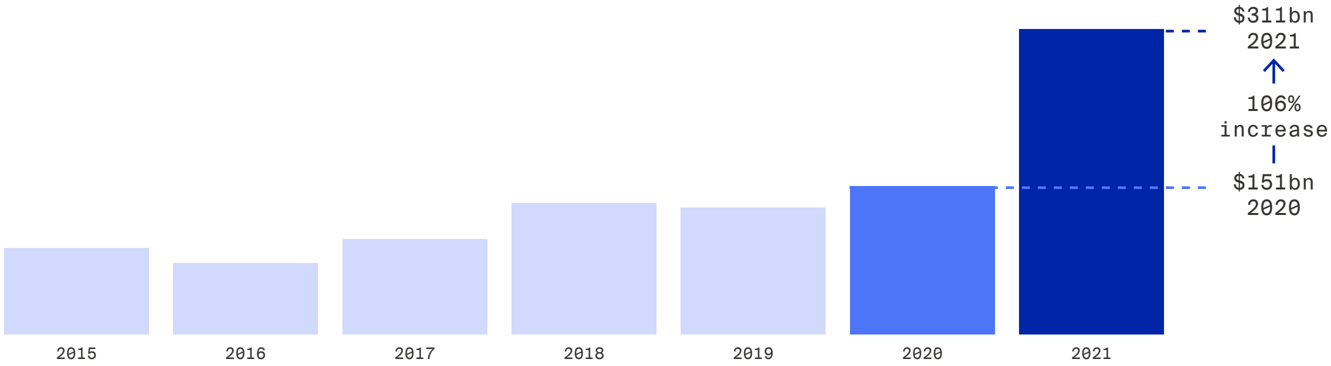


20. https://www.svb.com/trends-insights/reports/healthcare-investments-and-exits
21. https://www.svb.com/trends-insights/reports/healthcare-investments-and-exits
22. 2022 Preqin Global Venture Capital Report, Preqin
23. https://pitchbook.com/newsletter/fintech-company-mollie-worth-65b-with-series-c-tIE
24. https://www.mollie.com/en/news/post/mollies-black-friday-payment-data-reveals-51-increase-in-bnpl-usage
25. https://www.cnbc.com/2021/12/04/buy-now-pay-later-boom-shows-no-signs-of-slowing-this-holiday-season.html

(the two are often grouped together as one region), a 194% increase from 2020.[26]

US based startups continued to receive the most money per year, however, raising over $300 billion in 2021, around half the world's total of $621 billion. Elsewhere, Asian firms raised $174.4 billion from VCs, while European and Israeli startups collected €102.9 billion, an almost 120% increase from 2020.

Fig. 04 US continues to dominate global VC funding



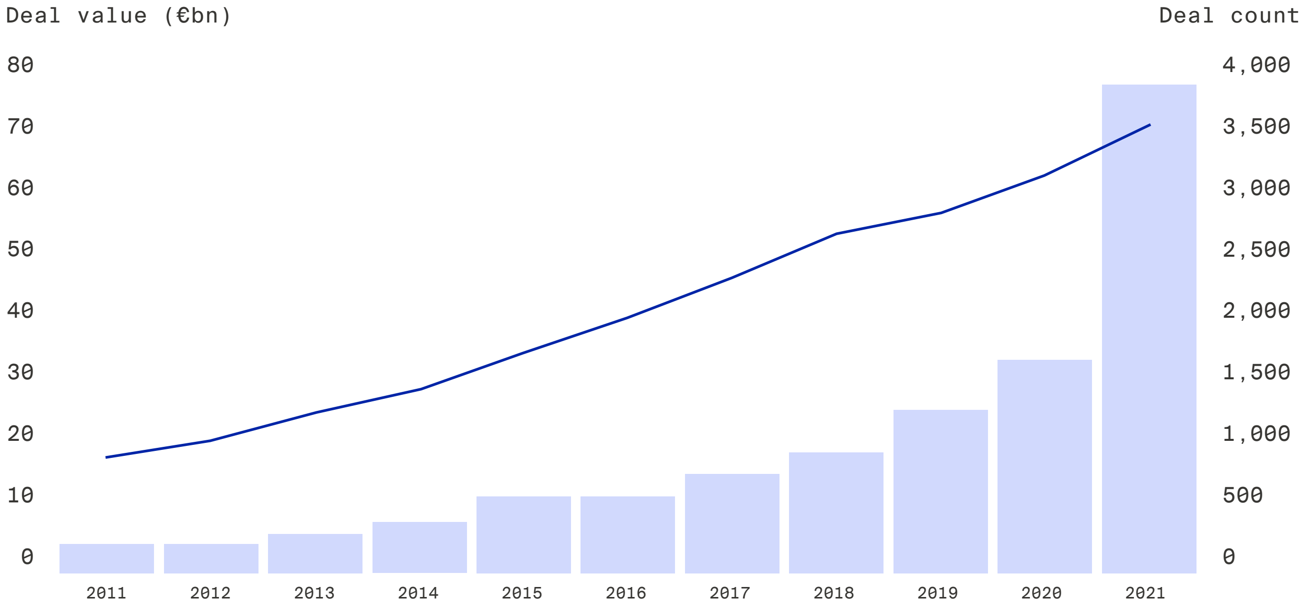
Source: CB insights 2022

The dominance of the US was further enhanced by a huge increase in non-traditional investors (NTIs)—such as mutual funds and sovereign wealth funds (SWFs)—entering the VC space. A record number of NTIs were involved in over $200 billion worth of U.S. VC deals.[27] Meanwhile, global VC investments from SWFs surged by 81% to a record $18.2 billion and reached over 30 countries. Of those 328 investments, 120 still went to Silicon Valley.[28]

NTIs flocked to European VC as well, with VC deal value with NTI participation hitting a record €78.4 billion in 2021.

