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Venture Capital and Private Equity

A Guide to High-Growth Fund Investments

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Abstract:

This report illuminates the VC/PE industry for prospective limited partners, with special emphasis placed on its rise in Saudi Arabia.

From its humble beginnings in the U.S. during the mid-20th century, venture capital and private equity ("VC/PE") combined **has grown into a global, $9.1 trillion industry**[i]**.** In part, this growth is due to the numerous benefits VC/PE offers its stakeholders. For the businesses receiving capital from these groups, research has found that VC/PE investment can drive growth, innovation, and increases in productivity. In tandem, many of the investors in VC/PE funds—known as "limited partners"—have realized strong returns for their allocations. In fact, the historical outperformance of VC/PE against public market asset classes (such as stocks or bonds) has been notable and has likely fueled growth in the industry's total assets under management. However, approaching VC/PE as a new limited partner can be daunting given the unique considerations associated with VC/PE investments.

Potential investors must be diligent and thoughtful in their approaches to VC/PE to increase the likelihood of realizing the exceptional returns the industry has generated historically. To this end, First, a background is given on the past and present state of the industry. This is followed by a look at the landscape of limited partners and a guide to calculating and assessing the performance of VC/PE investments. The report concludes with best practices in establishing a VC/PE investment program, including considerations around VC/PE portfolio construction.

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I am pleased to present the **"Guide to High Growth Fund Investments"** report in light of the transformation of venture capital and private equity in Saudi Arabia. Since 2015, this sector has experienced remarkable progress annual double-digit average growth which comes as culmination to the Kingdom's endless strive to diversify and enhance its economy in an exceptional and unprecedented manner.

The three fundamental elements of this transformation have substantial improvements in the regulatory environment, vast economic opportunities, and the emergence of fund of funds as influential market players. In turn, this has positioned the Kingdom as a leader in the Middle East and North Africa region, as evidenced by its prominence in investment rankings, notable increases in capital investment, and an expanding workforce. Both in the Kingdom and the Middle East broadly, prosperity has been attributed to concrete positive changes, enabling development, and remarkable improvements. This has been demonstrated through increased public awareness initiatives and investment opportunities and reforms, leading to promotion of an enticing and innovative environment and attracting both local and international businesses.

Within this report, we aim to offer the optimal practices and metrics concerning investments in venture capital and private equity in the region and broadly. It delves into important themes such as investor categorizations and performance assessment methodologies while integrateing insights from industry professionals to formulate comprehensive strategies for achieving success as an investor in the sector.

We hope this report will serve as a valuable point of reference for local, regional, and global investors, facilitating increased growth and prosperity.

As we continue at the Venture Capital and Private Equity Association our quest to continue shaping and fostering an innovation-driven sector, we extend our sincere appreciation for your unwavering support and confidence in us.

Qusai bin Abdullah Al Saif
CEO of the Venture Capital and Private Equity Association

I. General review of the VC/PE industry

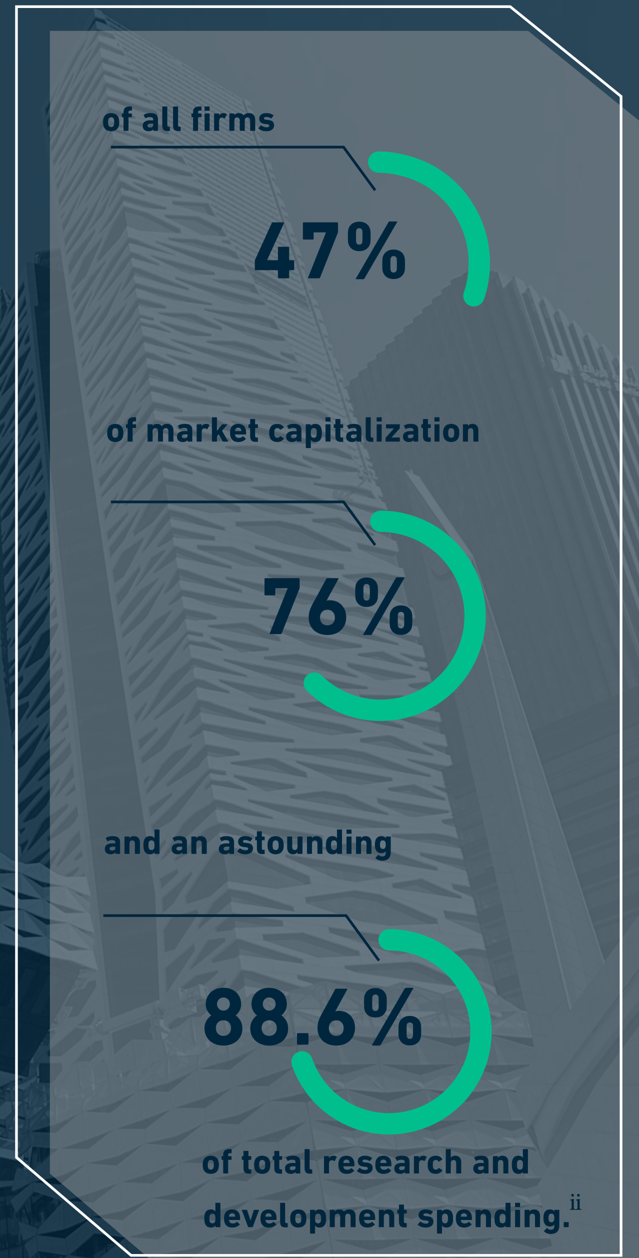
Among the most recognizable asset classes within private markets—markets for assets that are not traded on public exchanges—are venture capital and private equity (together, "VC/PE"). VC investments are typically minority equity investments into high-growth startups, while PE mainly refers to the purchase of controlling stakes in established companies through a combination of debt and equity (otherwise known as a "leveraged buyout" or simply "buyout").

