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PRIVATELY SPEAKING

*As venture capital enters a new cycle, co-head of global venture fund investment for Adams Street Partners Brijesh Jeevarathnam tells **Marine Cole** how having access to the best funds is more important than ever*

PHOTOGRAPHY BY CAROL VAZIRI

Brijesh Jeevarathnam took a huge risk when, at age 18, he gave up a coveted spot at a highly competitive medical school in India and decided to leave his family and friends to move alone to the US.

His family expected him to become a doctor, but instead he broke away and enrolled in a private liberal arts college in upstate New York. The move paid off. More than 20 years after that life-changing decision, Jeevarathnam is now a successful investor in venture capital funds and has made a living out of taking risks.

Indeed, although venture capital can offer outsized returns, the odds of failure for investors are proportionately high.

Jeevarathnam, who spent 10 years at CommonFund in Connecticut, most recently as managing director and co-head of global venture capital and global emerging markets, and who recently became partner and co-head of global venture fund investment for Adams Street Partners in Menlo Park, California, is well aware of such odds.

“You need some luck in venture capital,” he says, quickly adding that luck alone is far from enough to succeed – finding the most skilled venture capitalists out there is also key.

Private Equity International caught up with Jeevarathnam for breakfast at San Francisco’s Four Seasons deep in “unicorn” country: a stone’s throw from Twitter’s headquarters and LinkedIn’s giant base. He explains the specific skills he seeks when

identifying the best venture capital firms.

“When we look at a venture capital firm, we’re looking for truly special people and franchises that can see what’s not obvious,” he says. “We’re looking for people who are obviously very smart, but who can also see trends and opportunities before the crowd and who can attract entrepreneurs and founders that others can’t. We’re backing special people.”

Jeevarathnam is also seeking out firms with strategies relevant in today’s market, particularly in technology, with themes like consumer internet, cloud computing or healthcare, among others. Firms that Adams Street Partners will eventually back also need to demonstrate a strong track record and the ability to produce robust returns on a consistent basis.

BACKING A VIRTUOUS CYCLE

Adams Street Partners, which also makes direct venture capital investments, has the advantage of having been in the business of backing VC firms since the 1970s. Jeevarathnam explains that venture capital is prone to high “return persistence”; firms that are successful in one cycle have a strong likelihood of success in the following cycles, more so than buyout firms.

“The same firms tend to show up in the top quartile cycle after cycle and the next generation of great entrepreneurs want them on board, so those firms tend to see the top dealflow,” he says. “There’s a virtuous cycle in venture capital where success »

» breeds success. But there is some churn at the top and we look to find and be early investors in the best ‘rising star’ managers before they become well-known venture brands.”

Because of that virtuous cycle, Adams Street Partners has a high re-up rate. But it also focuses time and capital on backing first-time funds, because it has become common for some of the top venture capitalists with personal brands to leave long-established general partners and found their own firms.

These younger partners, usually already wealthy, are typically in the prime of their career and want to focus on making money through capital gains rather than management fees, a boon for limited partners like Adams Street Partners.

On average, Adams Street Partners sees dozens of these spin or carve-out firms every year, but may back only one or two, such as Aleph, a \$150 million VC fund led by Michael Eisenberg.

THE RIGHT BLEND

Adams Street Partners’ limited partners are attracted by this dual approach to investing in both established venture capital firms as well as first-time funds.

“We believe [Adams Street Venture Innovation Fund]’s blended approach of securing long-term relationships while also backing new funds [with seasoned partners] can capture more alpha than re-ups with the old funds,” wrote Contra Costa County Employees’ Retirement Association’s chief investment officer Timothy Price in documents recommending a commitment to Adams Street Partners’ latest venture capital fund in March.

For several decades, Adams Street Partners has raised a new global pool of capital every year – ranging from \$800 million to more than \$1 billion – to invest in varied strategies, including venture capital, growth and buyouts on a global basis. Around

\$150 million to \$200 million of that pool has typically gone to venture capital. The firm is now, however, raising a separate offering dedicated to venture capital to cater to LPs that want to better focus their commitments.

The Adams Street Venture Innovation Fund, which is currently being marketed to investors, aims to raise at least \$150 million and intends to invest in 10 to 20 venture capital funds between 2016 and 2018, according to the pension plan documents.

CCCERA started investing with Adams Street Partners’ predecessor firm, Brinson Partners, 20 years ago and has benefited from the GP’s strong track record in venture capital over the years. In the spring it agreed to commit \$75 million to the new fund. The net internal rate of return for Adams Street Partners primary venture capital funds since inception in 1979 was above 25 percent as of March, compared with less than 20 percent for the NASDAQ, according to data published in the CCCERA documents. Since 1981, the wider USVC market has returned a net 18.2 percent, according to the Cambridge Associates US Venture Capital Index.

Following in the footsteps of the firm’s existing venture capital strategy, the Adams Street Venture Innovation Fund will target venture capital funds focused on early-stage companies and will be skewed toward the US, with around 20 percent to 30 percent of the fund invested outside of the US – mainly in China, but also selectively in India, Israel and Latin America.