26. https://pitchbook.com/news/articles/2022-us-vcs-europe-deals
27. https://pitchbook.com/news/articles/2021-record-year-us-venture-capital-six-charts
28. https://globalswf.com/reports/2022annual

Fig. 05 Non-traditional investments in European VC surged in 2021



Note: Nontraditional investors are defined by PitchBook as including PE investors, mutual funds, sovereign wealth funds, hedge funds, corporations and family offices.

Source: PitchBook

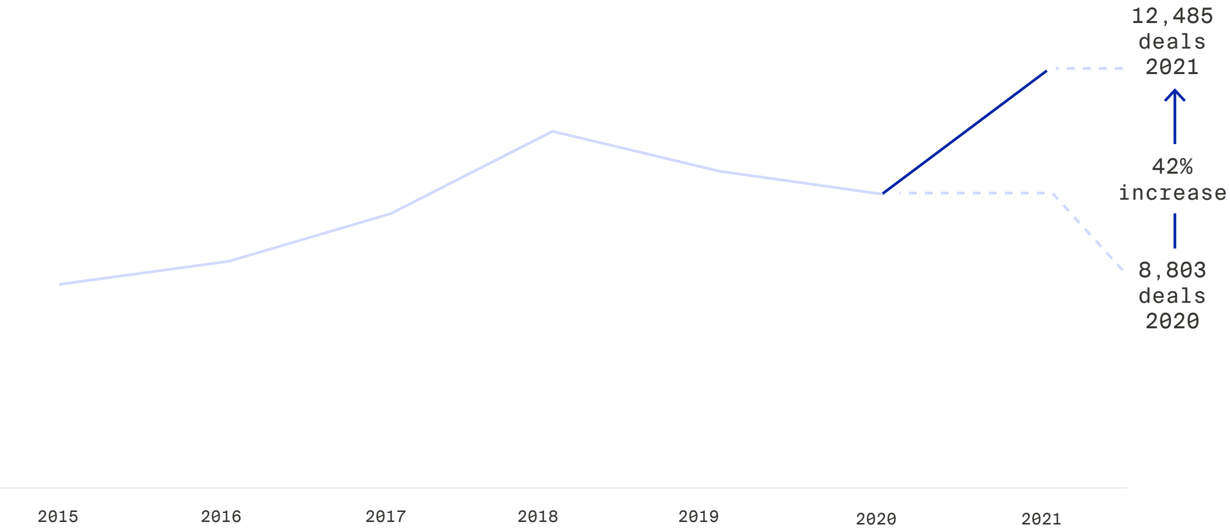
Asia is also seeing an emergence of non-traditional investors in VC, led primarily by family offices. For example, Singapore's JL Family Office set up Odyssey Venture Holdings, a VC division, in September 2020, to invest in Singapore and US early-stage funds. While Shanghai-based Gopher Asset Management, the alternatives unit of family office Noah Holdings, backs series C and later rounds.[29]

This surge is likely down to the ever-longer venture cycles. The elongation of this process means many later-stage investments become out of reach for most traditional VC funds, leaving a gap for larger institutional investors, such as SWFs, to fill. This also provides NTIs access to VC-backed companies pre-exit, potentially allowing them to capitalise on a startup's faster pace of growth. Indeed, the average global IPO valuation rose from $500 million in 2015 to $3 billion in 2021. Non-traditional investors who wait for an IPO could miss out on billions in valuation growth.[30]

In terms of deal share, Asia was the 2021 VC leader with 36% of investments. Asia's 12,485 deals meant it surpassed the US's deal count for the first time in seven years. The region as a whole is increasingly attractive for VCs and has created a number of its own innovation hubs in cities such as Beijing, Bangalore, Shanghai and Singapore.[31]

29. https://www.businesstimes.com.sg/garage/asean-startups-shine-with-asia-pacific-vc-deals-set-to-surpass-us152b-record
30. https://investableuniverse.com/2021/04/15/non-traditional-investors-pitchbook-venture-capital-q1-nvca-mega-deals/
31. 2022 Preqin Global Venture Capital Report, Preqin