The origins of VC/PE are rooted in facilitating innovation and enhancing productivity. These roots have carried into the present day: for example,

among publicly traded U.S. companies that listed between

1995 and 2019

those that were formerly VC-backed represented



There are signs Middle Eastern VC is following a similar trajectory. For instance, fintech and cleantech were the leading sectors in total investment with $1 billion and $409 million invested, respectively, in 2022.[iii]

Emerging leader within Middle Eastern VC/PE is Saudi Arabia. VC investment into Saudi Arabian startups grew at an astounding 102.8% per year between 2015 and 2022 [iv].

"Institutional investors including asset managers and family offices can unlock growth and diversification opportunities by embracing the dynamic world of venture capital and private equity. By partnering with the right fund managers, investors can strategically position their portfolios to fuel innovation, growth, and reap attractive risk adjusted returns."

Mazin A. Alshanbari
Chief Investment Officer - CIO
Jada Fund of Funds

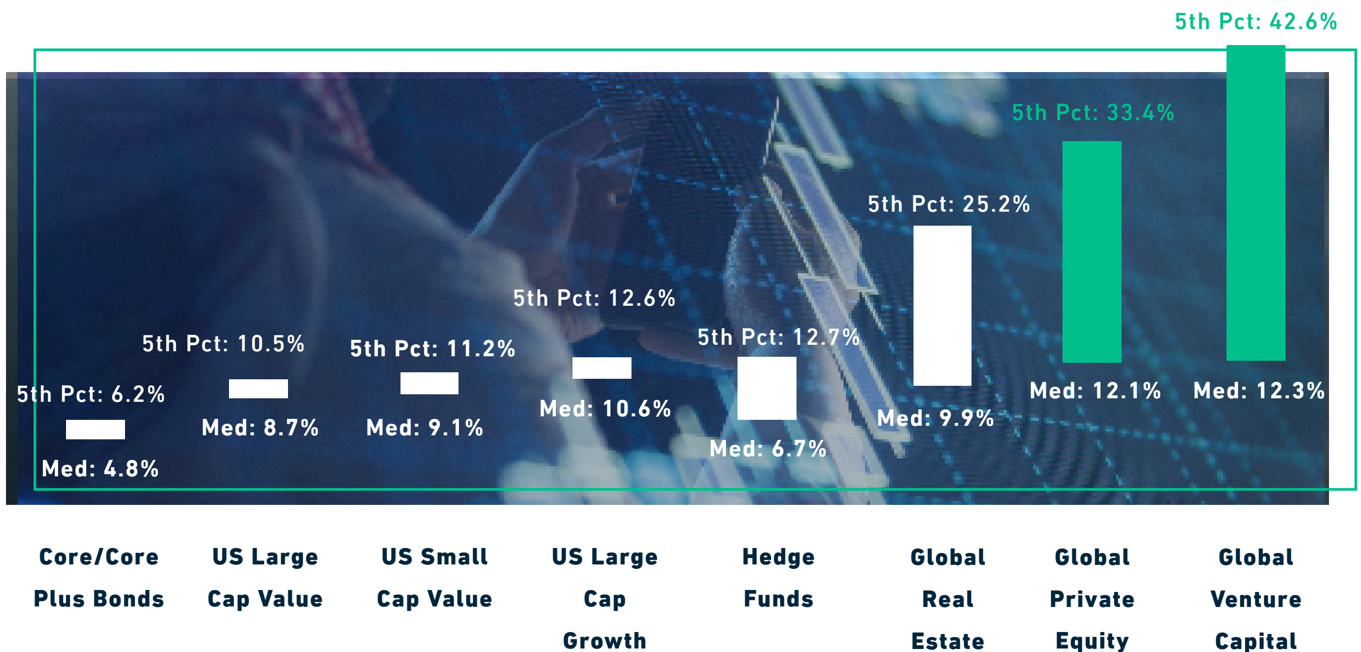
The combination of government and private sector initiatives within the Saudi Vision 2030 program, strong GDP growth, greater numbers of Saudi Arabian VC/PE investors domestically and abroad, and growing ranks of entrepreneurs has cultivated a flourishing VC/PE ecosystem in the country that will likely continue to expand.

Comparing VC/PE to other asset classes

Two significant differences between VC/PE and other asset classes are illiquidity and risk-return profiles. Illiquidity arises as a product of "committing" capital but waiting for fund managers to "call" that capital to make investments. Fund managers then add value to investments before "exiting" them through a sale to another group, initial public offering, or any number of other routes. This process takes time: VC/PE fund lives often exceed a decade, and the average holding period of investments is usually on the order of years (for instance, the average holding period for U.S. VC deals exited in 2022 was over 7 years).[vi] The VC/PE investing process results in a "J-curve" pattern of cash flow activity. Under this pattern, investors see initial outflows as capital is called to make investments, followed by eventual distributions from exits. As a result, VC/PE investors must be particularly cautious to match liability streams with cash flow needs.

In addition to risks associated with illiquidity, investors also face a much wider dispersion of returns when investing in VC/PE. For instance, Figure 1 shows the difference in returns between the top 5% of managers and the median manager by asset class[vii] .This highlights the greater risk—but potential for greater returns—associated with investing in VC/PE.

Figure 1. Annualized fund returns by asset class, 2005-2019[1]



