How the COVID-19 Crisis Ignited and Accelerated Venture Capital

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Based on the experience of the financial crisis of 2008, many feared that last year's coronavirus pandemic might devastate the world of venture capital. Instead, the industry is booming and changing, according to Harvard's Shai Bernstein, Bessemer Venture Partners' Felda Hardymon, and Fiona Darmon of Jerusalem Venture Partners. The three experts participated in a virtual venture capital round table organized by *Coller Venture Review*.

When the COVID-19 pandemic struck in early 2020, countries around the world went into lockdown, unemployment soared, and stock markets initially tanked in March and April. It seemed at that time that the double whammy of the health crisis coupled with the economic shock might devastate the world of venture capital investment. Much to the surprise of those who had expected a replay of the Great Recession of 2008, that did not happen. Felda Hardymon, a partner with global venture firm Bessemer Venture Partners, says "COVID-19, in fact, ignited venture capital. The truth is, it accelerated some parts of the industry and brought in even more outside capital."

These remarks were made at a virtual VC round table discussion organized in December by Tel Aviv University's *Coller Venture Review*. Shai Bernstein, an Associate Professor of Business Administration at Harvard Business School, hosted the round table with Fiona Darmon, a General Partner at Jerusalem Venture Partners (JVP), and Felda Hardymon of Bessemer Venture Partners.

Bernstein focused on three themes. First, he explored the impact of the coronavirus pandemic on venture capital, especially on the sourcing and geographic dispersion of investments. Second, he spoke about the emergence of mega-deals and the concentration of capital, including the fact that "80% of capital in the venture industry was allocated to rounds more than $25 million." Finally, he highlighted the

barriers to diversity and gender balance in the VC industry.

Bernstein began with an open-ended question: "How do you view the role of venture capital overall in society as an asset class?" he asked. In response, Hardymon noted that the pandemic has exacerbated a trend that has existed for the last four or five years and which has now taken off. "Growth equity is now increasingly treated as an intermediate, almost independent asset class," he said. "It has attracted hedge funds, private equity funds, even limited partners investing along with venture capitalists." The reason, Hardymon explained, is that "there is a perceived stability in startup companies that are well-sponsored and well-managed. Having been in the business for 42 years, [I know that] they are not all well-managed; in fact, often they are not. But in general, there is a kind of stability that is seen, and that has changed the way we do business."

Thanks in part to the infusion of fresh capital, Hardymon noted that

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Bessemer Venture Partners had approved 15 deals in two weekly meetings at the end of 2020. "Several of those were follow-ons," he said. "At least five were raising more than $100 million at a valuation of more than $1 billion. That used to be a public offering. Now it's just another Monday." The influx of outside capital had added to the stability, he added.

Entrepreneurs Without Borders

The COVID-19 crisis also accelerated another trend—the seeming disappearance of geographic borders for online business. "Entrepreneurship is borderless," Hardymon said. "Silicon Valley doesn't have a monopoly on innovation anymore. The COVID [pandemic] has accelerated online business and brought it forward [possibly] five to ten years." For example, he pointed to the software business, which is migrating increasingly to the cloud. "We are the largest investor in cloud software in the world," he added. "What does that mean? It means that Shopify, for example, can service the globe as far as startup companies go. It does not make any difference where you are. You can build a world-class company now on the cloud from any geography." As a result of these factors, Hardymon said, "venture capital is probably more important as an asset class than ever before."

Darmon agreed with Hardymon's view. "Both here in Israel and our offices in NYC, everything down to the last bit resonated true," she said. In March, at the onset of COVID, she and her colleagues at JVP "went into the trenches to strengthen the portfolio. We thought that no matter where the next 18 months were going to take the portfolio, we need to get ready. Our mind-set was, 'No matter the uncertainty, cash is king, and this is going to be a time for opportunity.'" Their top priority was to ensure that their portfolio companies had enough cash and credit to last at least 18 months. "We secured over $200 million of cash and about $70 million of credit facilities for the companies," she said. "It was all about ensuring that they had the resources to make it through, and even take advantage, of the storm."

