

What are the private markets?

A guide to understanding and capitalizing on this fast-growing economic sector

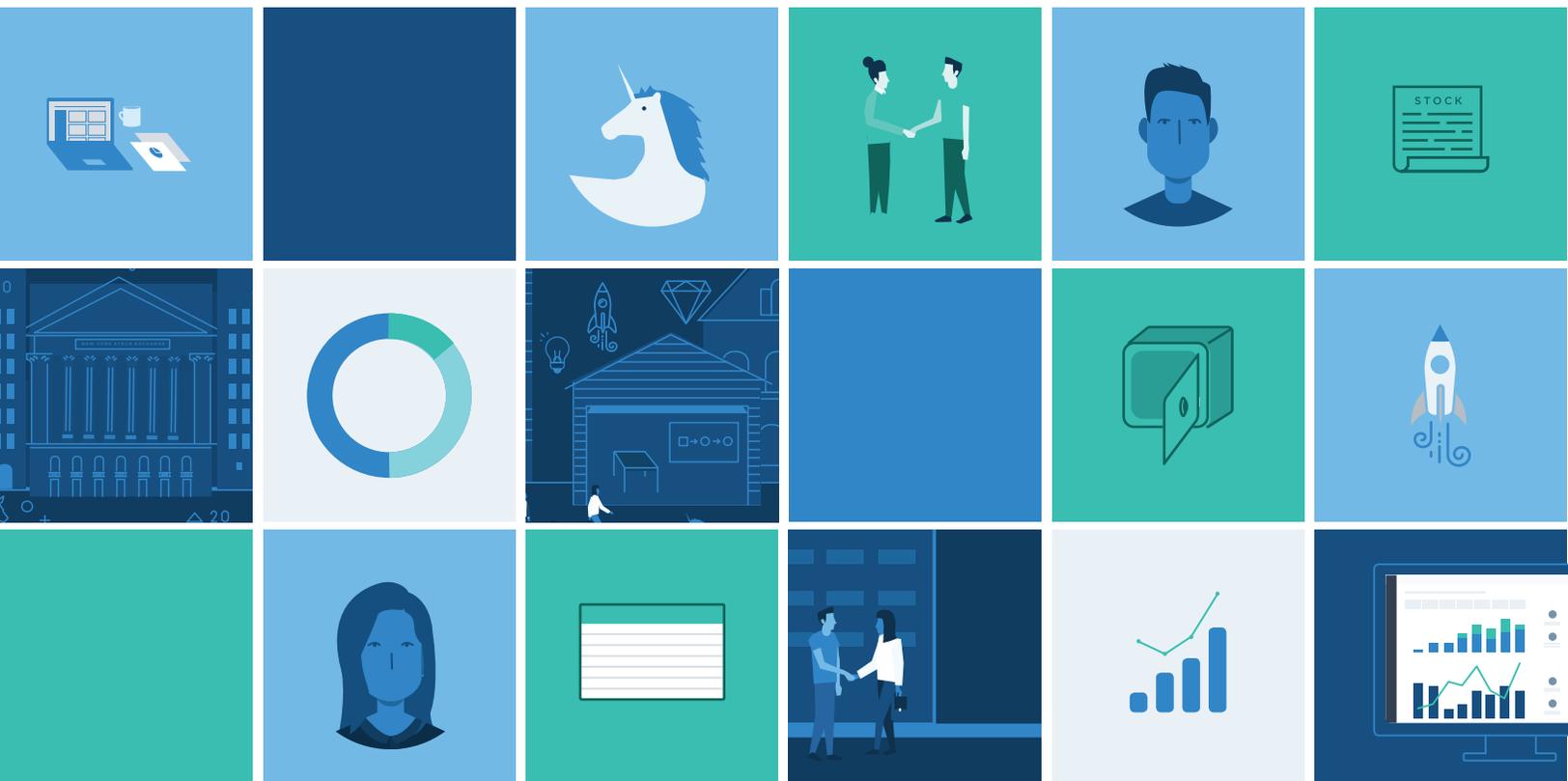


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What are venture capital and private equity?

Whether you're catching an Uber, booking an Airbnb or buying a pair of Toms, you use services and products from venture capital- and private equity-backed companies every day. Yet the average person is unlikely to know much, if anything, about this world. What does it mean, for example, when a company IPOs or gets funding? What does a limited partner or investment banker actually do? What makes a startup a startup?