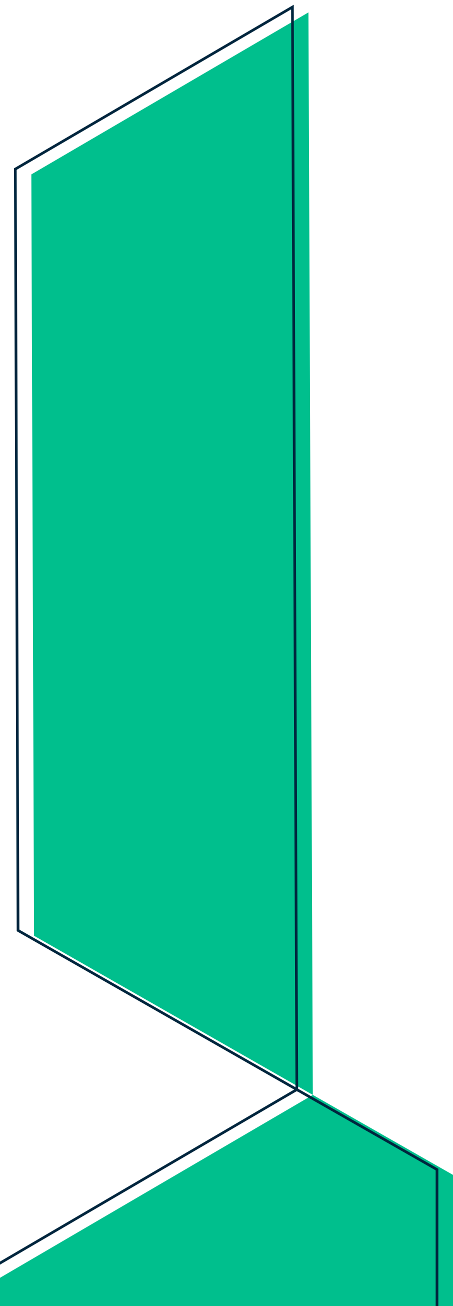
Comparing VC and PE to one another, they differ along various dimensions that include deal structure, size, and risk-return profile. For instance, VC strategies are characterized by "stage"—or level of development of target companies—ranging from nascent firms with just a pitch deck to existing, revenue-generating businesses seeking growth capital. As these companies are too risky for lenders, VCs typically use equity to purchase minority stakes.

[1] Returns for bond, equity and hedge fund managers are average annual compound returns (AACRs) for the fifteen years ended December 31, 2019, and only managers with performance available for the entire period are included. Returns for private investment managers are horizon internal rates of return (IRRs) calculated since inception to December 31, 2019.

VC strategies are characterized by "stage"—a term used to indicate the level of development of target companies—ranging from nascent firms with little more than a pitch deck who receive seed funding to relatively mature firms with an existing, revenue-generating business seeking growth capital to fund expansion. In contrast, PE firms generally use a mix of debt and equity to buy controlling stakes in established companies, with funds spanning a spectrum ranging from "small" to "mega" in size. When assessing the risk involved across VC/PE strategies, it is useful to think in terms of fundamental versus financial risk. On one end, VC is more exposed to fundamental risk as startups usually have unproven business models and are subject to market risk, technology risk, execution risk, and so forth. On the other end, PE is more exposed to financial risk due to the use of debt in transactions.

Fund formation and LP-GP dynamics

While there are a variety of ways to invest in VC/PE, the traditional vehicle to do so is the closed-end, blind pool fund. In this structure, investors' capital is pooled together and invested into companies on their behalf by fund managers. The organizational form that links the investors and fund managers is the limited partnership. The investors are known as limited partners ("LPs") due to their limited liability, and the individuals who make and manage the investments are the general partners ("GPs"). Typically, LPs are provided only broad information on the fund's intended strategy. They do not know or ultimately control what investment decisions are made, and they are not involved with the day-to-day operations of the fund.



The limited partnership agreement ("LPA") specifies the roles of LPs and GPs to minimize potential conflicts of interest. Of particular importance are the economics of the fund.[2] Fund managers are compensated primarily through fees and carried interest ("carry"). Management fees "keep the lights on," or cover GP operating expenses, during the investment period. Profit sharing via carry, on the other hand, serves to align financial interests between LPs and GPs, ensuring that fund managers are working hard to generate returns. The traditional structure is the **"2 and 20"** split: GPs charge a 2% annual management fee against the value of the fund and receive 20% of the profits as carry, a structure commonly used to this day.[viii]

II. The types of investors **in PE and VC**

LPs in VC/PE must be willing (and able) to deal with illiquidity and long investment horizons with the hope of earning outsized returns. However, many investors also may be driven by the desire to encourage social impact, promote economic development, or foster innovation. Others, such as corporate programs, may take an interest in VC/PE for strategic reasons (finding new partnerships, discovering new technologies, and taking advantage of early trends). For individuals, becoming involved in the VC/PE community opens the door for network-building that can lead to future ventures or collaborations.

[2] Other examples include the fund's intended size, its lifespan, and the minimum and maximum amount that can be invested into a given company by the fund. LPAs specify bounds around GPs' behavior as well. Please visit industry groups (such as the Institutional Limited Partners Association, https://ilpa.org/) who provide sample LPAs and regularly update guidelines for both LPs and GPs.

Traditionally, institutional investors such as endowments, foundations, and pensions have been the most active in—and well-suited for—VC/PE investing. More recently, given their long investment horizons and minimal liquidity requirements, family offices have also emerged as leading players in VC/PE: in 2022, eight out of ten family offices globally had VC/PE allocations.[ix] Family offices also have a median allocation of nearly 23% to VC/PE as a percentage of assets under management, the highest among all LP types.[x]

This is also true in Saudi Arabia: according to Preqin, as of September 2023

the largest group

of current VC/PE investors in Saudi Arabia is family offices

representing 82 of the 156 known LPs in Saudi Arabia.[xi] Moreover, as of 2022, 83% of Middle Eastern family office were already investing in VC/PE in some capacity,[xii] with the average Middle Eastern family office putting 11% of their investable wealth into VC/PE.[xiii] Saudi Arabia is already home to the most millionaires in the Middle East with 354,000 (and has nearly 1,100 ultra-high-net-worth individuals) as of 2022;[xiv] as such, the number of Saudi Arabian family offices investing in VC/PE is likely to increase.

What different LPs consider when determining their VC/PE allocations depends on many factors, such as investment horizons, liquidity needs, risk tolerances, mandates, assets under management, internal resources, and levels of sophistication. For instance, smaller investors may have more flexibility in choosing among investment opportunities compared to larger investors, as larger investors typically cannot (or will not) make numerous small commitments to funds (opting instead to make relatively fewer, larger commitments). However, larger investors often have access to more funds by having the capacity to deploy sizeable commitments and offering other benefits such as access to networks or expertise.

III. Performance assessment

LPs have been attracted to VC/PE in large part by the strong returns for which the asset class has historically been known:

the annualized performance of buyout and VC funds globally over the last 20 years has been 14.39%.[xv] However, the seemingly straightforward process of performance evaluation is complex in practice.

