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THROUGH HELL OR HIGH WATER, VC HOLDS TOUGH

RICHARD K. SUSSMAN
Partner at Black Dragon Capital

WWW.BLACKDRAGONCAP.COM

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By Richard K. Sussman, Partner at Black Dragon Capital℠

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"When everything seems to be going against you, remember that the airplane takes off against the wind, not with it" – Henry Ford

Background

Two and a half years ago, an article I published titled *It Is Time To Be The Optimist!* provided insight into how venture capital funds are able to push through tough times, such as the pandemic and maintain profitability and efficiency. Fast forward to July 2022, despite the uncertain times we successfully launched my second fund, Rebel Fund, which is also performing in the top 1%. Due to the volatility of almost every worldly measure since my first article, I believe it is important to reiterate once again that even now the optimist can triumph.

Over the past two and a half years, we have witnessed some of the hardest and most unprecedented times of the modern era. From quarantining, unparalleled global government spending, and severe economic uncertainty, people are being intimately affected whether they sit in multinational boardrooms or at family kitchen tables. While COVID does appear to be more manageable today, an economic crisis continues to be a stressor for many partly due to inflation increases, higher unemployment, supply chain issues, stock market volatility, the crypto collapse, and on top of this a war in Ukraine.

According to the United Nations, this has all caused "geopolitical and economic uncertainties [that] are damaging business confidence and investment and further weakening short-term economic prospects" (United Nations, 2022). The World Economic Outlook data collection for 2022 found that global economic growth is projected to slow from an estimated 6.1 percent in 2021 to 3.6 percent in 2022 and 2023 (International Monetary Fund, 2022). An important takeaway from this data is that this measure is the average slowing of growth across all industries. Thus, there are several industries that are slowing significantly more than the average and those that are barely slowing or actually growing. Industries like transportation and mining of oil and gas have been among those with the sharpest decline in growth and revenue due to their direct link to the shrinking workforce and halting of Russia's resources exports due to the war. Conversely, one of the few shining-light-industries during crisis continues to be Venture Capital.

Venture Capital Outperformance

When deciding to launch a new fund, the question had to be asked… "Why is it the right time?". The answer, which is good news for those who invest in, or are in Venture Capital, is that VC has consistently been able to outperform the public market, especially during economic downturns.

One of the most notable economic crisis's of the past decade and a half is the housing-bubble explosion of 2008. The crash of 2008 saw the US's GDP fall by 4.3%, making it the sharpest recession over the past half century. This downturn caused the bleeding of most industries to almost unrecoverable levels. Venture Capital however saw light quickly and was able to recover and continue growth. The VC industry saw a total recoup of investment value plus a nearly 22% increase from the height of the 2008 bubble in less than 3 years (Statista, 2022). Historically, this same downturn and relatively quick bounce back in the VC has become a staple of the industry which is why even though this happened a long time ago, it is relevant today. This same trend is occurring once again from the Covid hit in 2020 as well as with the issues we are facing in mid-2022.

Figure 1: Historically outsized returns (%)
Top quartile

Asset	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

Figure 1

When considering investment, the four major options are Venture Capital, Private Equity, Real Estate, and the Public Market – S&P 500. Each of these investment strategies are producing high returns, but none have been able to compete with Venture Capital.

Figure 1, pictured below, gives a visual representation of the continuous overachieving nature of venture capital compared to the public economy. As you can see, from time horizons between 5 to 25 years (1992-2017), VC top quartile returns (in %) outsized those of other investment alternatives. As you can see, VC has not only been the return leader in investment classes, but it has also doubled and sometimes tripled the returns of the next closest alternative. Although this data is a bit dated with the 5-year horizon closing out in 2017, this trend with Venture Capital on top has continued to be the case in years since then.

2018	2019	2020	2Q21
Venture Capital 20.6%	Venture Capital 19.0%	Venture Capital 55.3%	Venture Capital 23.7%
Infra. 12.3%	Private Equity 17.0%	Private Equity 23.9%	Private Equity 19.0%
APAC Core RE 9.5%	Infra. 12.6%	Hedge Funds 11.8%	Hedge Funds 10.1%
Private Equity 9.2%	Hedge Funds 10.4%	Asset Allocation 11.6%	Asset Allocation 9.0%
U.S. Core RE 8.3%	Asset Allocation 10.0%	Transport 7.8%	Transport 8.7%
Transport 8.2%	Direct Lending 9.0%	CML - Senior* 6.3%	Direct Lending 7.3%