Venture capital and private equity are two major subsets of a much larger, complex part of the financial landscape known as the private markets. Because this sector controls over a quarter of the U.S. economy by capital and 98 percent by number of companies, anyone in any business capacity, from sales to operations, should understand what it is and how to capitalize on it. Take a look! →

The difference between the public and private markets

The public markets

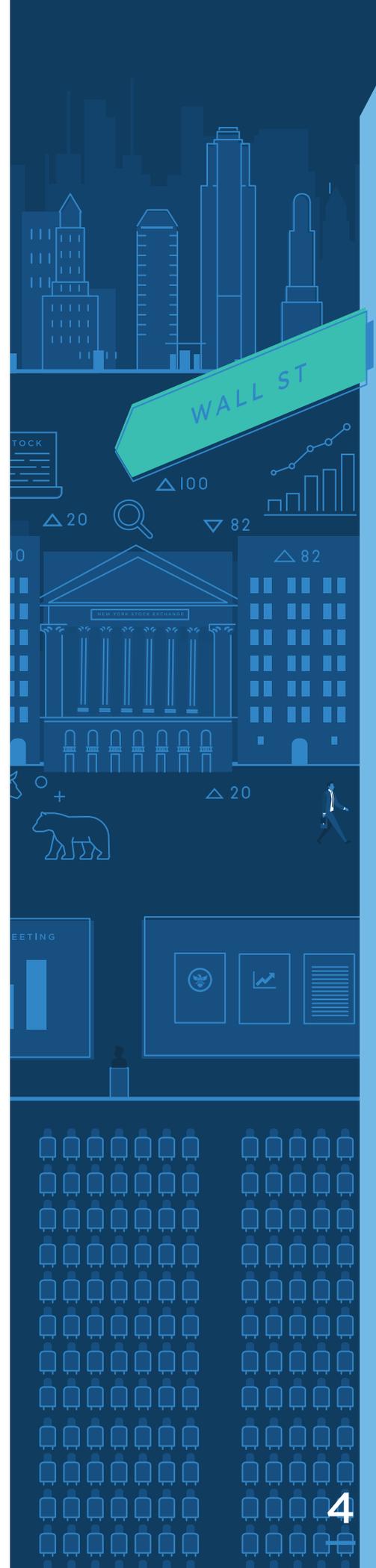
To understand the private markets, it's important to understand how this space differs from its more well-known counterpart, the public markets.

In the public markets, companies sell shares to the general population, who can then buy, sell or trade these shares on a stock exchange. When someone invests in the stock market—whether individually or through a program like a 401k—they own a small portion (a share) of the public companies they've invested in.

Often larger and more mature, public companies are heavily regulated by governmental organizations like the Securities Exchange Commission. To ensure they remain accountable to shareholders, these companies are also required to disclose information about their performance, which makes it easy to see their financials, revenue and more.

Key characteristics

- Individuals can invest in this market
- Public companies are heavily regulated
- Public companies must report on performance
- As a result, it's easy to find information about them



The private markets

In the private markets, on the other hand, fast-growing companies that are not publicly traded give professional investors equity in exchange for the funding and mentoring they need to continue growing. These investors include venture capital firms, which invest in young companies (startups), and private equity firms, which invest in more established companies. With the exception of extremely wealthy individuals, the general public cannot invest in this space.

Because private companies do not answer to public shareholders, they are less heavily regulated. They do not have to disclose earnings reports or submit financial statements for auditing, which makes it hard for outsiders to find reliable, accurate information about them.

It's important to note that not all private companies are backed by investors. A family or individually owned small business, for example, is unlikely to be backed by a venture capitalist or private equity firm, but it's still private—i.e., not traded on a public stock exchange. Most private companies fall into this category, but in this guide, we'll be focusing exclusively on private equity and venture capital.

Key characteristics

- | | |
|---|--|
|  Only professional investors (or very wealthy individuals) can invest in this market |  Private companies do not have to report on performance |
|  Private companies are less heavily regulated |  It's hard to find information about them |