Two performance metrics are most commonly used in the industry: the internal rate of return ("IRR") and the multiple of invested capital ("MOIC," often referred to as "TVPI," or "total-value-to-paid-in"). The IRR is commonly used to represent an annualized rate of return for VC/PE funds; technically, it is the discount rate that causes a series of cash flows to have a net present value of zero (it is thus a "money-weighted rate of return"). The TVPI is a somewhat simpler metric and is calculated as the sum of realized and unrealized value to-date divided by the sum of contributions to-date. It is thus a measure of "money out divided by money in:" it shows how much an investment has returned, plus any residual value tied up in unexited investments, as a multiple of the amount invested. A subcomponent of TVPI is "DPI," or "distributions-to-paid-in," which is the sum of returned capital to-date divided by the sum of contributions to-date.

There are tradeoffs, however, when using one metric versus another. For example, IRR accounts for the time value of money; but as a consequence, it places undue weight on early exits. Recognizing this, some GPs "game" IRRs by seeking "quick wins" to boost calculated returns.[xvi] Another limitation of the IRR is the "reinvestment assumption": it essentially assumes that the same return is generated in every period, which is certainly not the case in VC/PE (recall the J-curve). On the other hand, TVPI is somewhat easier to interpret, but it does not account for the time value of money. Moreover, the TVPI is susceptible to asset valuations: because the numerator of the metric consists of realized and unrealized value, inflated valuations can have dramatic impacts on calculated returns. As a result, industry practitioners should take a "big tent" approach under which they use these metrics, and perhaps others in tandem, to assess and understand performance.

Benchmarking performance

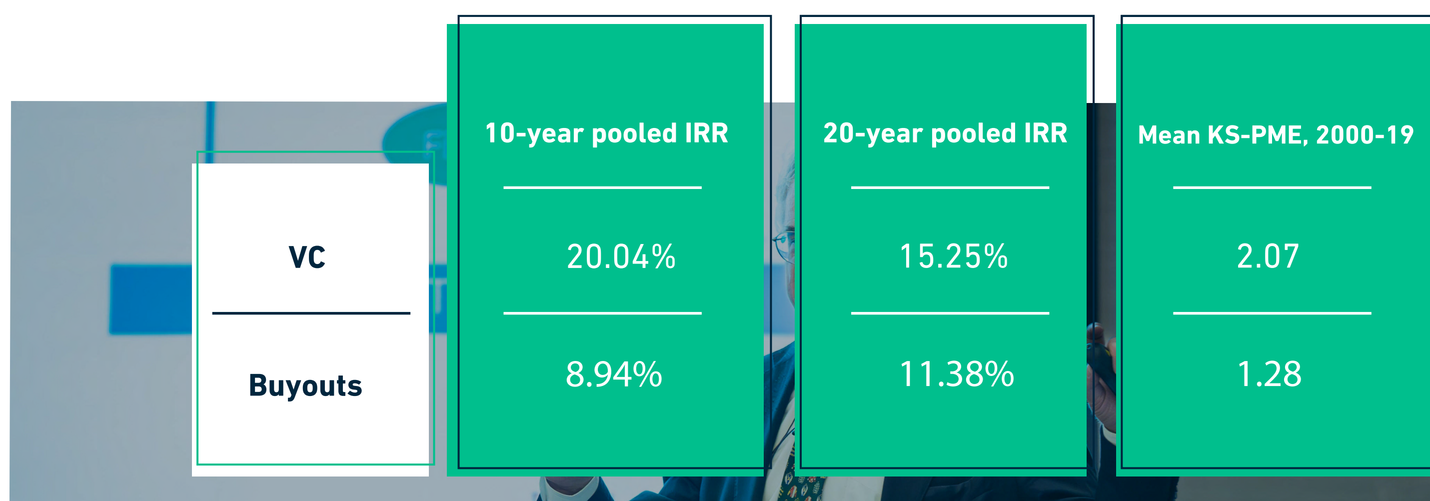
VC/PE fund performance is of relatively little value until it is compared against the returns that could be received elsewhere. This process is known as benchmarking and is typically done against other VC/PE funds using IRR and TVPI as metrics. Comparable funds are often matched on criteria such as vintage year (the year they were formed), strategy, geographic focus, industry focus, and others to ensure fair comparisons of investments' risks. Benchmark values are available from a number of different commercial data providers such as Burgiss, Cambridge Associates, PitchBook, Preqin, and State Street.

Benchmarking VC/PE performance against public markets using IRR or TVPI, however, is problematic for a variety of reasons. The central issue is that a standard public market index does not adjust for the irregularity of the timing of cash flows experienced by VC/PE funds. The public market equivalent metric ("PME") overcomes this issue by answering the question, "If I made contributions to a public market index instead of a VC/PE fund, and if these contributions (and resulting distributions) were of the same size and occurred at the same times as those for the VC/PE fund, what would the return have been?" The Kaplan-Schoar PME ("KS-PME") metric answers this question by providing a ratio that, when greater (less) than 1.0, indicates private market outperformance (underperformance) of a chosen index.[xvii]

VC/PE performance in Saudi Arabia

Due to the recent, rapid emergence of VC/PE in Saudi Arabia, there is not a history of regional performance data available. For instance, as of September 2023, data provider PitchBook has no Saudi Arabia-based funds with performance data. Instead, one can use emerging market ("EM") VC/PE returns more broadly as a proxy, shown in **Figure 2.**[3] Not only has EM VC/PE performance been strong in absolute terms, but PE outperformed public markets in 14 of 17 years between 2000 to 2019, while VC outperformed in 15 of those 17 years.[4]

Figure 2. Historical performance breakdown of VC/PE in emerging markets (KS-PMEs calculated against MSCI Emerging Markets Index)[xviii]



	10-year pooled IRR	20-year pooled IRR	Mean KS-PME, 2000-19
VC	20.04%	15.25%	2.07
Buyouts	8.94%	11.38%	1.28

[3] Emerging is defined to include the following regions as categorized by Cambridge Associates: Africa, Asia/Pacific-Emerging, Europe-Emerging, Global-Emerging, Latin America & Caribbean, Middle East-Emerging. KS-PME metric uses the MSCI Emerging Markets Index as reference.

