Will Uber's cash path spur others?

June 8 2016, by David Pierson And Tracey Lien, Los Angeles Times

Startups have long been the domain of venture capitalists. But with last week's staggering $3.5 billion investment in Uber from Saudi Arabia's Public Investment Fund, the tech world has been put on notice - sovereign wealth funds are loaded with cash and ready to do business directly.

Paltry interest rates and volatile oil prices have made technology companies attractive to these government investment vehicles, which have assets of $7.2 trillion today, according to the Sovereign Wealth Fund Institute.

That's more than double the amount from a decade ago as rapid development and a commodity boom in emerging markets such as Asia and the Middle East have bolstered the number and size of the world's sovereign wealth funds.

Having witnessed the explosion of e-commerce, mobile apps and on-demand services in their home countries, many have opened offices near Silicon Valley hoping to stash their money in new technologies.

China's Investment Corp. contributed to Uber-rival Didi Chuxing's $2 billion private equity round in 2015. As did Singapore's Temasek Holding's, which was also involved in Airbnb's $1.5 billion private equity round the same year.

Malaysia's Khazanah Nasional Berhad has invested hundreds of millions in startups such as Fractal Analytics, a data analysis firm, and Garena, one of Southeast Asia's largest gaming platforms. The Qatar Investment Authority has been a big backer of Uber and Flipkart, an Indian e-commerce platform.

Sovereign wealth funds are increasing their investments in funding rounds of $100 million or more for venture capital-backed companies this year, according to CB Insights.

As of May, government funds participated in as many as 22 percent of such investment rounds this year, up from 13 percent in 2015. Venture capital funds participated in 36 percent of such rounds in May, down slightly from 38 percent last year.

"Sovereign wealth funds are going to play a much bigger role now in tech," said Michael Maduell, president of the Sovereign Wealth Fund Institute. "They have the capital and are looking for the best returns."

That's good news for larger, private tech companies such as Uber, which is now valued at $62.5 billion. Sovereign wealth funds are used to writing big checks - and Uber is so valuable now that few in Silicon Valley have the funds to buy a stake.

"They need to look for investors with very, very deep pockets," said Evan Rawley, an associate professor of business at Columbia Business School. "They may run out of private investors that can pony up that kind of money."

Public investors would no doubt leap at the opportunity to shower Uber with billions. But the ride-hailing giant and other tech unicorns - startups valued at $1 billion or more - don't want to go public, at least not yet.

Sovereign wealth funds could offer companies such as Uber more favorable terms and less scrutiny than venture capital companies with their roster of anxious investors - or public markets, which require transparency and stricter regulation.

"You could be cynical and say all the smart money's gone," Rawley said.

The payoff for sovereign wealth funds such as Saudi Arabia's Public Investment Fund is a seat at the table at one of the world's hottest startups, establishing itself as a major player.

Saudi Arabia is attempting to reduce its reliance oil revenue and aims to diversify its assets under the guidance of deputy crown prince Mohammad bin Salman al Saud, a noted fan of Steve Jobs.

If major institutional investors such as the Saudi fund go directly to companies such as Uber, that could pose a problem for venture capital firms, which view themselves as gatekeepers to the next generation of valuable companies.

"With Uber getting big enough, it now makes enough sense for them to disintermediate the VC firms and go straight to Saudi Arabia or other institutional investors," said Timothy Spangler, a venture capital expert at UCLA School of Law.

"VC firms are the middleman," Spangler added. "And everything I've learned about tech since 1998 is about getting rid of the middleman."

Ajay Chopra, general partner at Trinity Ventures in Silicon Valley, isn't so sure. Sovereign wealth funds are relegated to the late rounds where there's less risk, but also less reward, he said.

"We don't see them as competition," Chopra said. "Venture is a different game. We're betting on companies that might not be successful. When sovereign wealth funds come in, it's a stage when success is all but guaranteed. It's just the level of success that's in doubt."

As for the companies, they also have to be wary of the governments they take money from. Another one of Malaysia's sovereign funds, 1Malaysia Development Bhd., or 1MDB, is currently embroiled in a money laundering scandal that has resulted investigations of its assets across the globe, including in the U.S., Britain and Hong Kong.

More often, though, the criticism blows over - such as when American labor organizations objected to China Investment Corp.'s $3 billion stake in U.S. private equity firm Blackstone Group in 2007 (Incidentally, it was China Investment Corp. that had to answer to criticism at home when shares of Blackstone tanked).

There were also rumblings last week that Uber had partnered with a country where most women are still restricted from driving.

"One cannot deny there is always a level of social and political risk when engaging in cross-border investing," said Maduell of the Sovereign Wealth Fund Institute.

Citation: Will Uber's cash path spur others? (2016, June 8) retrieved 25 April 2024 from https://phys.org/news/2016-06-uber-cash-path-spur.html