Alternative vs. traditional asset classes

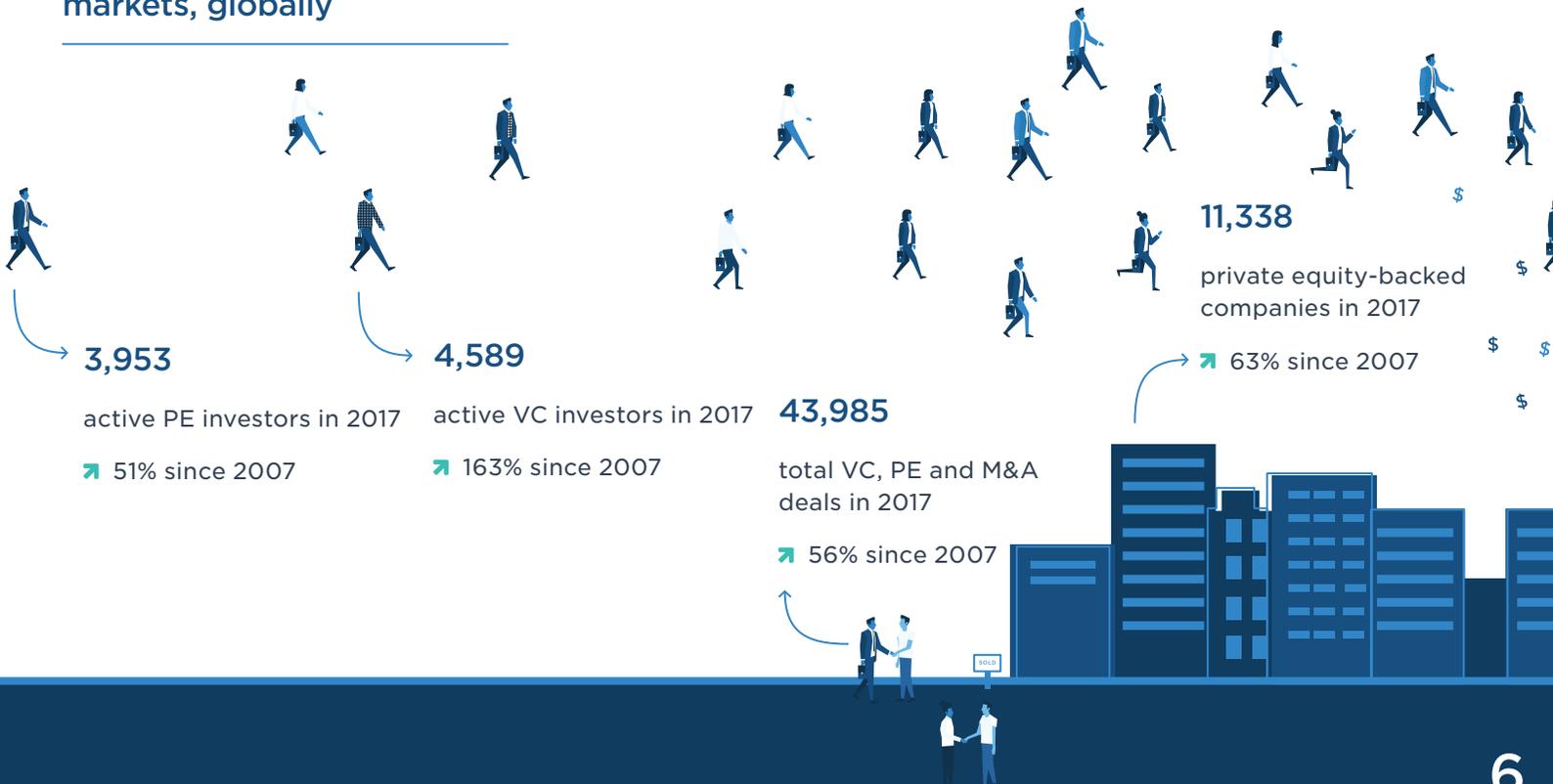
You may have also heard the term alternative asset classes—another word for the private markets. Alternative asset classes include venture capital, private equity, real estate and hedge funds. Traditional asset classes include stocks and bonds—more mainstream investments.

Why are the private markets valuable?

In the past, private companies often went public when their need for capital exceeded what private investors could provide. With a public debut, a company could quickly raise a large sum of money from public shareholders and use it to scale.

In the last decade, that approach has become less common. Take Airbnb, for example. Founded over 10 years ago, the online vacation rental platform has received funding from investors 11 times. It is now valued at \$31 billion and has offices in more than 15 countries—a size previously unattainable without a public debut. What changed?