[4] Note that while the MSCI Emerging Markets Index has outperformed the MSCI World Index since the end of 2000 (annualized net return of 7.3% versus 5.97% as of August 31, 2023), emerging markets have well underperformed the world market over the last 10 years (2.99% versus 9.28% as of August 31, 2023).

Moreover, several Saudi Arabian VC/PE funds and investments have demonstrated the potential for strong returns in the region

For instance, **Impact46** is a VC firm headquartered in Riyadh that focuses on technology startups in fintech, e-commerce, and software-as-a-service. Founded in 2019, **Impact46** has so far invested over 600 million riyals in 35 portfolio companies and achieved 5 exits.[xix] The company reports that its first fund, The Seed Fund, generated a TVPI of 3.6x on its investments, and its second growth fund (launched in 2021) has produced a TVPI of 1.9x on its investments already.[xx] Another example is Riyadh-based Jadwa, who is not only the largest PE investor in Saudi Arabia but also a leading investment management firm across the entire Middle East and North Africa ("MENA") region.[xxi] In December 2022, Jadwa reported intentions to invest over half a billion dollars in new PE deals and list stakes in three of its portfolio companies by 2025.[xxii] Across eight exits, Jadwa has returned nearly $3 billion in distributions to its investors.

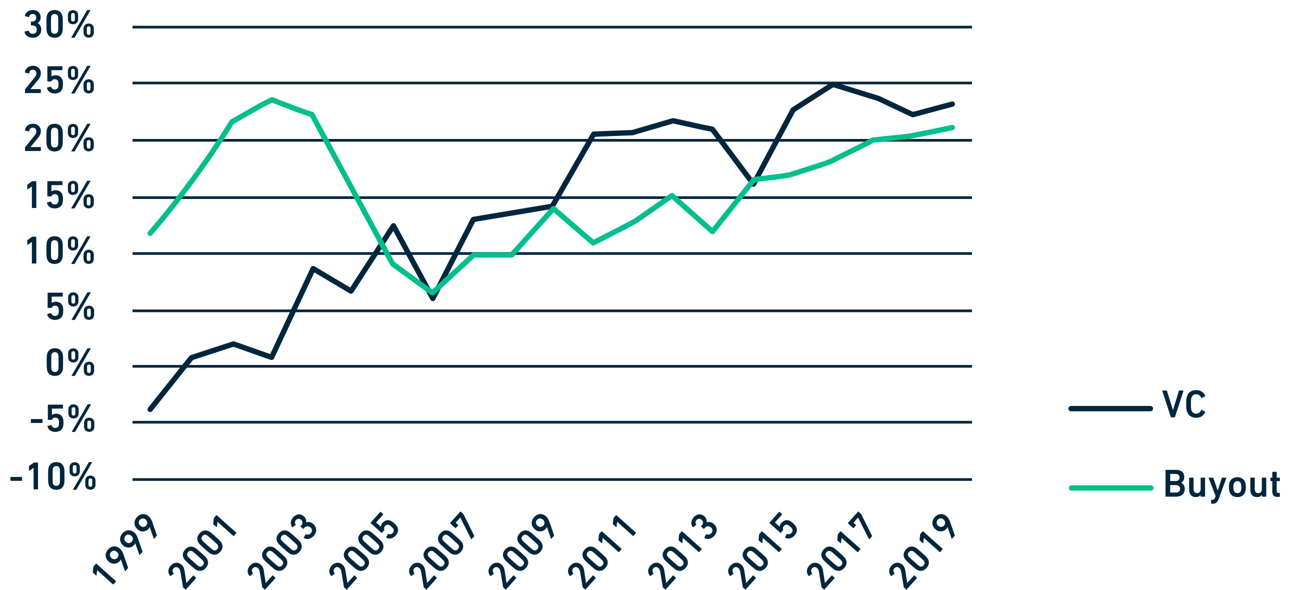
"Saudi Arabia has the vision, resources and ambition to deploy into startups in a way that is almost unmatched"[v]

Courtney Powell
COO and Managing Partner of renowned VC firm 500 Global

The PE/VC industry is highly cyclical in terms of fundraising, investment activity, and performance.[xxiii] Investors realize strong returns, which attracts additional capital to the asset class. This, however, results in an excess of commitments, typically causing prices paid by GPs for investments to rise as too much money chases too few deals. As conditions decline, investors tend to retreat from VC/PE and reduce their allocations. Deal prices then decline again, and as market conditions improve, returns bounce back – and the cycle continues.

IV. Best practices for implementing and maintaining a VC/PE program

Figure 3. Pooled IRRs for buyout and VC funds globally by vintage year, 1999-2019



However, this does not mean investors should try to time entry into (or exit from) the market. Not only is market timing notoriously difficult due to the episodic nature of fundraising, issues of access, and the unpredictability of capital calls and exits, but researchers found that market timing-based VC/PE investment strategies produced minimal benefits—and sometimes even worse returns—versus making fixed annual commitments to funds.[xxiv] Cyclicality instead implies LPs should stay the course through adverse market conditions. Not only were some of the best performing funds formed during or just after market downturns, but innovation itself may be countercyclical as a form of "creative destruction:" as opportunity costs decrease during downturns, entrepreneurs start ventures and firms explore new technologies.[xxv]

Short-sightedness can also have serious adverse effects on returns. The Great Financial Crisis produced many examples in which LPs (by choice, or by necessity) took short-term actions that negatively affected their long-run returns. Researchers found that LPs sold assets at an average discount of almost 50% during the depths of the crisis.[xxvi] Some groups went so far as to completely exit from their VC/PE programs, which resulted in billions of missed gains in some instances.[5]

[5] The most notable example is the California Public Employee Retirement System ("CalPERS"), who paused commitments to its PE program and cut its VC allocation to less than 1% between 2009 to 2018, resulting in up to $18B in lost gains as private markets boomed. See Josephine Cumbo. "Calpers Admits Ignoring Private Equity Boom Cost up to $18bn of Gains." Financial Times, September 19, 2022. https://www.ft.com/content/ff5587af-bdd0-405b-a151-7e187b697ef4.