Fig. 06 Asia sees most VC deals of any region in 2021

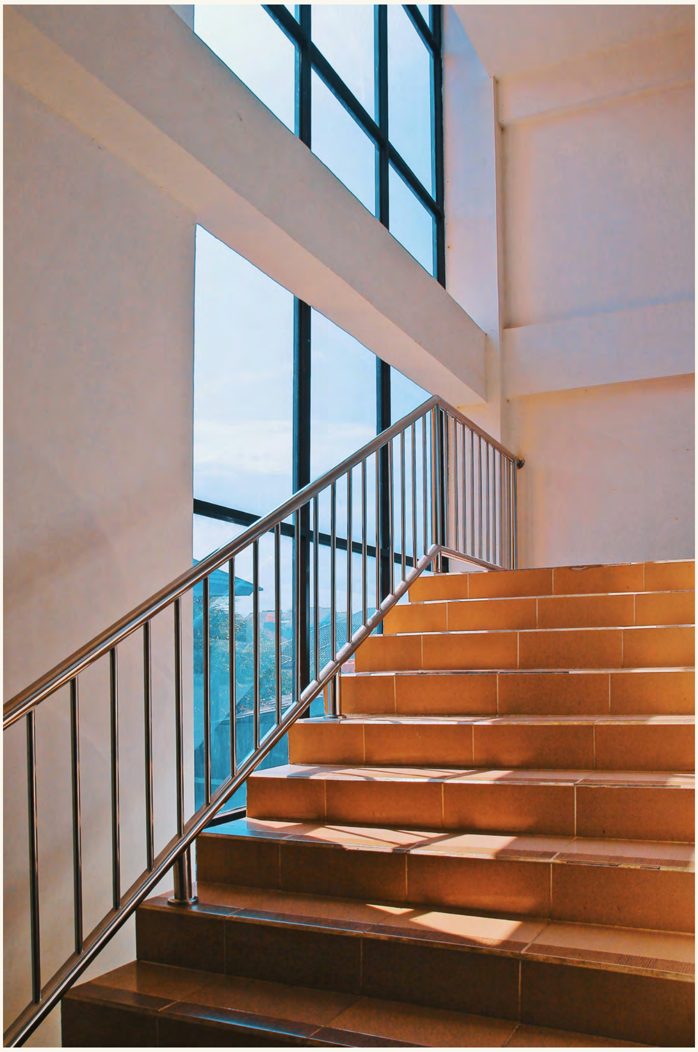


Source: CB insights 2022

A growing middle class—and thus, a growing consumer class—has boosted technological innovation and, as such, a number of the region's leading startups are consumer facing. This includes Neso Brands, a Singapore-based subsidiary of Indian eyewear e-commerce Lenskart, which completed a $100 million funding round in May 2022. As further evidence of the increasingly global nature of VC and non-traditional investors, backers of the raise included notable global firms including firms KKR and Alpha Wave Global and Singaporean SWF Temasek.[32]

32. https://www.techloy.com/indian-eyewear-company-neso-brands-raises-100-million/

3. The *lifecycle* of a VC-backed startup



Supporting companies in their formative stages grants VC investors access to a growing part of the economy that is not usually accessible through traditional markets. In addition, as equity investors, it gives them significant say in shaping the company's future from product development to future funding rounds, en route to hopefully a successful and profitable exit. It also provides VCs with networking opportunities to meet other founders and potentially find future investment opportunities.

These two case studies, WhatsApp and Samsara, demonstrate two examples of that lifecycle, ending with a trade sale and IPO.

WhatsApp

Case study: WhatsApp

Looking back, the investment history of WhatsApp does not suggest the makings of a now-ubiquitous messaging service that would go on to be acquired in what is still history's biggest takeover of a VC-backed startup.

Other than initial angel backers, founders Brian Acton and Jan Koum received outside investment from just one VC firm, Sequoia Capital, from its founding in 2009 through to the 2014 $19 billion Facebook deal. In the end, Sequoia walked away with a reported $3 billion on the $60 million invested. Sequoia has previously invested in AirBnB, Instagram and most recently Stripe, highlighting the persistence of top tier managers.

The deal raised eyebrows when it was first announced. WhatsApp had recently made a net loss of $232.5 million. However, it was the rapid growth of the company - in 2014 it was bringing in over a million new users a day - and its high global usage in regions Facebook was struggling to reach that caused the social media giant to go all in on WhatsApp.[33]

WhatsApp timeline - from investment to exit[34]

2009
Founders raise $250,000 via friends and family.

2011
VC firm Sequoia Capital invests $7 million in series A round.

2013
Sequoia invests another $50m in series B round, valuing WhatsApp at $1.5 billion. Sequoia's stake is now estimated to be around 18%.

2014
Facebook acquires WhatsApp for $19.6 billion, its largest acquisition to date. Sequoia makes a reported $3 billion from the exit.

33. https://www.investopedia.com/articles/investing/032515/whatsapp-best-facebook-purchase-ever
34. https://www.crunchbase.com/organization/whatsapp/company_financials

Case study: Samsara

Founded in 2015, Samsara offers businesses a cloud based platform for Internet-of-Things devices such as video cameras and data collection devices.

It was one of the VC success stories of 2021 when it went public after seven initial private funding rounds, picking up multiple investors along the way.

Prior to its IPO, Samsara reported annual recurring revenue (ARR) of $492.8m compared with $293.1 million in the year previous. ARR is a metric often used by software-as-a-service companies to show how much revenue the company can expect based on subscriptions.[35]

This level of potential saw some of the world's most prestigious VC firms invest including its primary investor Andreessen Horowitz (a16z). By the time Samsara went public in 2021, a16z owned almost 10% of the company.[36]

Samsara timeline - from investment to exit[37]

May 2015
a16z invests $25m in series A round.

December 2016
a16z invests a further $15 million in series B round.

January 2017
General Catalyst leads a $40 million series C round, joined by a16z and Samsara's founders.

March 2018
General Catalyst and a16z invest a further $50 million in a series D round.

December 2018
The same investors team up to provide Samsara $100 million in additional funding. Following the investment, Samsara is valued at $3.6 billion.