The growth of the private markets, globally



1. Investors have flooded the private markets

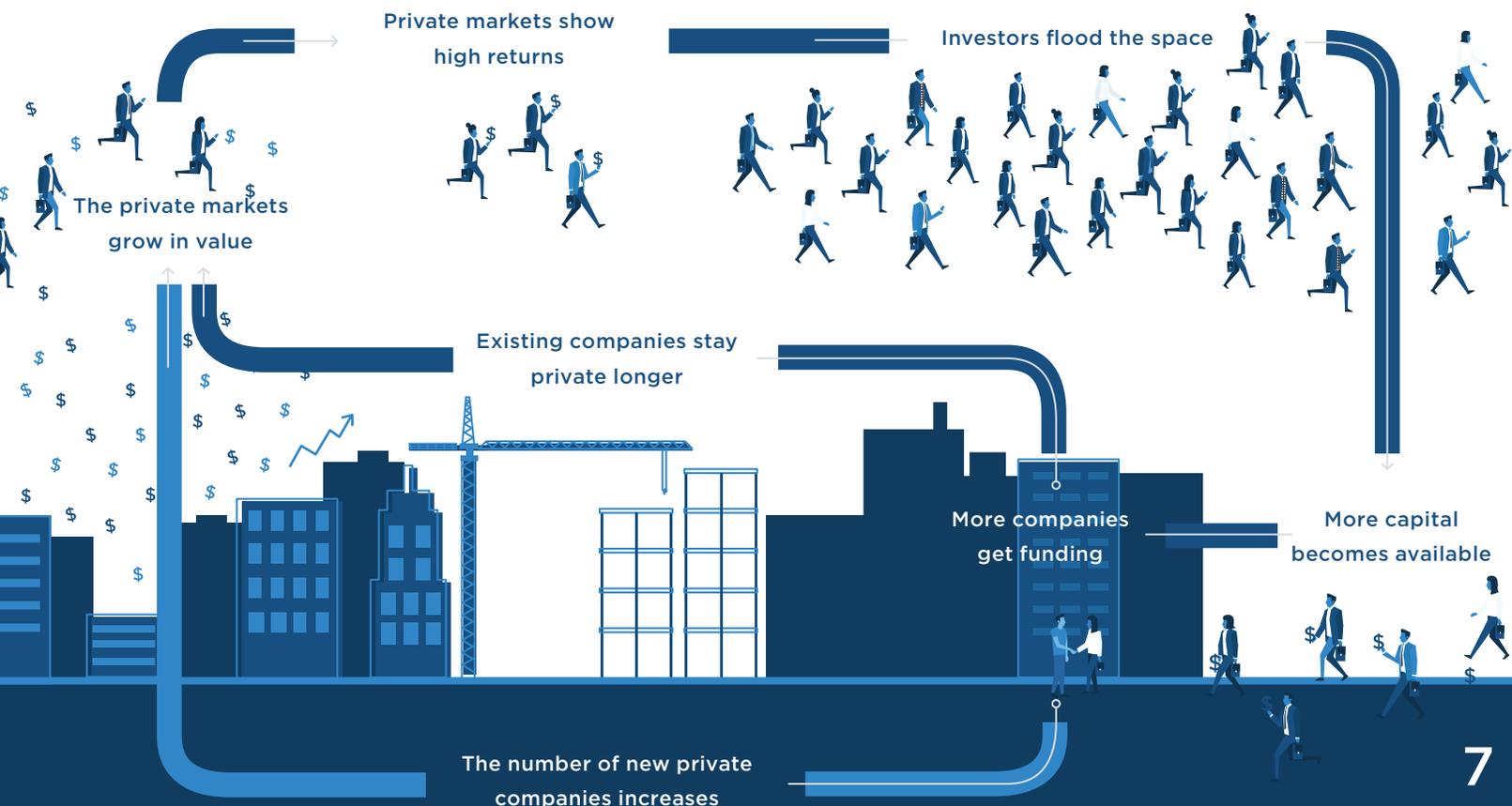
In recent years, investors—attracted by the potential for high returns—have flooded the private markets. This spike has created an influx in available capital, which, in turn, has altered the trajectory of private companies: No longer forced to raise capital on the public market, companies like Airbnb can rely on funding from investors and stay private longer.



2. More private companies are getting funding

As more investors pour more money into the private markets, it's now easier than ever for new private companies to get the funding they need to grow. As a result, we've seen a sharp influx in the number of VC-backed startups and PE-backed companies in recent years.

In other words, as more money flows into this space and as more companies stay (and start up) within it, the private markets will continue to grow in value and opportunity.



Who works in the private markets?

A large part of the economy and the tech industry, the private markets are home to millions of professionals and businesses, from investors like venture capitalists to service providers like accounting firms. Whether you're looking to find new clients in your current market or looking to uncover an entirely new source of revenue, making connections in this space will help you quickly build your business.

To help you navigate this crowded landscape and make sense of who does what, we've defined the players below. At the top, you'll find professionals who operate squarely within this realm. As you continue down the list, you'll discover more peripheral players—professionals who work closely (though not exclusively) with private companies and their investors. Take a look! →



Venture capital firms

Using capital raised from limited partners (see limited partners below), venture capital (VC) firms fund and mentor startups or other young, often tech-focused companies in exchange for equity. If a company the firm has invested in is successfully acquired or eventually goes public, the firm makes a profit. The firm could also make a profit by selling some of its shares to another investor in what's called the secondary market. Investors working at a venture capital firm are called venture capitalists.



Corporate venture capital

Corporate venture capital (CVC) is a subset of venture capital in which large companies strategically invest in startups—often those operating within or adjacent to their core industry—to gain a competitive advantage or increase revenue. Unlike VC investments, CVC investments are made using corporate dollars, not through contributions from limited partners (see limited partners below).



Private equity firms

Like VC firms, private equity (PE) firms invest in businesses with a goal of increasing value over time before eventually selling at a profit. In contrast to VC firms, PE firms often take a majority stake—meaning 50 percent ownership or more—in mature companies in traditional industries. This practice, however, is changing as PE firms increasingly buy out VC-backed tech companies.