As the months rolled by, Darmon and her colleagues realized that several companies, especially those engaged in enterprise, data, cyber and e-commerce, were thriving rather than struggling. "The move to home offices is only just one major example," she said. More and more people self-isolated and practiced social distancing because of the pandemic, and this sparked a surge of what Darmon described as "solace buying… from the comfort of your own room." She sits on the board of a company that went public last year, and it had to "digitize its packaging because everybody wanted more efficiently sized boxes for shipments. It became a crazy year. We have seen businesses go on steroids. We were getting ready to brace like [the recession of] 2008, and suddenly all these categories blew out of the park."

Among the additional sectors that saw robust growth were digital health, telemedicine, and logistics, Darmon noted. Banking was another sector that was forced to go digital almost overnight. "The banking sector in Israel didn't even know what online was until the pandemic kicked in," she said. "Suddenly you did not have to go to your branch any more to sign the forms; all that moved online. Many mom-and-pop stores moved online. Sadly, what stayed behind were the small domestic businesses that couldn't digitize their operations fast enough."

“Everything has changed. The most important thing is that the end game is different. We are looking bigger; we are seeing bigger”

Darmon, like Hardymon, witnessed the waves of new capital pouring into the industry. “We are seeing a tremendous amount of co-investment,” she said. “That was already the trend in 2019, but in 2020 it massively kicked up speed.”

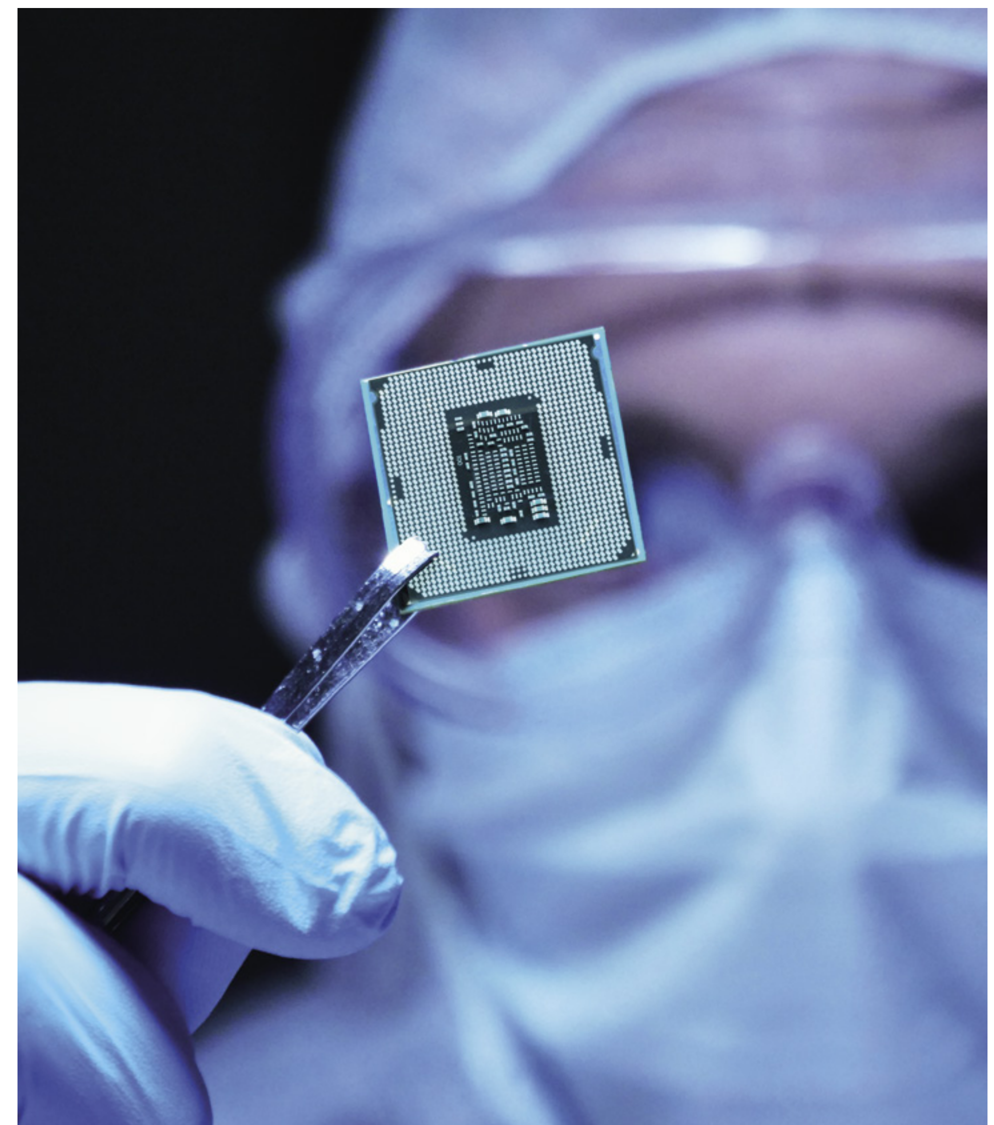
Darmon reiterated the critical importance of venture capital as an asset class. “There are so many great deals out there now,” she noted. “Nobody is looking at the capital market as the exit scenario.” Though Darmon had taken a company public in Tel Aviv two weeks before this discussion, she did not view it as an exit. “It is a form of growth equity, and we continue to build up these players,” she said. “Everything has changed. The most important thing is that the end game is different. We are looking bigger; we are seeing bigger.” Darmon observes more patience among Israeli entrepreneurs because they are ready to go further. “In terms of the role of the asset class, it is the most interesting one. It is driving the economy. It is creating jobs. It is creating an alternative to the old world.”