September 2019
General Catalyst and a16z are joined by investors including Dragoneer Investment Group for a growth equity round that raises $300 million, valuing the business at $6.3 billion.

May 2020
Samsara raises a further $400 million that sees the existing VC investors joined by several larger investors including Warburg Pincus, Franklin Templeton and AllianceBernstein.

December 2021
Samsara announces terms for an IPO, with plans to offer 35 million shares at $20 to $23 each. The company raises $805 million.

35. https://www.marketwatch.com/story/samsara-ipo-5-things-about-the-cloud-based-operations-company-11639435572
36. https://www.bloomberg.com/news/articles/2021-12-15/samsara-rises-in-trading-debut-after-ipo-fetches-805-million
37. https://www.crunchbase.com/organization/samsara-2/company_financials

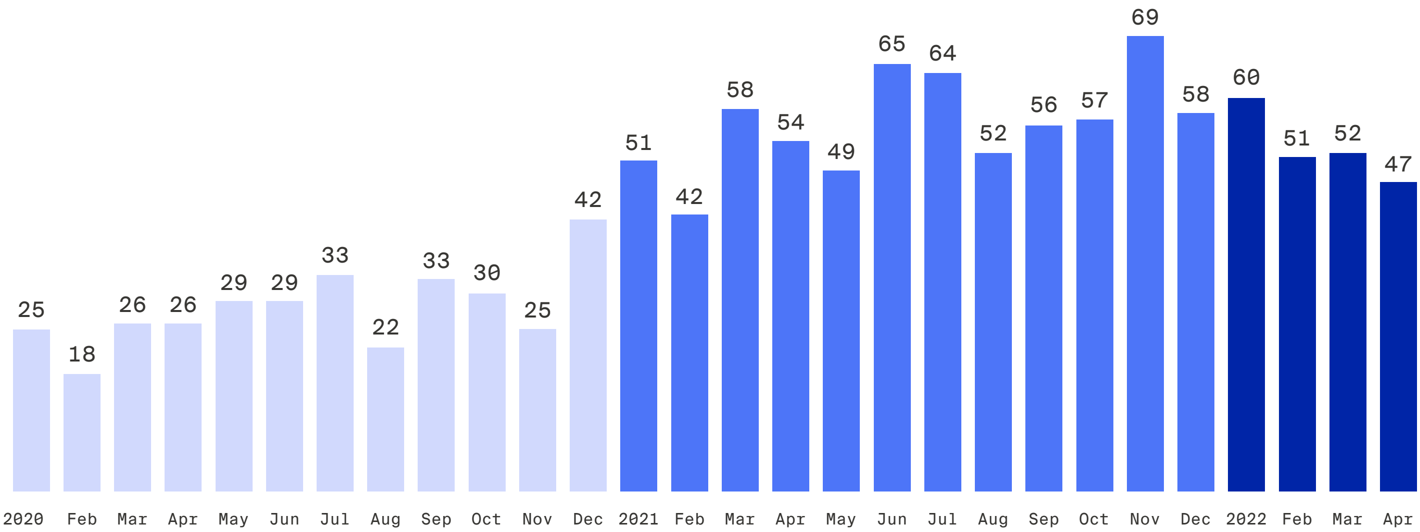
4. Venture Capital in 2022 *and beyond*

Investing momentum to continue at a healthier pace

On almost every level, 2021 was a phenomenal 12 months for VC; and also quite clearly an outlier. Per PitchBook, if the pace of dealmaking for the final six months of 2021 was extrapolated for a full year, the total deal value would have outstripped the existing dry powder for all funds at the time.[38] This isn't sustainable and as we go through 2022, a drop off from last year has been inevitable.

Fig. 07 Venture capital funding slows down in 2022

Global funding by month through April 2022 ($bn)



