Early stage investing in startups and innovation ecosystems key component in wealth creation

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Faisal AlOthman, Director of Third-Party Solutions at Kamco Invest, moderated the discussion between Ihsan Sancay, Executive Director of Private Equity at Kamco Invest, Fahad AlSharekh, Founder and Managing Partner of TechInvest, an advisory firm that provides investors with early and growth stage investment opportunities in US tech companies, and Jake Zeller, Partner at AngelList, the world's largest platform for startup investing supporting over USD2.5bn in assets under management with 77 unicorns in their portfolio.

AlOthman commenced the webinar with an overview of how the pandemic transformed the venture capital scene from an unpredictable state to an opportunity filled industry led by the fast-tracked shift towards digitization. As quarantine and isolation protocols were implemented worldwide, the effects have proved to have a positive impact on the technology sector. Performing at a level far exceeding analyst projections, the sector is now considered a major player in streamlining the path towards the new normal. A major concern with the ongoing pandemic was the impact it would have on exits from VC-backed companies. Not only did high-profile exits continue in 2020, but they also increased liquidity to new levels. The total exit value in 2020 amounted to USD290.1 billion, exceeding the total value in 2019 over a similar number of exits (around 1,101 exits). IPOs, M&As and buyouts were active, however, the enormous IPOs drove the record exit value.

US venture fundraising activities in 2020 were strong and witnessed the highest raised amount during the last decade. In 2020, a total USD73.6 billion was raised, higher than the previous record in 2018 of USD68.1 billion. Some of the main factors that led to the record amount were the shifts in industry dynamics, accelerated technology adoption rates, and role of technology in enhancing life during the pandemic, in addition to a strong IPO market. The accelerated adoption rate within one year equates to a decades’ worth of digital technology as businesses push to shift online and digitize their operations. The potential to generate attractive returns while making a significant and positive impact has embraced VC as a critical component of long-term investment strategies for investors. Venture capital firms raised 44 mega-funds in 2020 consisting of USD500 million or more, nearly double the 24 funds closed in 2019.

The panelists agreed that the risk of venture capital is overstated and based on historical data that goes back to the 90s with 51% loss ratio and 65% impairment ratio. Today the average loss ratio is closer to 20% and performance could be higher if working with good managers and calibers. This makes venture capital as one of the best performing asset classes as the risk factor decreases and the possibility of higher returns increases.

They also agreed that Silicon Valley is much more developed compared to other markets as it has been a large return driver, has the positive network effect, and supports IPOs of growth companies that have not been profitable.

Sancay added that venture capital is globally becoming more important due to the need of transformation and change. Silicon Valley, for an example, has one of the most mature and active tech ecosystems worldwide in terms of innovation and exits. The industry is almost 70 years old with a high concentration of talent, innovation, entrepreneur's academia, and capital, with investors showing a strong appetite for shares of companies making their publicly traded debuts.

Investing in transformative technology is the inevitable way going forward. Traditional industries such as retail, finance, communication, and others are all being transformed by new technological innovations that are evolving traditional methods and applications. One click easier or one process less is all that is required to trigger the transformation process. Additionally, the pandemic has clearly proved the importance of the online economy as that is how individuals have spent most of their time for almost a year and will continue to do so in the future.

Sancay mentioned that the venture capital industry has evolved since 2000, and fund managers are implementing a more rigorous, risk-managed assembly of companies. Venture capital funds are surrounding themselves with “incubator” forums and core communities of advisors, as well as setting aside capital for follow-on needs. These additional measures provide critical resources that enable startup companies to find solid product market fit and to scale accordingly. There needs to be a healthy balance of investing in emerging managers and directly in companies that have been filtered and invested by those emerging managers to provide acceptable returns within a balanced risk profile.

AlSharekh believes that the push for new investing avenues comes as GCC investors seek alternative asset classes, such as venture capital, to further diversify their portfolios beyond real estate, fixed income, and listed equities, such as venture funds, to diversify away from holdings in real estate, fixed income, or public equity markets. Ultra-high-net-worth individuals and family offices are looking to follow sovereign wealth funds by investing in tech-companies abroad.

He emphasized that data collected from the past decade shows that venture capital was the best performing asset class. Furthermore, loss and impairment ratios for venture capital funds went down materially becoming less of a risky asset class and more of a rewarding asset class.

Venture capital is currently outperforming other assets classes in the US. According to the 2019 NACUBO-TIAA Study of Endowments, venture capital was the highest-performing asset class for university endowments with 13.4% in 10-year average annual returns, bringing in more than U.S. equities (8.2%). The world's top institutional investors have allocated 5-15% of their portfolios to VC or early-stage PE. Some of the more mature endowments hold up to 20% of their AUM in VC, such as Yale University Endowment. As such, top performing institutional investors understand the importance of venture capital and its positive impact on their portfolios. This has been a key driver in increasing venture capital allocations, reaching a mean of 15% of their portfolio.

A study released by AngelList revealed that Q4-2020 was the best quarter on record for early-stage startups. More than 80% of the startups that changed valuations in Q4 were marked up, according to AngelList investments into 3,449 active startups.

AlSharekh noted that it is important for investors to understand how the risk profile of venture capital investing has changed considering that today’s market is not the same as it was 20 years ago. The industry has evolved, and fund managers have learned from their mistakes. Before the 2000 tech bubble, venture capitalists relied on capital and luck, since then, they started implementing a more rigorous risk management approach. They focus on how to add value and scale their portfolio companies.

Zeller believes that when looking at venture capital, the focus is on the areas where all the returns are happening and that is usually a few outsized examples that drive all the returns. He prefers investing in a single opportunity like Doordash, Uber or Snowflake where returns are concentrated and capable of achieving gigantic scale versus other 100 startups that end up being irrelevant.

Although Silicon Valley is one of the two major tech capitals of the world, Zeller considers it to be the ideal hub for startups: thanks to the innovative ecosystem and strong network of industry leaders across various functions. Furthermore, the venture capital deal flow from San Francisco is much larger than any other market.

AlOthman concluded the session by emphasizing that Kamco Invest aims to provide its clients with access to best of breed opportunities in various asset classes, including VC. Sharing the approach of seasoned and successful industry professionals in open discussions falls under the Company’s commitment to educate the public by providing valuable insights on some of the opportunities available in the investment world today.

Kamco Invest hosted a webinar to provide GCC investors with deep insights on the importance of the venture capital industry as it evolved into a key asset class for diversification and wealth creation. The webinar focused on the evolution of the venture capital industry as modern-day technology continues to enable the shift towards digitization, becoming a defining moment for digital transformation and a critical component of long-term investment strategies.