Incubators and accelerators

Incubators and accelerators are competitive programs that offer entrepreneurs financial support, connections, mentorship, working space and technical resources in exchange for a minority stake in their business.



Angel investor

An angel investor is a high net-worth individual who provides capital to an early stage startup in exchange for equity.



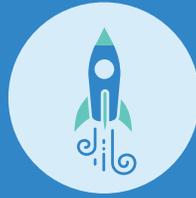
Limited partners

Limited partners are large institutions (like insurance or pension plan providers) that must steadily increase their cash reserves to financially provide for the large groups of people they serve. They do this (in part) by committing capital to funds raised by VC or PE firms, who then invest in promising companies and provide financial returns.



Private companies

A private company is a company that is not listed on a stock exchange or publicly traded. Its shares are owned by the founders, the employees or some outside investors (like VC firms)—and are not available for the public to purchase.



Startups

A startup is a fast-growing private company in an early stage of development. Often led by entrepreneurial founders who have built a new product or service in response to a market need, startups rely on funding from investors (like venture capitalists) to scale and grow.



Unicorns

A unicorn is a startup valued at \$1 billion or more. Once relatively rare, unicorns have become more common as startups stay private longer, securing higher and higher valuations with each new round of funding.



Strategic acquirers

Strategic acquirers are companies that purchase other companies to eliminate competitors, secure new technologies, move into new verticals or gain other competitive advantages. Acquisitions are usually carried out by an internal group called a corporate development team.



Investment banks

An investment bank (I-bank) serves as an intermediary in transactions, representing either the buyer or seller of a company. Among other services, an I-bank can provide advice on deal structuring, pricing and negotiation, or serve as the underwriter in an IPO.



Lenders

A lender loans capital to an individual or business with the expectation that the funds will be repaid with interest. Because debt often plays a critical role in financial transactions, lenders work with many companies and firms in the private markets.



Law firms

Law firms are involved in almost every private market transaction—whether they’re representing the buyer or seller of a company, advising on the formation of funds or protecting clients from legal risks associated with the exchange of capital.



Accounting firms

Accounting firms provide auditing and valuation services for transactions, help newly merged or acquired companies run smoothly and work with investors to ensure their portfolio companies are operating efficiently.



Vendors

Vendors—from marketing automation software providers to office furniture suppliers to insurance companies—outfit private market companies and professionals with the products and services they need to do business.



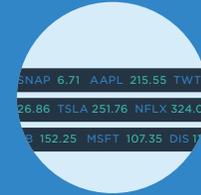
Commercial real estate firms

Commercial real estate firms help companies find new space as they grow. Because private companies often use funding from investors to hire more employees, they frequently need to lease bigger offices or open new locations.



Executive search firms

Executive search firms help companies build executive teams or hire employees as they grow. An executive search firm might be hired by the company itself or by an investment firm that wants to ensure its portfolio companies are securing top talent.



Public companies

Although public and private companies operate within different sectors, crossover is common. A public company can become private in what’s known as a public-to-private buyout—something that occurs when investors, founders or management buy back publicly issued shares, thereby removing the company from the stock exchange. Public companies also often purchase private companies in order to grow or compete (see strategic acquirers, page 10), and many private companies aim to eventually go public.

What kinds of financial events take place in the private markets?

Home to millions of professionals and companies, the private markets are a fast-growing, fast-moving arena where major financial events and transactions take place. Here, venture capital and private equity firms raise funds and invest in promising targets. Startups receive capital from investors and use it to grow. Companies undergo mergers, make acquisitions and navigate changes like restructuring, management shifts or office moves.

Because these events indicate the company or firm needs new products or services, understanding private market activity is a powerful, efficient way to uncover business opportunities. We've highlighted the key events you should know about below—dive in! →

Key events

Opening a fund

When a VC or PE firm opens a fund, it's in the process of raising a large pool of capital, which it will then use to invest in promising private companies. VC and PE firms raise this money from limited partners (see limited partners, page 9).

Closing a fund

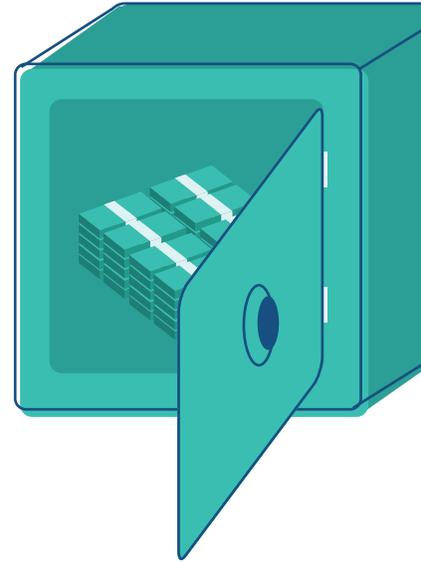
When a VC or PE firm closes a fund, it has completed the fundraising process and is focused on investing in private companies.