Note: Includes seed, venture and private equity for venture-backed companies

Source: Techcrunch 2022

38. https://pitchbook.com/news/articles/2021-pe-deals-tech-20-year-high

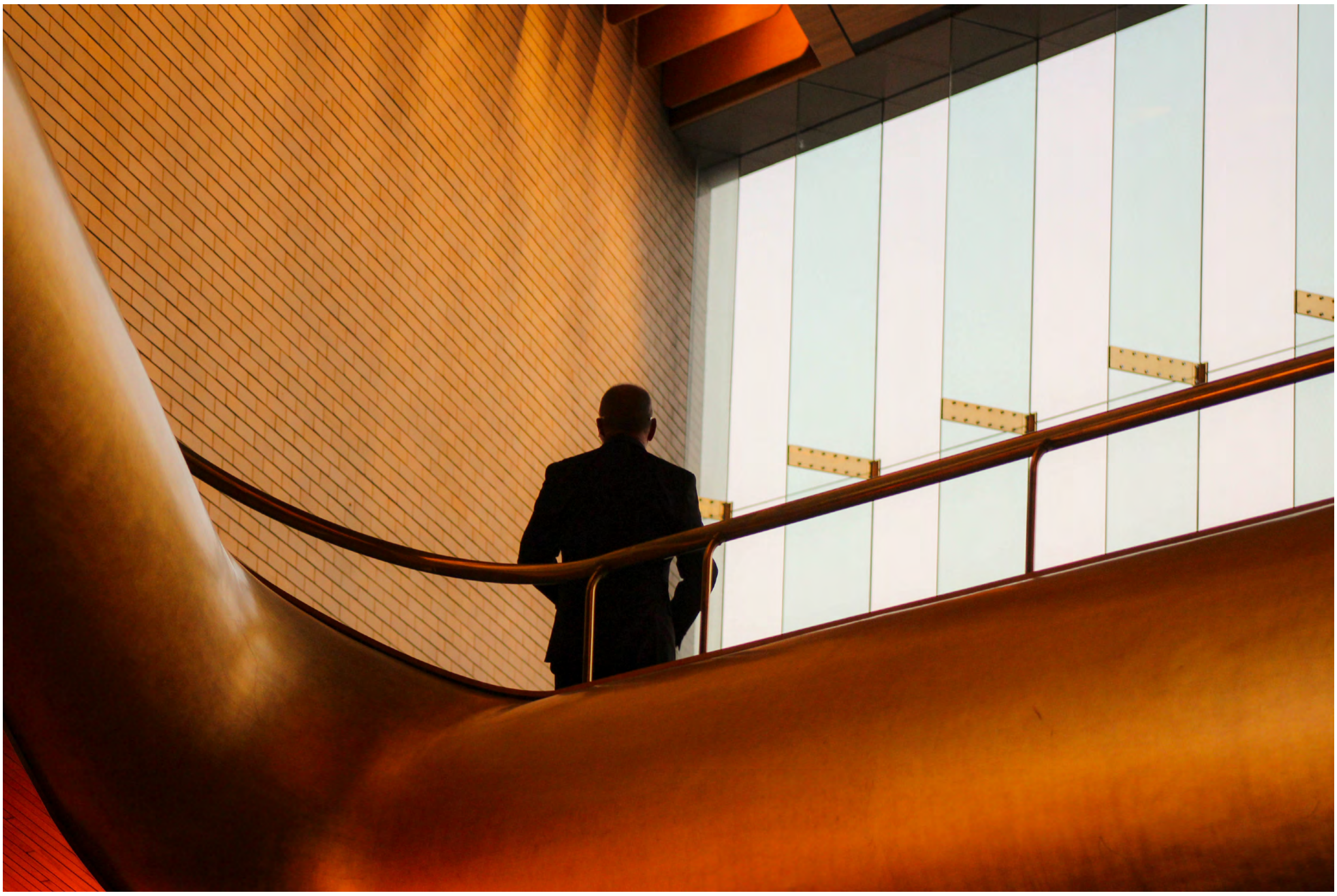
But there are wider reasons to be cautious. The war in Ukraine, rising inflation and interest rates, turbulence in the global capital markets, and ongoing supply chain challenges are all contributing to a slowdown in investment activity. In turn, this is causing VC investors to be increasingly wary.

Plus, this is all taking place against a backdrop of declining public market performance. This has naturally impacted venture capital deal sizes and valuations, especially for pre-IPO companies given the relatively muted exit environment and its proximity to public market valuations. As such, new unicorn births in Q2 of 2022 are on pace to reach 62, the lowest quarterly total since 2020.[39]

Despite this, we believe there are more reasons to be optimistic than pessimistic. Underlying secular trends around the importance of software and technology have remained incredibly strong. This is good news for VC investors on the search for new innovators. Although the world is hopefully entering the final days of the pandemic, our level of reliance on software and internet technology is bound to continue. Therefore VC investing should maintain momentum as the digital transformation continues at pace.

In addition, ongoing macroeconomic concerns could foster an environment that allows for large amounts of capital to be invested but in a potentially healthier valuation environment.

“VC investing should maintain momentum as digital transformation continues at pace.”



39. https://www.cbinsights.com/reports/CB-Insights_Venture-Report-Mid-Q2-2022.pdf

Key sectors to watch

Cybersecurity

The increasing importance of technology in most facets of our lives has, in turn, heightened focus on protecting people from being targeted by criminals for online theft or fraud, making cybersecurity more critical than ever. The aggregate deal value in the cybersecurity sector surged from $5.9 billion in 2016 to almost $13 billion in the first three quarters of 2021.[40]

With the global cost of cybercrime forecasted to reach $10.5 trillion by 2025, it's understandable why VCs are keen to back companies potentially offering solutions in this sector.[41] The first quarter of 2022 already saw $6 billion invested into cybersecurity startups, with 17 nine-figure rounds and three rounds of a quarter-billion dollars or more.[42] This included Texas start-up Securonix, a cloud-based security specialist, which raised over $1 billion from Vista Equity Partners in February.[43]

Web3

Web3 technology focuses primarily on blockchain technology and cryptocurrencies. It's deemed to be the third iteration of the internet. In our view, increased financial literacy and the continued adoption of blockchain infrastructure and cryptocurrencies will generate attractive opportunities for VC investors looking to inject capital into Web3 ventures.

In Q1 of 2022, $9.2 billion was invested in Web3 startups.[44] This included a number of mega rounds such as crypto infrastructure company Fireblock's $550 million series E. The round was led by D1 Capital Partners and Spark Capital.[45]

On top of this, Web3 startups have managed to avoid the valuation drops impacting consumer facing startups.[46] As of April 2022, late-stage post-money valuations for VC-backed cryptocurrency and blockchain companies had climbed 91% on average, to $3.95 billion. In contrast, average global late-stage VC valuations had fallen to $697.6 million—a drop of 14%.[47]

Enterprise Technology

The pandemic has accelerated technology adoption globally. This disruption has resulted in wider cloud adoption and the influence of AI. Indeed, research from Gartner forecasts that IT spending focused on enterprise software will grow by $672 billion this year, an uptick of around 11%.[48] We believe the Enterprise Technology sector will be highly attractive to VC investors, while the global shift to subscription-based revenue models speaks for more resilient revenue generation in the future.