The firm has also been concentrating its allocations in fewer venture capital funds over time, and as a result investing more money per manager.

“We have driven toward fewer relationships and more dollars per relationship,” Jeevarathnam says. “We’re fortunate to have good access and good allocation sizes, so it moves our return needle when we have IPO and M&A exits.” »





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» As co-head of global venture fund investment, Jeevarathnam works closely with Kelly Meldrum, who opened Adams Street Partners’ Menlo Park office 10 years ago and is now focusing more on the overall primary investment strategy at the firm.

As Jeevarathnam is taking over the venture capital arm of Adams Street’s primary investment team, the competitive landscape in venture capital has been evolving, with non-traditional sources of capital

competing with venture capital funds to invest in the best companies.

The participation of these emerging venture capital players – mainly comprised of hedge funds, mutual funds, large US corporations and sovereign wealth funds – has been pushing valuations up in recent years and have contributed to the creation of unicorns: venture capital-backed companies with valuations of \$1 billion or more.

Venture capital firms have raised on average \$30 billion a year for each of the

past two years, according to the National Venture Capital Association, while startups have raised on average \$40 billion to \$50 billion during those years, the difference being filled mainly by these non-traditional sources of capital.

"All those four sources of capital are huge relative to traditional sources of venture capital and all they have to do is make a minor incremental change in what they invest to change capital inflows, valuations and dynamics meaningfully," Jeevarathnam says.

"Venture is like a small tidal pool relative to the ocean of capital out there."

He anticipates that the non-traditional sources of venture capital are here to stay for a number of reasons. Generally speaking, they are all seeking high returns in a world where interest rates remain extremely low. Sovereign wealth funds are also looking to diversify their portfolios of investments, as Saudi Arabia's sovereign wealth fund, Public Investment Fund, recently demonstrated when it injected \$3.5 billion into car-sharing company Uber.

For mutual funds like Fidelity and T Rowe Price, investing in late-stage rounds of startups is akin to investing in technology companies' initial public offerings the way they did 10 years ago, since startups are staying private longer than they used to.

Some hedge funds, including Coatue Management, Tiger Global, Passport Capital and Third Point have, for their part, raised dedicated pools of capital to invest in tech startups, indicating they could be in venture capital for the long term.

Meanwhile, large corporations have upped their stake in tech startups to understand how millennials consume and to grab market share in that segment of the population. General Motors, for instance, recently invested in Lyft, one of Uber's main competitors.

Another recent change in venture capital has been more cyclical. After several years

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of strong valuations and attractive exits for startups, the market has now entered a more subdued period; 2014 and 2015 appear like they may have been the peak.

The exit market has somewhat shut down, with fewer IPOs, mainly due to higher volatility in the public markets. There were only six venture capital-backed IPOs in the first quarter, all from biotech companies, making it the slowest quarter since the third quarter of 2011, according to data from the NVCA. That number rebounded somewhat in the second quarter to 12 IPOs, but remains below the average of nearly 20 IPOs a quarter last year. The slowdown in public exits began in 2015, when the number of venture-backed IPOs fell to 77 from 117 in 2014.

STRONG RETURNS

Public market volatility has also had an impact on M&A activity, as strategic acquirers have been unable to use their stock as currency for acquisitions as easily as before. In 2015, there were 360 venture capital-backed M&A deals, or 90 per quarter on average, according to data from the NVCA. This was already down from 472 during the previous year. So far this year, there were 61 venture-backed deals in the first quarter and 79 in the second.

"In the last few years, we've had very strong returns and liquidity in venture capital," says Jeevarathnam, referring to the deal-heavy period between 2010 and 2015. "This year has not been good in terms of exits, and 2017 could go either

way depending on whether bellwether companies decide to go public next year and on whether they have a good reception in the public market."

But Jeevarathnam points to the fact that due to lock-up periods after IPOs or to venture capital firms not selling all stock immediately after an exit, distributions to LPs can often lag. As a result, his firm has continued to receive liquidity from exits that happened last year.

Meanwhile, the volume of venture capital investment has remained steady at around \$15.3 billion in the second quarter, which also represented the 10th successive quarter with more than \$10 billion going into venture-backed companies, according to the MoneyTree report from PricewaterhouseCoopers and the NVCA. But valuations have remained flat or even down in some cases, Jeevarathnam notes, pointing to the investment opportunity presented by the "innovation cycle".

"In terms of new investments, that's more dependent on the innovation cycle than on the capital market cycle," he adds. "The pace and scope of innovation is so robust that we still find the environment very attractive to invest. The investments we're making today will come to fruition in five, six or seven years."

Whether challenges come from new types of investors in venture-backed companies or from the cyclical nature of capital markets, Jeevarathnam believes that the fundamentals of venture capital investing have not changed.

"It is still an outlier business where only between 10 and 20 companies matter every year, out of the many hundred startups that get venture backing," he says.

"It is still a business where access matters and where being in the right funds matters. If you miss the best funds, you miss the best companies, which means that your returns are really not worth being in venture capital." ■