Introduction to Venture Capital

What Is Venture Capital?

Venture Capital, commonly referred to as “VC,” is a form of private equity financing in which investment firms, or high-net-worth (HNW) individuals, provide capital to startups, or emerging companies, to grow their businesses. These VC-backed companies exhibit high growth potential and aim to offer highly innovative products or services. Because new businesses face significant challenges, including product development, customer adoption, market evolution and financing risks, among others, many venture-backed companies may fail. Effective strategies in venture seek to offset those losses with outsized returns from successful investments. Venture portfolios tend to be well-diversified, as a result, and it can be common for just one or two investments to offset dozens of losses.

VC investing is generally concentrated in high-potential, highly scalable industries such as software, fintech, digital infrastructure, and pharmaceutical/biotechnology, although the reach of venture has expanded over time.

Who Are Venture Capitalists?

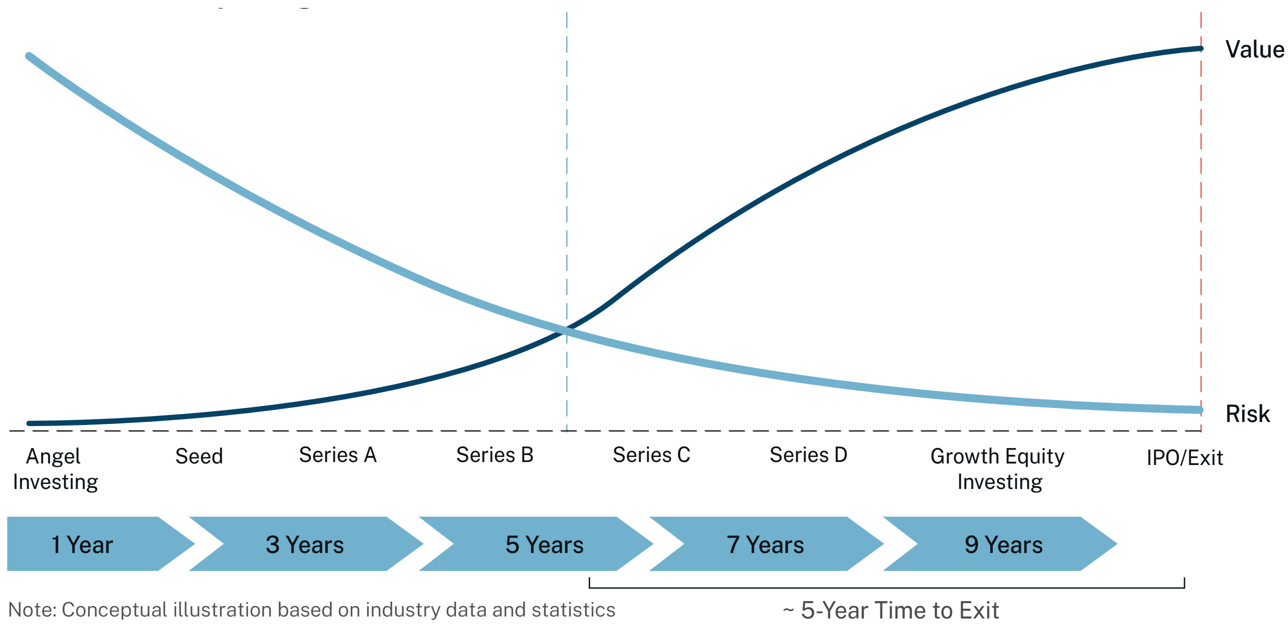
When it comes to VC, venture capitalists are the main players involved in raising and investing capital. Venture capitalists use a similar fund structure as other private market strategies with venture capitalists serving as the general partners and capital providers, collecting capital from and distributing it to limited partners, such as pensions, endowments, sovereign wealth funds and individuals. Venture capitalists then invest the fund’s capital into startups and return capital following “exit events” at portfolio companies, such as initial public offerings (IPOs), merger and acquisition (M&A) sales or secondary transactions.