In Q1 of 2022, we have seen a number of mega rounds, including a global logistics platform Project44. The supply chain specialist raised $420 million in its series F, in a round led by Thoma Bravo, TPG and Goldman Sachs Asset Management.[49] Specialist funds in the space also popped up, with Amazon launching its $1 billion Industrial Innovation Fund to invest in logistics startups.[50]

> "Enterprise technology will be highly attractive to VC investors as companies shift to more resilient subscription-based revenue models."

Artificial Intelligence (AI) and Machine Learning (ML)

In our view, with the ever-increasing computational power and the proliferation of structured data, AI and ML have the potential to generate outsized returns over the next few years. This is because almost all industries will be using it to enhance their products' capabilities.

40. 2022 Preqin Global Venture Capital Report, Preqin
41. https://cybersecurityventures.com/annual-cybercrime-report-2020/
42. https://news.crunchbase.com/cybersecurity/cyber-vc-funding-q1-2022-monthly-recap/
43. https://news.crunchbase.com/news/cyber-vc-funding-q1-2022-monthly-recap/
44. https://www.cbinsights.com/research/report/blockchain-trends-q1-2022/
45. https://www.blog.cointracking.info/top-crypto-vc-rounds-in-2022
46. https://medium.com/torre-capital/valuation-reset-who-are-the-gainers-and-losers-90957a5ec27
47. https://pitchbook.com/news/articles/crypto-blockchain-startups-venture-capital-valuations
48. https://www.networkworld.com/article/3648533/worldwide-it-spending-to-reach-45-trillion-in-2022-gartner-forecasts.html
49. https://www.prnewswire.com/news-releases/project44-receives-420-million-investment-led-by-thoma-bravo-tpg-and-goldman-sachs-valuing-business-at-2-2-billion-pre-money-301458551.html
50. https://www.geekwire.com/2022/amazon-launches-1-billion-industrial-innovation-fund-here-are-the-first-startups-to-land-cash/

For example, all of the top three cybersecurity funding rounds were for companies that used machine learning in some way.

In October 2021, Cloudera, an enterprise data cloud company with services that uses machine learning-enabled analytics, was sold to private equity firms Clayton, Dubilier & Rice, and KKR for $5.3 billion.[51]

It will even have an impact on the VC that powers these startups. Today less than 5% of VCs use AI algorithms to inform their investments. This is predicted to rise to 75% by 2025.[52]

Key trends to watch

Companies continuing to stay private for longer

VC-backed companies staying private for longer isn't new. The average age of companies going public over the last 10 years has been 12. Between 1997 and 2001, it was 5.5.[53] This important trend looks set to continue which is potentially good news for VC investors. Companies like Uber and Airbnb stayed private for over 10 years before filing for an IPO, with a large share of profits captured by private investors.

Valuations to come back down to earth

Valuations hit record highs in 2021. The year ended with 517 unicorn births, driven primarily by rapidly rising valuations at late-stage deals. As of January 2022, there were 44 decacorn startups - meaning they are valued at upwards of $10 billion - across the world.[54] In 2020, there were just 15.[55] However, many VC managers believe these valuations are overblown - inflated by the hope a start-up could be the next Uber or Airbnb.

A public market downturn in 2022 is having an impact on private market valuations and this is already being reflected in VC funding rounds. From the last two months of Q4 2021 to the first two of Q1 2022, the average Series A dropped by roughly $5m, series B by $13m and series C by $15m.[56]

This isn't great news for startups, but as already mentioned, could create a healthier investment environment for VCs as lower valuations at entry can mean favourably-priced deals, with the expectation that valuations will pick up again over the coming years and still result in solid exits for investors.

> "Lower valuations at entry can mean favourably priced deals, potentially resulting in solid exits for investors."

War in Ukraine to have an impact

While the pandemic created a headwind for VC investment, pulling in the other direction is Russia's invasion of Ukraine - especially for European investment and exits. After a blockbuster year for European IPOs, Russia's invasion of Ukraine depressed the potential for listing activity in the region.

We predict that new listings activity will stay muted until later in the year. However, broad secular trends such as digitalization and the energy transition will provide further impetus for new listings. As long as volatility eases, listings should return to European markets, just as they did following the pandemic's initial impact. The global IPO market dipped heavily during the first half of 2020, before picking up strongly in the second half of the year.

51. 2022 Preqin Global Venture Capital Report, Preqin
52. https://techcrunch.com/2022/04/24/deep-science-ai-simulates-economies-and-predicts-which-startups-receive-funding/
53. https://news.crunchbase.com/news/investing-early-late-startup-venture/
54. The State of Venture, Global 2021, CB Insights
55. https://news.crunchbase.com/news/decacorn-startups-2021-global-record-data-charts/
56. https://techcrunch.com/2022/03/16/new-data-shows-how-far-vcs-are-pulling-back-on-us-series-a-b-and-c-valuations/

5. *Portfolio benefits* of Venture Capital

When you look at the major successes of VC-backed startups such as WhatsApp, Uber and AirBnB, which are outlier success stories, there is one clear benefit to adding VC to your portfolio: larger return potential. But the benefits go much deeper than that. And with the right management and due diligence, the asset class can prove a far more resilient, persistent and valuable portfolio component than often thought.