Figure 2

The JPMorgan "Guide To Alternatives Report" helps to fill in this gap from 2018 with findings that the returns of Venture Capital investment from 2018 to as recently as Q2 of 2021 have also sat atop of the return measurements. Figure 2 below from the

JPMorgan report gives a more up to date representation of VC compared to other asset classes. Over these four years, VC had an average return of 29.65% while other asset classes lagged behind. Private Equity which had an average investment return of 17.38%. The S&P 500, over this same time horizon had an average return of 14.97% (Yahoo, 2022). The real estate market has seen house prices boom recently but still falls behind VC with an average real estate investment return of 18.8% with inflation correction. Although this real estate number is high, it is important to note that the average return in real estate is actually declining in the past year and a half at a rate of -4.75% and fluctuates at a high rate from state to state (IPropertyManagement, 2022). With investment returns like these, it demonstrably demonstrates that Venture Capital provides the best likelihood for highest investment returns.

In Q1 of 2022, global venture funding was just over $144 billion across 8,835 deals. This amount of both funding and deal numbers was down 19% from the previous quarter, but even during this slowdown, this first quarter of 2022 still marked the fourth-largest funding quarter on record (CBInsights, 2022). Almost a 20% decrease in funding between quarters to the majority of industries would set off alarm bells but VC is not worried since we have been here before. VC utilizes diversification of market segments, startups, and cyber alternatives to successfully rebound funding cycles across the world.

As you can see from Figure 3 below, provided by KPMG, when looking at the long-term growth evolution of the global venture capital industry, Q1 of 2022 is still holding relatively steady and maintaining value and deal count. This Q1 data for 2022 continues the trend from the data visible through COVID that VC has gained high

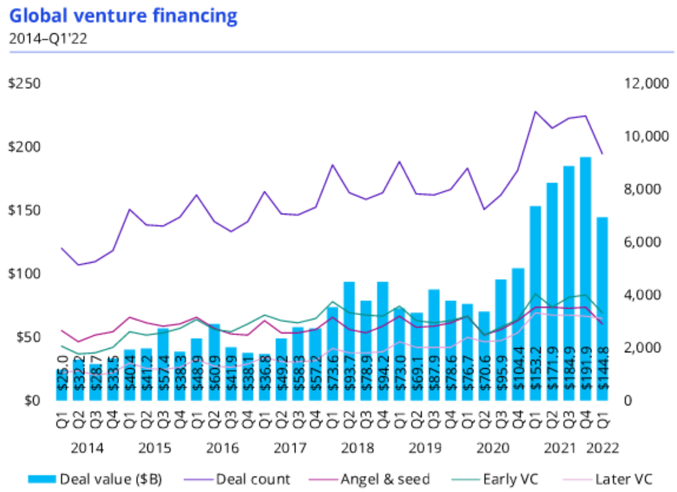

Figure 3

growth levels even during economic uncertainty. This figure also helps to visualize the dramatic growth that the industry has witnessed in both deal count and deal value over just shy of a decade.

Ann Kim, a managing director at the Silicon Valley Bank, has identified that when valuations of companies fall due to economic downturns, opportunity is created (Fernholz, 2022). This opportunity is the availability of VC firms to back early stage companies at lower prices than they were previously available at a few years ago. In fact, “from an investor’s perspective, it’s a better environment to invest, as prices have come down and funding rounds are less competitive, allowing time for due diligence and getting to know founders” (Teare, 2022). According to PitchBook data, Q1 preliminary data found that “68.1% of reporting VC funds show[ed] a drop in valuations from their 2021 peaks” (Carmean, 2022). More importantly, this data suggests that this rapid decrease in valuation provides opportunities for new funds to enter the market and invest at lower valuations, therefore creating a bottom-line at a level with significant levels for future growth.

When to launch our new fund is based upon the data noted above, which paints the picture that when economic crisis strikes, the opportunity for unscathed and fresh funds becomes significant. With less baggage of past struggles, low valuations of businesses, and an increase of startup or growth stage opportunities, we believe now is absolutely the right time for emergence. Our team of advisors and diverse management helps us to go onto the scene as a new fund while conducting business with tenure and experience.

Geographic Assessment

To better assess this benefit of VC funds, it is important to know which countries and their respective economies are best suited for success.

The UK and Ireland have asserted themselves as the European VC hub, especially in the first half of 2022. “The area has continued to display solid growth this year despite rising macroeconomic uncertainty and the ongoing effects of Brexit on the economy. So far, $14.3 billion has been invested across 1,456 deals in the two countries” (Hodgson, 2022).