WHAT YOU SHOULD KNOW:

- Venture capital is a form of private equity financing that helps start and grow new businesses.
- Venture capital investing comes with a long-term investment horizon and high return potential but also high risk due to the early-stage nature of startups. While new ventures may fail, successful ones can potentially provide significant returns.
- Venture capital offers investors considerable benefits, including portfolio diversification, the potential for long-term, compounding returns and exposure to innovative businesses.

Venture capital firms differentiate themselves among peers based on their ability to source, access, assess and add value to startup companies. In many cases, venture capitalists will take on advisory roles to help startups improve strategically and operationally. These roles typically take the form of board seats or strategic advisor positions. Successful venture capitalists are highly sought-after by startups for their expertise, which can lead to long-term advantages.

What Are the Types of VC Investments?



Note: Conceptual illustration based on industry data and statistics

VC investments vary by risk and return, but typically become less risky and more valuable over time.

1. **Angel Investing:** This type of investment typically comes at the very start of a business when individuals, often friends and family, make small investments. Angel investors take on higher risk and can provide mentorship and strategic guidance in the early days of a company's formation. Companies at this stage may only have one or two individuals and an idea.

2. **Seed Investing:** Seed investors are normally the first institutional investors in a business and help companies build their first commercially viable product and land their first few customers. In most cases, seed companies have not yet generated any revenue at the time of their seed round.

3. **Venture Investing:** The typical path for successful startups is to raise subsequent rounds of capital from venture managers as they hit milestones and require more capital to sustain their development. These rounds are labeled as letters starting with "Series A" followed by Series B, C, D, and so on as needed. Some managers deploy a "multi-stage" approach and invest across many of these rounds, while some target only certain stages.

4. **Growth Equity Investing:** Once a venture-backed company has achieved enough scale to meaningfully reduce its risk profile, subsequent rounds of investment are considered "growth equity." The round at which a company moves from venture to growth equity varies by company and different market players have different definitions, oftentimes with significant overlap. However, growth investors tend to focus on companies that have proven products and existing clients (known as "product-market fit"), which need additional capital to continue to scale their businesses.

What Are the Benefits of Venture Capital?

VC offers several benefits, both to VC-backed companies and investors:

Benefits For VC Investors:

- **Portfolio Diversification:** With a relatively low correlation to other equity strategies, VC offers investors a chance to diversify their portfolios. Venture also benefits from disruptive platform shifts (e.g., internet, mobile, cloud, AI, etc.), helping position a portfolio towards emerging market segments and offset some of tech's impact on legacy industries.
- **Potential for High Returns:** VC investments offer the possibility for significant returns, particularly regarding multiples on invested capital. Venture-backed companies benefit from long-term compounding growth and the longer hold periods of early-stage venture strategies tend to result in strong multiples on invested capital.
- **Exposure to Innovation:** VC provides investors with exposure to cutting-edge technologies and disruptive business models. By supporting innovative startups, investors can help shape the future of various industries.

Benefits For VC-Backed Companies:

- **Capital for Growth:** VC helps to grow and scale businesses, which may be challenging to finance through traditional means.
- **Expert Guidance and Mentorship:** Venture capitalists often provide valuable industry experience, knowledge and networks of customers, partners and experts. Their guidance and mentorship can help startups navigate challenges, make strategic decisions and avoid common pitfalls.
- **Validation and Credibility:** Securing VC funding can act as a stamp of approval, potentially giving companies credibility in the marketplace and possibly leading to additional funding from other investors.

How Can VC Fit in Investors' Portfolios?

VC investments can play a role in diversifying an investor's overall portfolio as they offer exposure to high-growth, early-stage companies with the potential for substantial returns. Including VC in a portfolio can enhance its risk-reward profile and provide opportunities for long-term compounding gains, but consideration should be given to the strategy's higher risk profile and longer duration.

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