Larger return potential for just a little more risk

VC, growth equity and buyout returns are by no means equal. This means investors can add VC investments to an existing portfolio and adjust the risk-return ratio based on their own individual appetite for risk - the higher the risk, the higher the potential reward.

For investors willing to take on only slightly more risk than other private market investments, the return potential of top quartile VC is considerably larger.[57] As such, top quartile absolute returns for VC have historically exceeded those for other asset classes.[58] Nevertheless, it's important to keep in mind that investing in new ventures involves a high level of uncertainty and a high risk of failure.

Fig. 08 Venture capital has delivered historically outsized returns

Top quartile (%)

Assets	5-year	10-year	15-year	20-year	25-year
Venture capital	48	38	29	92	57
Private equity	25	22	27	31	31
Real estate	27	24	26	24	24
Large-cap equity	12	7	5	8	10
High yield bonds	5	6	7	6	8
Aggregate core bond	4	5	5	5	6

Notes: Private equity asset class excludes venture capital. 5-, 10-, 15-, 20-, and 25-year returns representative of average pooled IRR for vintages dating back from 2014. Top quartile returns for all asset classes shown. Large-cap equity proxy is Lipper aggregated US large-cap equity fund performance. High yield bond proxy is Lipper aggregated high yield bond fund performance. Aggregate core bond proxy is Lipper aggregated core bond fund performance. Returns as of Dec. 31, 2015. Sample size for each asset listed is as follows: venture capital: 91-440; private equity: 174-630; real estate: 71-207; large-cap equity: 62-674; high yield bonds: 30-421; and aggregate core bond: 22-385. Past performance is not a guarantee of future results.

Source: Cambridge Associates Global Venture Capital, Global Private Equity, and Global Real Estate Benchmarks Return Report

57. Harries, R. S., Jenkinson, T., Kaplan, S. N., & Ruediger Stucke. (2020). (working paper). Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds (pp.30-33). Chicago: Becker Institute for Economics at UChicago.
58. https://apinstitutional.invesco.com/dam/jcr:1f35880c-bdf9-42ea-8afe-ab69b85bc7a4/The%20Case%20for%20Venture%20Capital.pdf

Early stage investments can get you ahead of the game

By its very nature, early stage VC investment fuels innovation and economic growth. VC investment means simultaneously capturing the broad set of next-generation structural trends while staying at the forefront of innovation. In the long run, this can also act as a diversifier against more traditional business and declining sectors.

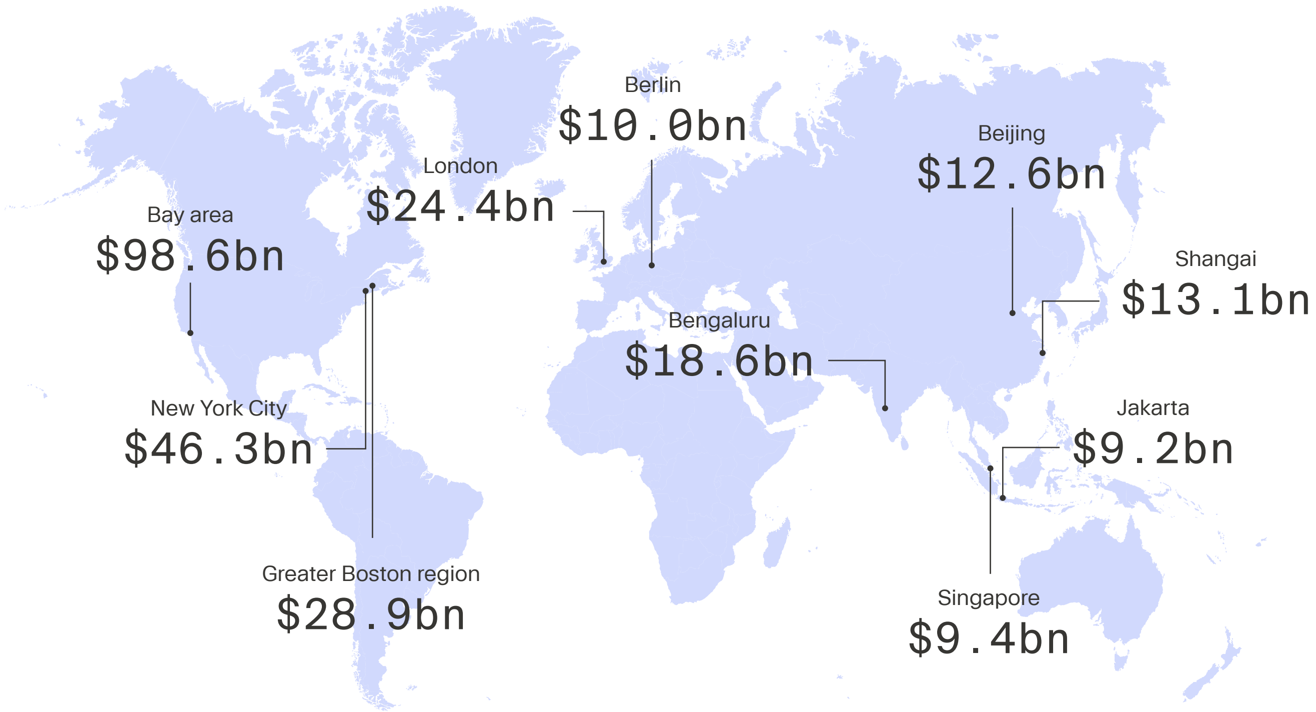
Plus, where other investments may be at the mercy of global disruption, VC often thrives. The pandemic is a good example of this. Startups that solved the logistical problems Covid-19 inflicted on our lives did particularly well. Look at companies like Hopin, the virtual events startup. It was only founded in 2019 and by 2020 had just eight employees. Hopin is now valued at $7.75 billion after raising $450 million in funding.[59] Elsewhere, grocery delivery startup Gorillas completed a $1 billion funding round in 2021 after being founded just over a year before.[60]