Limited partner commitment

VC and PE firms receive the capital they need to invest in promising companies from limited partners (see limited partners, page 9). When a limited partner agrees to contribute a certain amount of capital to a VC or PE firm's fund, it makes what's called a commitment.

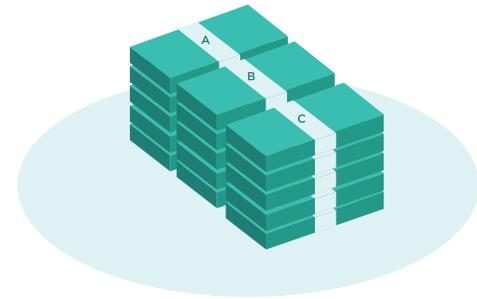
Seed round

When a venture capitalist provides an early stage company with a relatively small amount of capital to be used for product development, market research or business plan development, it's called a seed round. As its name suggests, a seed round is often the company's first official round of funding. Seed round investors are typically given convertible notes, equity or preferred stock options in exchange for their investment.



Venture capital round (venture capital financing or venture capital deal)

Once a company has a viable product or service, it often receives additional funding from venture capitalists, which it uses to fine-tune its product, hire staff and scale. Venture capital is invested in rounds, or series, designated by letters: Series A, Series B, Series C, etc.



Valuation

A valuation determines a company's current dollar value based on a variety of factors, including capital and ownership structure. Often (though not always) each round of investor funding increases a company's valuation, which is why valuations are often referred to as pre- or post-money ("money," in this case, refers to a round of funding). If a private company goes public or is acquired, its valuation is used to help calculate the share price or purchase price.

Cap table (capitalization table)

As startups receive funding, their capital structure evolves. Cap tables are important because they show who invested in each round at what share price. They also outline liquidation preferences. This helps investors understand how valuable their equity is as well as how diluted shares may be.

Series terms (deal terms)

With each new round of funding, new series terms are negotiated. These terms define how a deal is structured, outlining liquidation preferences, dividend rights, anti-dilution provisions, voting rights and more.

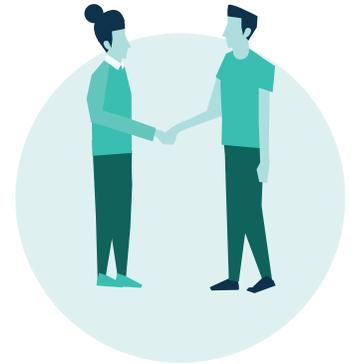
| Series | # of shares authorized | Par value | Dividend rate (\$) | Original issue price | Liquidation | Liquidation pref. multiple | Conversion price | % owned |
|--------|------------------------|-----------|--------------------|----------------------|-------------|----------------------------|------------------|---------|
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Leveraged buyout (LBO)

In a leveraged buyout (LBO), an investor purchases a controlling stake in a company using a combination of equity and a significant amount of debt, which must eventually be repaid by the company. In the interim, the investor works to improve profitability, so debt repayment is less of a financial burden for the company.

Mergers and acquisitions (M&A)

A merger is a financial transaction that results in the combining of two companies to form a new company. Following a merger, the new company might combine names or re-brand itself to reflect its newly merged products, operations or strengths. An acquisition, on the other hand, occurs when one company buys another company and folds it into its operations.

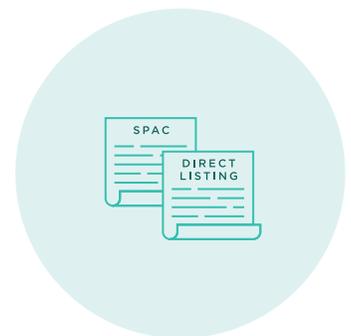


Initial public offering (IPO)

When a company goes through an initial public offering (IPO), it debuts on a public stock exchange and goes from private to public; at that point, the general population can invest in it. Companies tend to go public when they can no longer raise the necessary funds for growth from private investors. Before a company goes public, the SEC must deem it stable and suitable for public investment.