Considerations for portfolio construction

As with public markets, investing in VC/PE requires careful planning along at least two dimensions: diversification and manager selection.

1. Diversification within VC/PE portfolios

Diversification within VC/PE portfolios builds on the ideas of modern portfolio theory, pioneered by the late Nobel Laureate Harry Markowitz, which show that holding a number of financial assets that do not perform in lockstep generally results in reduced risk for the same (or greater) level of returns. In VC/PE portfolios, this means holding funds that vary by vintage year, strategy, and other factors (including industry and geography), as well as increasing the number of funds held in one's portfolio.[6]

LPs may approach diversification in other ways as well. For example, in some cases, due to minimum investment sizes and access issues, it can be impractical for an LP to make enough VC/PE investments to create a diversified portfolio. As a result, some (especially newer) investors instead turn to already-diversified VC/PE vehicles, the classic example being the fund-of-funds – a fund that selectively invests in other VC/PE funds, coming at the expense of an additional fee layer.

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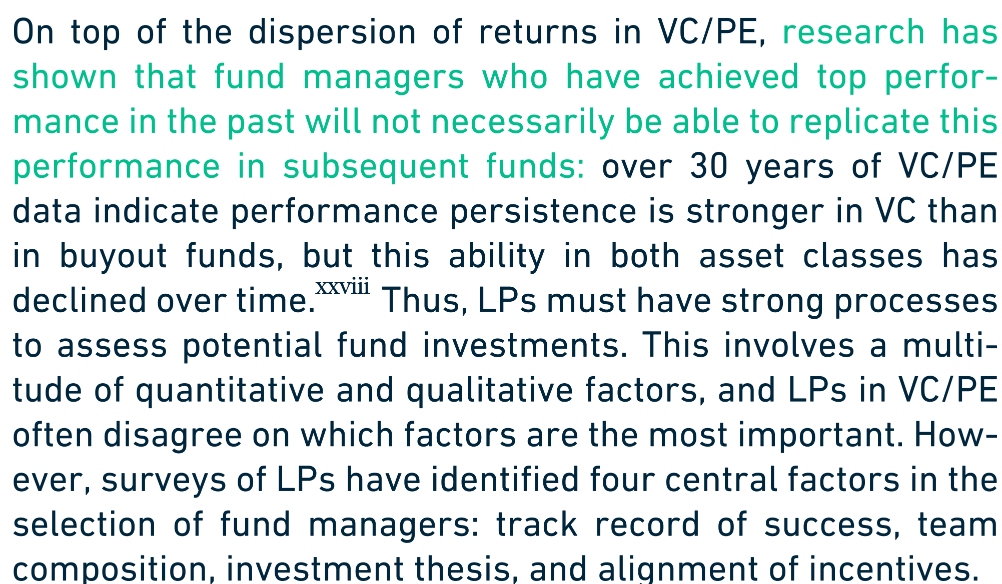
[6] For example, vintage year is among the most important considerations when diversifying a portfolio of VC/PE funds due to variations in deal pricing and exit environments. When looking at global buyout funds, the correlation between pooled IRRs calculated using funds of the same vintage year and those of the prior vintage year (e.g., vintage 2000 funds vs. vintage 2001 funds) is 0.72 but drops to 0.25 for two-year vintage differences (e.g., vintage 2000 funds vs. vintage 1998 funds) and -0.25 for three-year vintage differences (e.g., vintage 2000 funds vs. vintage 1997 funds). In other words, funds formed just several years apart can offer diversification benefits. Source: Author's analysis using return data from the State Street Private Index, accessed August 17, 2023.

In contrast, more established LPs may prefer to make direct investments in companies, bypassing VC/PE firms. This comes at the cost of concentrated exposure but gives investors complete autonomy over the selection of investments, timing of exits, and profits generated. However, direct investments are certainly not for everyone, as this route requires an investor to take on the rigorous roles of a GP such as due diligence, value creation, mentorship, and so forth. Research also shows that direct investments struggle to beat fund performance, and that deals requiring more active management and monitoring from the investor (such as investments in earlier stage companies) generally perform worse.[xxvii] Well-established and experienced groups tend to perform better when investing directly, as do deals that have reduced information barriers (for example, deals that are more local to the investor and are less specialized).

2. The importance of manager selection



On top of the dispersion of returns in VC/PE, research has shown that fund managers who have achieved top performance in the past will not necessarily be able to replicate this performance in subsequent funds: over 30 years of VC/PE data indicate performance persistence is stronger in VC than in buyout funds, but this ability in both asset classes has declined over time.[xxviii] Thus, LPs must have strong processes to assess potential fund investments. This involves a multitude of quantitative and qualitative factors, and LPs in VC/PE often disagree on which factors are the most important. However, surveys of LPs have identified four central factors in the selection of fund managers: track record of success, team composition, investment thesis, and alignment of incentives.

Deal sourcing and managing portfolio companies to a successful outcome is incredibly laborious.[7] Thus, before committing capital, LPs must be confident that a potential manager can skillfully execute their strategy, find deals, win deals, and produce returns. For new GPs without a track record of performance, investors can look at previous experience or individual deals completed at a former firm. New GPs can also showcase their investment approach by developing a potential deal pipeline or even executing an example deal as a preview for the fund.[xxix]

LPs also want to see that a team is equipped to carry out a fund's investment thesis and function well together over the fund's life, particularly given the industry is highly relationship-based. For instance, a study on deal origination found that 31% of completed deals came from a VC's professional network and 20% were referred by other investors.[xxx] In addition to possessing relevant domain knowledge from prior roles (in terms of assessing and completing deals), a high-quality team also adds value to their portfolio companies by recruiting skilled people from their networks.