Southeast Asia has also displayed continuing promise due to a rise of new companies backed by seasoned operators aiming for higher returns than those that have recently perished before them. The companies in this region are thought to be capable of this aggressive goal due to the fact that “pretty much every metric on technology continues to grow and secularly grow in the long term” (Tong, 2022).

The UAE and their Hub-71 ecosystem, an effort from the government to promote growth among multiple tech start-ups, is also an area to keep close watch on. “A rising number of start-ups and VC fund managers domiciled in the region, increasing inbound investment, and increasing activity from Middle Eastern sovereign wealth funds in the sector, both within the region and overseas, are all testament to this” (Ashurst, 2022). “This” being the claim that the middle east is one of the most rapidly increasing locations for venture capital activity even with the global economic worries.

Last but not least is the United States. From 2006 to 2017, the value of VC investment in the US grew at a stable rate going from $30 billion to $88 billion in that time span. The past four years however have told a different story, since 2018 the value has increased from that $88 billion mark to over $330 billion. Although recent events have slowed down this rapid growth, first quarter numbers are maintaining. (Statista, 2022).

With a continuation of investment into innovative technologies together with venture capital, operational, and entrepreneurial guidance, these regions, and others are well poised to mature from start-up nations to growth nations.

Target Markets

Alongside the geographic locations, there are also several market segments that we have identified as bullish. These markets include but are not limited to FinTech, eCommerce, Media & Entertainment, Cyber Security, and Green Tech. We are also targeting areas in Web 3.0, Blockchain and AI, all can be considered the foundational pinning to the above-mentioned segments.

Fintech, or financial technology, has shown great growth over the past decade but substantial growth is still to come. According to Vantage Market Research, "The market size [of Fintech] stood at USD 112.5 Billion in the year 2021. The Global Fintech Market size is expected to reach USD 332.5 Billion by the year 2028 and is expected to grow exhibiting a Compound Annual Growth Rate (CAGR) of 19.8% during the forecast period" (Vantage Market Research, 2022).

The eCommerce sector is one of the few that has exploded due to Covid. With more people online than ever, the global ecommerce growth rate was 26.4% in 2020, 16.3% in 2021, and is estimated to decrease slightly from 12.2% to just below 10% from 2022 to 2025 (Gaubys, 2022). These sudden jumps in growth and then steady decreases are not worrisome since it makes logical sense that as Covid dissipates less people will spend their time online. As most have come to realize from continuing to work at home or have zoom meeting alternatives, the growth in digital utilization from Covid is here to stay and therefore represents a significant opportunity for investment.

With Covid came a need from media & entertainment companies to diversify their products and align them with a more digital and technologically advanced audience. By this half-way-point of 2022, this industry has successfully researched and implemented new and exciting subcategories of products for their consumers. The most notable of these advancements are the NFT space and the AR and VR metaverse. The Deloitte 2022 Media & Entertainment Industry Outlook document states that, "in 2022, media & entertainment will continue to evolve quickly, not only reckoning with ongoing trends and disruptions within the industry, but also in its continued response to pandemic led behavioral changes" (Deloitte, 2022). This provides opportunities to VC since a lot of these newer tech based forms of media and entertainment are in early-stages or growth-stages.

Cyber Security is another market of interest due to the rise of cyber based attacks during the pandemic. This increase in number of attacks helped to sustain and grow the demand for cybersecurity solutions. In fact, according to new study found that "the global cyber security market size is projected to reach USD 500.70 billion by 2030, registering a CAGR of 12.0% from 2022 to 2030" (Grand View Research Inc., 2022). The fact is that when everything went digital the past couple of years, the need for increased cyber security went through the roof and therefore there is tons of opportunity for investment.

Next we have Green Tech, the application of environmental science to produce clean/green technologies. The rise of concern regarding climate change and its potentially devastating impacts on the global environment have caused the green tech industry to be expected to reach over $74 billion by 2030. This is a 740% increase from the $10 billion valuation it had in 2020 (Flynn, 2022). There are several different types of green tech like wind turbines and solar that have dominated the industry, but there are also new technological advancements that are entering the market everyday with the potential to revolutionize the marketplace. We strive to be green at our fund and see this target market as not only one of high monetary potential, but also one with high upside for humanitarian and environmental causes.