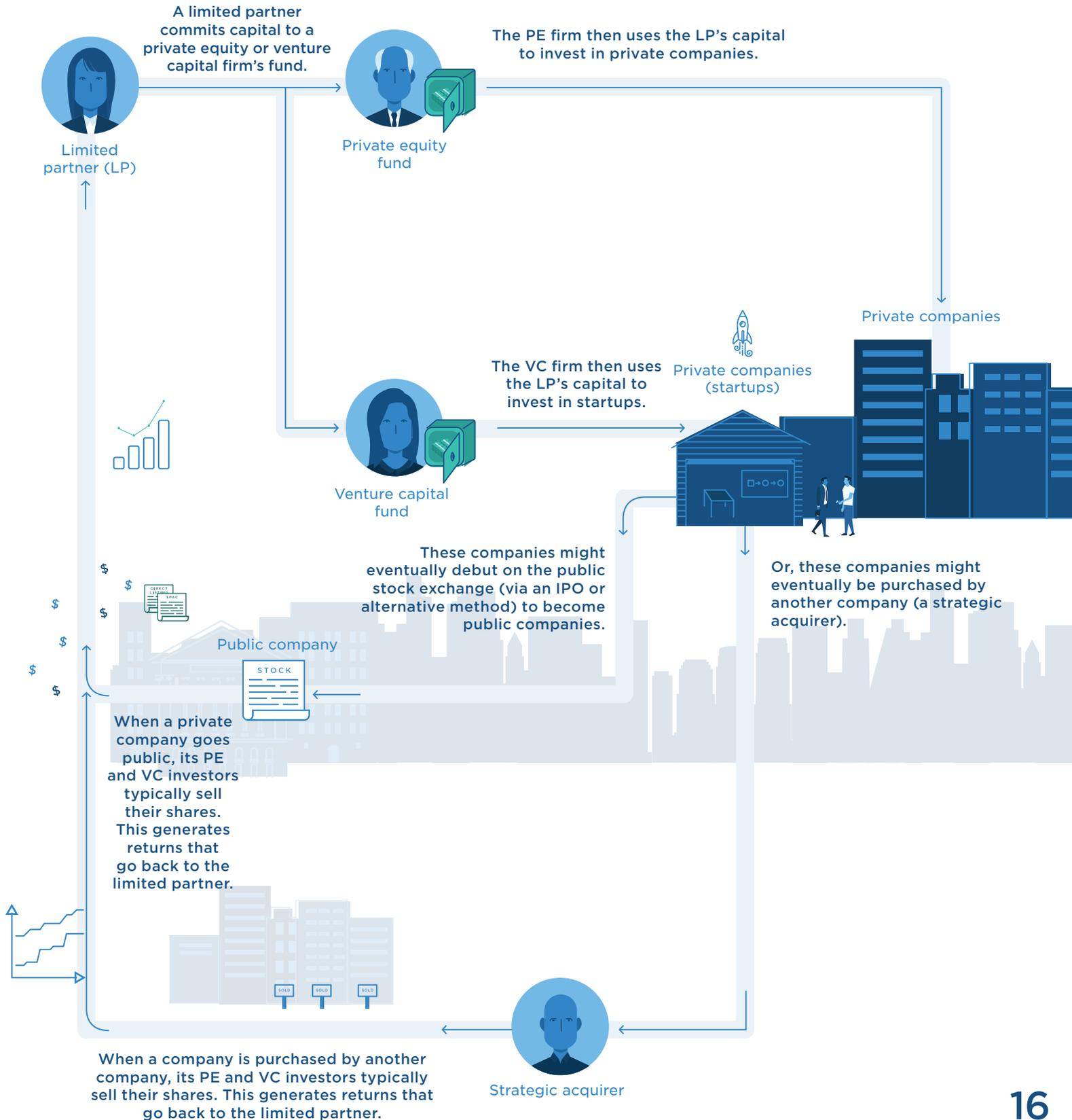
Alternative ways to go public

Because an IPO can be a complex, lengthy and expensive process, some companies opt to go public through alternative methods, like via direct listings or special purpose acquisition companies (SPACs).