Bernstein asked Hardymon which sectors of industry were changing most because of the pandemic. The response: “One in every ten dollars in venture capital this year is going into digital healthcare.” While that might seem predictable, Hardymon believes that these investments are not a bubble. “It’s going to stay,” he said. “Like so many other things, things are getting moved forward that will be that way forever.” Software as a service (SaaS) is also an area that is attracting capital. “Even now, it accounts for 40% of our dollars going out,” he added.

Boom in Semiconductors

Hardymon believes “we are on the verge of another big boom in semiconductors.” He has a ringside view of this sector as a board member of a semiconductor company; and Bessemer has four or five semiconductor companies in its portfolio. “We have seen Nvidia buying everything that AMD or Intel can’t buy, he said. “There has been big consolidation at the top. And coming up underneath is a new set of semiconductor companies, which are going to be fundamentally different because we no longer depend on Moore’s Law.” Hardymon added that “materials are still really, really interesting,” and that “some of the semiconductor companies are now pushing materials. Quantum computing is fundamentally a materials thing. We have positions in all of those…they are now close enough that they are out of the science stage and into the development stage.”

Bernstein wondered what Darmon and Hardymon thought about the trend of capital growth and increasingly larger rounds of VC investment. “That triggers concentration on the venture side as funds are becoming bigger to keep up with the pace. But can this have made VCs even somewhat narrower in terms of the type of companies they are willing to fund?” he asked. “If you are an early-stage investor, you need to find companies that have the potential to absorb these large sums of capital down the road.”



Darmon noted that the question relates to a discussion going on within the venture capital sector about the changing role of seed capital. “Statistics show that in 2020 seed [investment] went down materially. This is primarily because a lot of capital has moved along the food chain. It is not necessarily because of concentration, but it is just that there is a tremendous amount of money available now, and that is probably one of the more interesting alternatives to the capital markets to a degree.” She added that as more capital has become available, VCs have been making some of it available to their portfolio companies to pursue strategic acquisitions. She did add though, that seed investments must continue, as these deals feed the food chain, and create the major companies of tomorrow, emphasizing the need to continue to allocate a certain number of investments to seed.

Bernstein asked how the presence of bigger funds—combined with the change in early-stage investing—has altered the investment strategy of venture capital firms. Hardymon replied that it has changed the whole VC industry. “I do think what Fiona (Darmon) said is one way that has happened. An even bigger force has been just the rush into the intermediate and growth stage capital from civilians and non-venture capitalists…The way the industry invests has changed.”

During the tech bubble of the late 1990s, the venture capital industry stage-shifted its strategy downwards. In contrast, the present transformation is different. “Two things have happened,” Hardymon noted. “One is that funds that can raise the money have done so and started to participate more in the middle and late rounds. You have the phenomenon of a lot of the big managers, us included, who have multiple funds that include later-stage funds. We have also made ➲

links down to the seed stage. We have several seed initiatives. We are not the only venture capital firm that has that." Some firms have alliances with entrepreneurship accelerators such as Tech Stars. "We have changed the way we do our business to catch things coming out and to get started early, and then having the drive power to ride them out. As a firm—and as an industry—we look at things differently."