Team backgrounds also relate to how managers expect to generate returns. GPs may use different levers (making operational improvements in companies, using multiple arbitrage, taking advantage of leverage, and so forth),[xxxi] so it is key to understand the value-add strategy of a fund. In recent years, LPs and GPs alike have put greater emphasis on areas of operational improvement that contribute to returns (i.e., growing or refining a business rather than relying on financial engineering or "buy-low-sell-high" approaches exclusively). Operational skills are especially important during downturns: one study found the average net IRR for 2009 to 2013 vintage PE funds with a dedicated operations value creation team was 5% higher in absolute terms versus funds without such a team.[xxxii] Research also suggests firms with specialized investment theses are linked to outperformance,[xxxiii] and specialist firms (as well as firms with specialized partners) attained greater deal success rates.[xxxiv]

[7] In one recent study of VC firms, the authors find that the median VC firm completes only four deals per year, but for each completed deal, the firm considers 101 potential investments.

Finally, investors wish to see their incentives aligned with those of their managers. A shared investment philosophy and a willingness on behalf of the GPs to negotiate the structure of fees, carry, and related provisions are positive indicators when assessing managers. It is also important for investors to assess whether compensation structures within VC/PE firms are fair to ensure team stability, since LPs are partnering with GPs over the long term and economic inequality within VC/PE firms has negative consequences (such as dissension, lack of motivation, and top performers leaving).[xxxv]

Institutionalization

Institutionalization is the process that helps to create a foundation for growth and to make success replicable and scalable. In VC/PE, an investor's processes must reflect a long-term perspective to prevent short-term impulses that produce deleterious long-term effects. At the same time, there must be processes in place to monitor the performance of investments appropriately and to understand how managers are generating returns.

Institutionalization also incorporates elements of "brand building," or becoming a desirable investor. This helps an organization attract not only talented people, but also the best GPs. GPs are focused on building a stable, diverse base of investors that understand the industry and can be depended on for capital. Institutionalizing processes that ensure team stability and reflect an ongoing commitment to long-term investing are critical in this regard.

Finally, despite the long-term nature of VC/PE, the timelines for investment decision-making are accelerated, particularly given rising competition. Therefore, it is critical to have an approval process with clear investment criteria (industry, geography, transaction sizes, portfolio fit, and so forth) in a checklist format and to mandate decisions to be made quickly. Related is the ability to assess existing managers, as the decision to reinvest in the next fund of a GP is the central means by which LPs can adjust their portfolio, make use of inside information obtained during the investment process, and exert governance pressure on the GP.[xxxvi] Better selection of follow-on funds also helps to explain historical differences observed in performance among different LP types.[xxxvii]

Case study: MASIC

To provide a real-life example of LP best practices in action, below presents a case study of the Mohammed I. Alsubeaei & Sons Investment Company ("MASIC"), a Riyadh-based and multi-billion-dollar family-owned investment company.

Establishing a VC investment **program: MASIC**[8]

Starting off as an LP in VC is challenging – however, by gaining a deep understanding of the asset class and applying best practices, investors can better ensure the initial and sustained success of their VC investment programs. An LP who has accomplished the latter is MASIC, the family-owned investment company of the late Saudi businessman Mohammed I. Alsubeaei.

MASIC, headquartered in Riyadh, was established exclusively to manage the assets of the family of Mohammed I. Alsubeaei. The company manages its multi-billion dollar portfolio using a three-pronged approach of investing in public equity, private equity, and real estate. Within the private equity strategy, there are two main components: direct investments and investments as a LP into premier venture capital and growth equity funds. The VC investment program was formed after the appointment of a new CEO in 2021 as a means to diversify the family's portfolio and its exposure across geographic regions. As a result, the VC investment program mainly focuses on opportunities in the United States and opportunistically in Europe, complementing the portfolio's domestic holdings.

[8] This case is based on interviews with MASIC's investment staff and https://masic.com.sa/. It has been reviewed for accuracy by MASIC.

MASIC's VC investment program embodies three best practices in particular:

1. Maintaining a long-term perspective.
2. Strong manager selection.
3. Diversification.

First, MASIC recognizes that "[VC] is a long-term asset class and hence you need to have a long-term view on how this impacts your firm." This perspective is reflected in how the firm manages the liquidity challenges of VC investments. MASIC stresses the importance of maintaining liquidity during a fund's investment period – generally the first two to five years of a fund's life – to ensure all capital calls are met. Starting off, MASIC recommends that an LP consider how the type of fund impacts cash flow planning. For instance, MASIC recognizes that early-stage funds may offer greater returns, but late-stage funds can provide distributions sooner. Given the strategies of their fund investments, LPs should plan for the "J-curve" to avoid any liquidity crunches – or worse, defaulting on their capital calls.

On top of poor returns from forced sales of VC investments, defaulting on one's obligations as an LP has negative impacts on credibility. MASIC underscores that reputation is a precious commodity in VC; and, to gain access to top quartile managers, LPs need to build extensive networks and references. MASIC notes the huge disparity in returns between top and bottom quartile fund managers, and the fact that a single investment in a top company can make a fund a "winner," underscores importance of manager selection. MASIC stresses that LPs in VC funds have, in fact, a limited role – "You ... are not involved in the day-to-day operations nor any investment decisions as you are investing into a blind pool." Consequently, investors should be diligent in who they invest with for a decade-long partnership. However, MASIC is not afraid of backing quality new managers. The firm understands that by taking the risk of committing a small amount of capital to new managers, it may find the next top quartile manager and gain long-term access to that GP's funds.

Finally, diversification is a core consideration for MASIC's VC program. The firm understands that VC is a cyclical industry that goes through "ups" and "downs" – LPs need to be "attuned to such factors and take the necessary actions to mitigate them … to reduce any adverse impacts of such cyclicality." In addition to a long-term mindset, MASIC mitigates cyclicality and other risks by diversifying across sectors, stages, and especially vintages by committing a consistent amount on an annual basis to VC. Diversification will help an LP weather downturns in the market and offset poor performance from any single investment.

While the firm's VC investments are currently internationally focused, MASIC believes in the imminent growth of the Saudi VC ecosystem. The firm writes, "In the years to come, the [Saudi VC] ecosystem will become more developed and will attract even more talent globally, which will in turn fuel the innovative nature of the younger population." The firm predicts three major events that will occur in the years to come: more innovative ideas will emerge from "Phase 1" successes (such as ride-hailing and food delivery companies), more global VCs will enter the Saudi market and invest in Saudi startups, and more global startups and SMEs will expand into the Kingdom to capture revenues driven by the rapid growth of the economy.