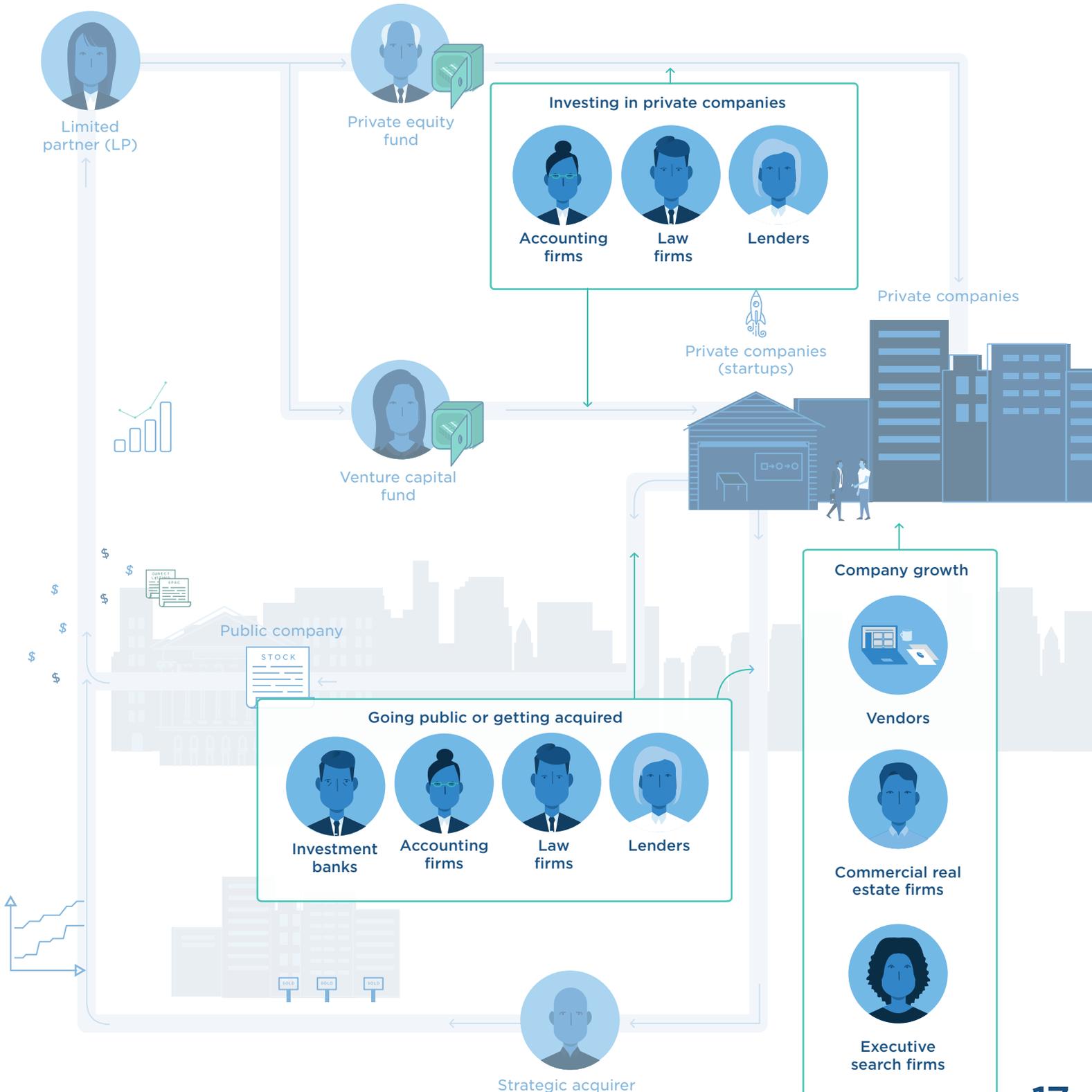
The exchange of private market capital

As capital flows through the private markets, it moves from entity to entity through a series of financial transactions. Below, we've illustrated a simplified version of this exchange.



Where businesses can get involved

Every time capital changes hands in the private markets, professionals advise on or execute the transaction, which then initiates a growth or transition phase for the company (or companies) involved. Here, we've highlighted where businesses can enter the process.



Why your business should be tapping into the private markets

Now that you've seen how capital flows through the private markets (and how professionals, firms and vendors can get involved at every step), you've also seen why tapping into this space is essential for growing your business. If you're overlooking it, you're overlooking a major, fast-growing sector of the economy—one that includes millions of companies, from venture-backed startups like Lyft to private equity-backed franchises like Safeway.

Last year alone, more than 40,000 deals involving venture capital financing, private equity financing or mergers and acquisitions took place. Each of the companies and investors involved in those deals likely:

- Hired skilled professionals (like lawyers or accountants) to facilitate those transactions.
- Purchased new products (like software or office equipment) to navigate growth and restructuring.
- Relied on outside firms (like executive search or commercial real estate firms) to handle hiring or moving.

43,985

total number of VC, PE and M&A deals closed in 2017

56% since 2007

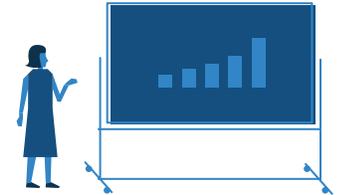


A valuable market

With an understanding of the private markets, you can become the vendor or service provider these professionals and companies turn to. Here's how:

Find fast-growing companies

Get in early with startups and work with them at every stage of their growth. They are growing fast and likely need your products or services.



Reach out at the right time

Follow financing events (like mergers and acquisitions) to see when companies are undergoing big changes and reach out at the right time.



Pursue the right targets

Identify new industries, territories and accounts to pursue based on where venture capital and private equity firms are investing.



Build business relationships

Create relationships with VC and PE firms so they come to you every time one of their many portfolio companies needs your products or services.



Scale your business faster than ever with private market data

The private markets are full of valuable opportunities for business development—and PitchBook has the comprehensive data you need to capitalize on them.

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