Diversity and Gender Balance

As the discussion neared its end, Bernstein brought up the issue of diversity and gender balance in the venture capital field. According to Hardymon, this is an important issue, and "it is a problem in our industry." While Bessemer has had several "wonderful women partners, they… are at a bunch of other places because they got recruited away from us," he said. "But we have more in the pipeline." Darmon asked, "That is a question that you need to explore: Why do they move on?" "Well, because they get attractive offers," Hardymon replied. And Darmon said: "Okay… you just answered the question."

Darmon said JVP has an interesting situation. "Without ever putting it as an agenda, a statistic, a plan, we are 50% women partners," she said. "What suddenly happens when it's so balanced, it suddenly becomes more natural when you're recruiting to be looking at both women and men without realizing or consciously doing that." Darmon noted that women with strong positions in a VC firm usually cannot be brought from outside; they must be grown from within. "We have never made diversity a conscious agenda at JVP. It is just the way it is. There are times when there are more women than men around the table. It is so balanced because no one feels that they are there for any reason except for merit."

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Bernstein concluded the round table by asking both participants what should be done to make the venture capital industry more inclusive. Darmon noted that it was important to grow inclusiveness from within. "Very often, it is about mentorship, about growing another generation, giving them room to grow, and recruiting in very diverse places." Hardymon agreed with Darmon that VC firms need to grow diverse talent from within, "and we all have responsibility for that." In addition, he said that Bessemer has "always seen women as being part of the founding group [of portfolio companies], but we are also seeing more and more companies led by women. We are recruiting more and more women as CEOs, and that is because of the consciousness of the last 10 years. We are hitting the knee of the curve, at least in some places."

Darmon noted that venture capitalists—partners and managing partners—need to be rainmakers. "And for women to be strong partners, they must be rainmakers as well," she said. "The more female-led companies we see, CEOs we see, founders we see, we will also see them crossing the lines and becoming partners and leading funds." ■

About

Fiona Darmon, General Partner at Jerusalem Venture Partners is an integral part of the leadership team at JVP, overseeing the firms ongoing operations including defining the groups' strategy as well as leading the raising of numerous funds that have allowed JVP to continue building world-class technology companies. Darmon has over fifteen years of experience in venture capital, strategic planning, capital raising and investments in public and private companies, having previously held a variety of executive roles with leading Israeli investment conglomerate, Koor Industries, as well as serving as a founding member of the first Israeli corporate VC—Koor CVC.

Darmon started her career as a financial analyst with Claridge Israel LLC, the investment arm of the Bronfman family of Canada. Darmon was an Officer in one of the renowned units of the Israeli IDF, and holds a BA in Finance and IT and an Executive MBA from the Kellogg School of Management's international program in collaboration with Tel Aviv University.

Felda Hardymon, Partner at Bessemer Venture Partners since 1981 and Professor of Management Practice at Harvard Business School, focuses on investments in the software, semiconductors, communications, and storage sectors. At Bessemer, he led early investments in Parametric Technology, Staples, Cascade, Sirocco, Sahara, Celtel, and Endeca, all of which led to multi-billion dollar outcomes.

He taught and researched at Harvard Business School, where he held the appointment of MBA Class of 1975 Professor of Management Practice, and served twice as a visiting Professor of Finance at the London School of Economics.

In 2011, Professor Hardymon received the National Venture Capital Association's Lifetime Achievement award.

Now retired from academia, he is a co-author of *Venture Capital, Private Equity, and the Financing of Entrepreneurship*, the standard textbook for venture capital.

Professor Hardymon holds a Ph.D. in Mathematics from Duke University.

Professor Shai Bernstein is Associate Professor in Entrepreneurial Management at Harvard Business School and a Faculty Research Fellow at the National Bureau of Economic Research (NBER). His research focuses on financial issues related to startups and high growth firms, and their interaction with innovation and entrepreneurial activity. Prior to joining Harvard Business School, he was a faculty member at the Stanford Graduate School of Business.

Some of Professor Bernstein's latest research includes: *Does Venture Attract Human Capital and The Creation of Evolution of Entrepreneurial Public Markets.*

Professor Bernstein holds a Ph.D. in Business Economics from Harvard University.