Amid government initiatives, rapid economic growth, and digitization of the economy, VC is poised to promote greater technological change and innovation within Saudi Arabia. This is all the more reason for new LPs to follow the lead of top groups like MASIC who understand the challenges of the VC asset class and apply many of the best practices discussed in this report.

V Summary: A roadmap for new LPs

VC/PE has quickly become an influential and pervasive multi-trillion-dollar global industry. The asset class can offer much to investors, including the potential for outsized returns and portfolio diversification benefits. However, investing successfully in VC/PE is challenging for new and seasoned investors alike. To summarize, we conclude with a general roadmap for those starting off as a new LP.

A roadmap for LPs establishing a VC/PE investment program

1. Understand and articulate goals and objectives

Can include financial objectives (expected return, risk tolerance, etc.) and strategic goals. Consider if goals are realistic and how VC/PE will complement the overall portfolio.

2. Build out internal expertise

Consider the team needed to operate the investment program, and if new personnel will be needed. Employing advisors with existing relationships and deep industry knowledge may be beneficial.

3. Institutionalize processes

A long-term perspective must be ingrained into a VC/PE investment program. Checklists provide a simple framework for comparing potential GPs and investments (see, for instance, ILPA's sample questionnaire). Ensure that your allocation schedule will allow for sufficient liquidity to meet capital calls.

An active and informed investment committee should set broad policy direction, while staff grapple with day-to-day operations. Reward systems should balance short-term accountability with long-term decision-making.

4. Develop relationships and build networks

Consider how to leverage existing connections and attend industry conferences, seminars, and other networking events to develop insights and references. Bringing on advisors or full-time staff with previous experience in VC/PE can expedite this process.

5. Make fund investments

For a given level of risk and return, ensure that fund investments are properly diversified across time, sector, stage, etc. Fund-of-funds can help if resources are limited.

6. Monitor and manage investments

Focus on a limited number of performance metrics in a systematic way and compare them against different benchmarks over different time frames.

Track qualitative information about GPs as well, including team backgrounds, key junior members, thoughts regarding the portfolio and its largest investments, and insights gathered from informal conversations and meetings.

7. Learn continuously

Stay abreast of developments in the VC/PE ecosystem and continue to learn. Utilize new information to refine investment strategies and processes.

VII. Endnotes

About Josh Lerner a Professor of Investment Banking at Harvard Business School

Josh Lerner has dedicated his life to studying private markets. He is the Jacob H. Schiff Professor of Investment Banking at Harvard Business School. During his years at Harvard Business School, he has published extensive research focusing on VC/PE organizations as well as policies on innovation and how they impact firm strategies. Much of his research is collected in the 11 books has authored.

Josh co-directs the National Bureau of Economic Research's Productivity, Innovation, and Entrepreneurship Program and serves as co-editor of their publication, Innovation Policy and the Economy. He founded and runs the Private Capital Research Institute, a nonprofit devoted to encouraging access to data and research, and has been a frequent leader of and participant in the World Economic Forum projects and events. Among other recognitions, he is the winner of the Swedish government's Global Entrepreneurship Research Award and Cheng Siwei Award for Venture Capital Research.

Josh is the Managing Partner at Bella Private Markets, a consulting and advisory firm focused exclusively on providing solutions to the challenges facing the private capital industry. Through Bella, he transfers the insights of his research from the halls of academia into the executive offices of client firms, helping managers overcome the daunting and ever-changing obstacles that confront private markets.

VENTURE CAPITAL
AND PRIVATE EQUITY
ASSOCIATION

The Saudi Venture Capital and Private Equity Association (VCPEA)

The Saudi Venture Capital and Private Equity Association (VCPEA) is an organization dedicated to placing Saudi Arabia as one of the top-performing VC/PE markets in the Middle East and North Africa. Established by a resolution issued by the Saudi Council of Ministers in 2019, VCPEA uses expertise and professionalism in addressing the challenges faced by investment fund managers, angel investors, and start-ups. VCPEA helps to coordinate meetings between VC/PE stakeholders, review and improve regulations in the sector, improve the legislative environment, and increase awareness through quality training programs and discussion sessions that highlight the innovative and sustainable prospects of VC/PE investing. For more information, please visit https://vcpea.org.sa/.

The Financial Academy

The Financial Academy has started operating on the basis of its long history and experience in the field of training and professional development in addition to its experience in offering professional certificates, so that its services cover all sub-sectors related to the financial sector: Banking, Insurance, Financing, and Capital Market, as well as relevant bodies, and new graduates wishing to join the financial sector.

The Financial Academy began operating based on its first note in 1965, when it was founded under the name of the Institute of Banking; it was a training department affiliated to the Saudi Central Bank, formerly Saudi Arabian Monetary Authority (SAMA). It aimed to implement the best international training practices in order to sharpen the technical and administrative skills of workers in the banking sector at that time.

In 2019, with the cooperation of the Capital Market Authority and the Saudi Central Bank, the Financial Academy was established to cover services in the financial sectors: (Banking, Insurance, Financing, and Capital Market).

The Capital Market Authority and the Saudi Central Bank Are considered key partners in establishing the Financial Academy and covering its financial budget in accordance with the memorandum of cooperation signed between them in this aspect, as part of the initiatives of the Financial Sector Development Program, one of the main programs of Saudi Vision 2030.

Jada جـدا
شركة صندوق الصناديق
Fund of Funds Company

Jada Fund of Funds

Jada was created to promote the development of a thriving private equity and venture capital ecosystem, which could in turn finance the growth of small-and-medium enterprises in Saudi Arabia in a sustainable manner. Launched by a resolution of the Council of Ministers, Jada was established by the Public Investment Fund with an investment capital of SAR 4 billion (approximately USD 1 billion). The creation of Jada is a critical component of Saudi Arabia's Vision 2030, the Kingdom's comprehensive economic and social development plan. Jada seeks to partner with private equity and venture capital funds that are focused on the Saudi market and committed to international best practices in governance and fund management.

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