Lastly, we have placed significant interest into the markets of Web 3.0, Blockchain, and Artificial Intelligence (AI). Web 3.0, Blockchain, and AI have already been utilized globally with crypto, video games, supply-chain machinery, etc. and they continue to impress and innovate. Recently, these three innovative technologies have been flooding the news, forums, and financial sectors due to their incredibly high forecasted growth rates. Web 3.0, also known as the third and newest iteration of the World Wide Web which focuses on distributed ledgers such as blockchains, "is expected to register a CAGR of 43.7% during the forecast period [2022-2030]" (Emergen Research, 2022). Blockchain technologies, a digital ledger equipping a safer way to record information making it harder to change, cheat, or hack, is forecasted to "[grow] at a compound annual growth rate of 67.54% by 2030" (Market Research Future, 2022). AI, a generated simulation of human intelligence with the ability to self-learn conducted by computer systems and machines, "is [projected to expand] growth at a CAGR of 38.1% from 2022 to 2030" (Precedence Research). The unbelievable growth rates of these three markets and technologies are undeniable, but what we find the real eyecatcher and reason for their placement in our target markets is due to the fact that innovation and application of new tech alternatives is what has been, is, and always will be that which guides our society into the future.

Conclusion

Before I conclude, I wish to give a shout-out to Adam Stiller, my analyst-intern, for his terrific research. This has been a rough couple of years no matter who you are, what you do for work, or where you come from. It seems as though it has been one conflict after the next, and because of that it has been difficult to identify shining lights in all of this gloom. However, one light is, has been, and will continue to be, Venture Capital. When you have an experienced team like we do and the ability to utilize low valuations and carry minimal baggage of past struggles, the countless economic and humanitarian obstacles of today present a path for triumph and success.

Key Takeaways

- With Covid, Inflation, Supply-chain issues, the War in Ukraine, and more, there has been a significant economic struggle in the past two years that appears to be continuing into the foreseeable future.
- When economic downturns occur, one of few shining lights is and has been Venture Capital. Whether looking from a 25-year time horizon or as recently as the past handful of years, VC has consistently had the highest % of top quartile returns when compared to other investing and fund alternatives.
    - The average VC returns since 2018 stand at 29.65% while alternatives like Private Equity, Real Estate, and the S&P 500 lay within the mid to high teens.
- The 2022 economic disaster, among others, has placed VC into a situation for potential benefit, especially for new funds, based on the precedent of VC's positive reaction to historically similar events. New funds can utilize low valuations of businesses and the lack of baggage from previous downturns to create unmatched value when compared to long-standing funds.
- The geographic climate for venture capital is extremely diverse across the globe and shows positive signs in the UK, Southeast Asia, UAE, and USA.
- Potential target markets for venture capital funds are those that have products or services in the early to growth stages. Currently there are areas of high-growth in blockchain, web 3.0, cyber, and AI which have direct impact across all industries including media & entertainment, finance, medicine, infrastructure, commerce, education, and the environment.

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Author Biography

Richard K. Sussman is a Partner at Black Dragon Capital, focused on early-stage technology investments. His career spans private equity, venture capital, Fortune 500, and start-ups across various technology segments scaling revenue, technology, and capital across a diverse portfolio globally. Mr. Sussman has run operations, IP and revenue generating business units at several tech/media/data companies with ~$1B market caps (The Nielsen Company, IPG, and Gracenote-Tribune Media…); as well as co-founding two venture backed media, entertainment & e-commerce technology platforms (with respectable exits) and two venture capital funds. The first, a European-American early-stage fund, Nordic Eye VC, with a portfolio of 30+ investments worldwide returning ~700% IRR for investors, tracking top-decile fund performance and awarded Venture Capital firm of the year in the Nordics. The second, Rebel Fund, a ~80 portfolio seed stage venture fund which leverages data science and Silicon Valley's most accomplished founders to invest in a portfolio of Y Combinator startups with the statistical power to outperform, also tracking top-decile fund performance with a 53% mark up to date.

Mr. Sussman is often interviewed on the state of technology by media publications such as the Los Angeles Business Journal, TechCrunch, Wall Street Journal, CNBC, and The Los Angeles Times to name a few. He speaks at industry events such as Goldman Sachs' Special Situations Group, Digital Analytics Association, the International Consumer Electronics Show (CES), and CABSAT. He is also an occasional guest lecturer at UCLA, USC, and other Universities and has published several thought-pieces on the state of technology and Venture Capital. Mr. Sussman holds a Masters in Organization Management from Saybrook University, a Bachelor's in political science and German from Franklin University Switzerland and is an alum of Harvard Business School. He is a recipient of several industry awards, including the two-time recipient of ARF's Great Mind Award, Nielsen's Best of the Best Award, and nominated as one of the 50 most influential alumni in 50 years from Franklin University Switzerland.