VC is now a global opportunity

VC is no longer Silicon Valley-centric. It has gone global, which allows for further diversification opportunities. Not considering VC now means forgoing exposure to disruptive and innovative companies which have the potential for huge returns, albeit with higher risk.

Fig. [09] Venture capital is now a global opportunity

Comparing the total VC funding in top cities around the world, 2021



Source: dealroom.co, Finshots

59. https://www.cnbc.com/2021/08/05/virtual-events-startup-hopin-valued-at-7-75-billion.html
60. The State of Venture, Global 2021, CB Insights

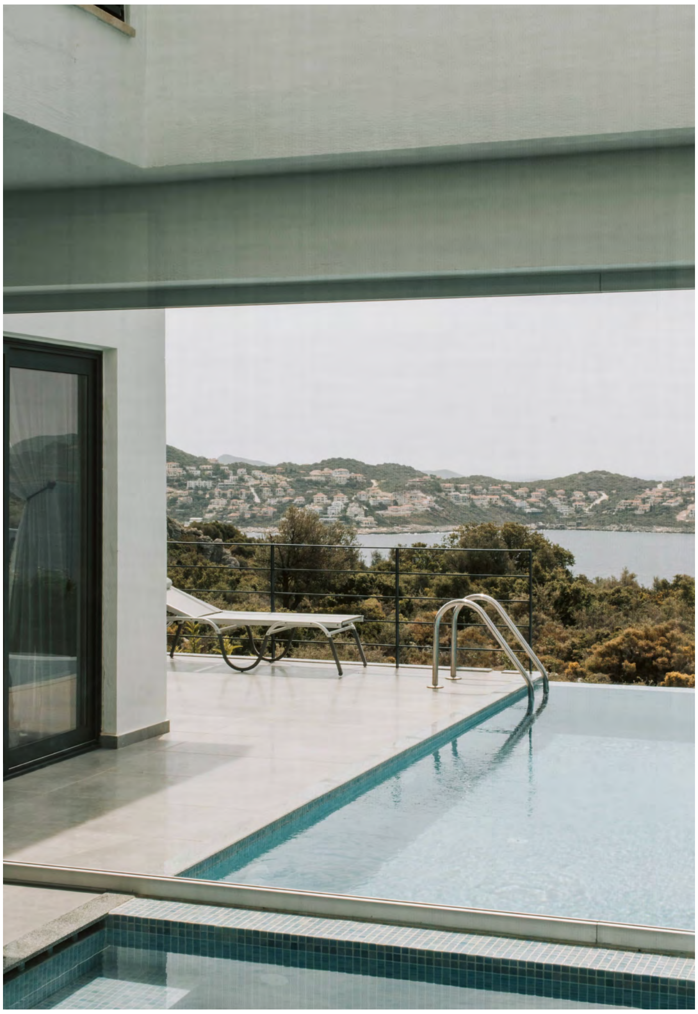
The VC industry is also very deep and the opportunity set is consequently very high. In the US alone, there are over 700 funds in action,[61] while global venture funding reached a record $621 billion in 2021.[62] These numbers speak for intense activity and thriving innovation, but also mean the performance dispersion can be incredibly high.

Access to top-tier managers vital for persistent returns

Despite all of the above, VC is still a high-risk investment and requires a particularly high level of experience and expertise. Rigorous selection of VC managers is therefore vital. VC managers' performance tends to show persistence over successive funds, so gaining access to top-tier VC firms increases the chances of outperforming the overall market and mitigating against strong dispersion. For subsequent funds, the top-quartile are expected to continue outperforming the market and have a 45% probability to remain in the first quartile and 69% probability to perform above the median.[63]

This is even more the case as industry focus shifts further towards specialisation. With early stage tech-investment the driving force behind VC's current boom, a genuine high-level of understanding is vital to succeeding in such a deeply competitive space.

The same goes for strategy. As VC-backed companies continue staying private far longer, the industry has expanded from seed investments to late stage and growth equity strategies. Each of these stages requires its own specialised skill set.



As the market moves into a new and measured investment landscape, access to managers with a proven track record has never been more important.

61. https://www.jdsupra.com/legalnews/venture-capital-set-records-in-2021-1011895/
62. The State of Venture, Global 2021, CB Insights
63. Harries, R. S., Jenkinson, T., Kaplan, S. N., & Ruediger Stucke. (2020). (working paper). Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds (pp. 11). Chicago: Becker Institute for Economics at UChicago.

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