FINTECH ONE-ON-ONE PODCAST 371-MATT HARRIS

Welcome to the Fintech One-on-One Podcast, Episode No. 371. This is your host, Peter Renton, Chairman and Co-Founder of Fintech Nexus.

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Peter Renton: Today on the show, we have a fascinating interview I conducted on the Keynote Stage at Fintech Nexus USA on May 26th, it was with Matt Harris, longtime Partner at Bain Capital Ventures. The title of the talk was "How VCs Are Navigating Today's Turbulent Market" and Matt has some very interesting things to say about what happened in 2021, what's happening now, what he thinks is going to be happening in the 12 to18 months.

He doesn't pull any punches, he lays it out in pretty stark language as you will see here. It wasn't all about that though, we also spent some time chatting about his Forbes article from last year on "The Future of Money" which I thought was an astounding piece, he takes us, you know, 20/30 years into the future and how money is going to look and he has some fascinating ideas there. Anyway, it really was one of my favorite conversations I've had in a long time and I hope you enjoy the show.

Matt Harris: Okay, see you, sir.

Peter: Yes, good to see you. Thank you, Bo, okay. So, we have a slide on the Opening Remarks yesterday that said, we live in interesting times.

Matt: Indeed.

Peter: We do and for people, there might be a handful that don't know you, why don't you just give a quick intro first.

Matt: Matt Harris, Partner at Bain Capital where I run the fintech practice. Started at Bain Capital in 1995, left, started my own early-stage venture firm in late 1999 to focus on fintech, came back ten years ago when fintech became more of a thing, delighted to be here not for the first time.

Peter: No, not for the first time indeed and we're delighted to have you back. So, maybe you can give us your take, it's been an interesting couple of years in fintech, particularly if you're a venture capitalist, why don't you give us your take on the state of the fintech market today.

Matt: I think if you take it from the perspective of a customer, it's fantastic.

Peter: Right.

Matt: I mean, the solutions are amazing, maybe too good in certain cases (laughs), gotten ahead of ourselves in terms of various propositions, particularly in lending and proptech and some of them are balance sheet-intensive propositions, but even if you think about B2B solutions, the amount of

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investment that's gone into it, the delta between the value propositions and the elegance of the design and the functionality of the products that consumers and businesses are enjoying today versus were we were five years ago is amazing. That said, you know, as human beings do, we got a little over exuberant about what all that is worth in terms of equity valuation and sadly now, we're kind of reaping the harvest of that over exuberance.

Peter: Right, right. So, I remember you were in our webinar with Steve McLaughlin and several others, Nigel Morris and a few others, very early in the pandemic you said that, you know, we're not going to do deals via Zoom, that just not going to happen. Obviously, that did happen, but do you think that was a contributing factor to this sort of crazy time we had last year where term sheets were coming out in days and there was a lot of pressure to really compete with all the other VCs because there was so much money available?

Matt: A number of really important points this question brings out, the first one is that you should take everything I say with a grain of salt (both laugh) because about half of that is I'm being wrong so keep that in mind. The second is that Zoom contributed to what became, I would even go so far as to say a toxic situation in terms of how funding was raised, how much of it was raised than it would valuation and that actually, sadly, the victims of that toxicity, in some part, will be the investors, but actually will be the founders who raised all this money at this prices that they now have to live up to and hired all these people as we're hearing day in, day out now some of them will have to be let go and it was highly problematic. I mean, I'll just say for my part, I took 2021 off entirely, didn't do a single deal.

Peter: You didn't do a single deal?

Matt: Yeah. I did some via Zoom in 2020, as you point out, and I actually think Zoom is....the thing that Zoom did for us was turn our business global.

Peter: Right.

Matt: The last deal I did was in London and the next deal I do will probably be overseas as well just because we can now spend relatively intimate quality time with cross border founders. So, that's a great event, it's great for the world that funding be distributed even more evenly geographically, both within the US and globally, but like most great technologies it empowered wonderful things and it empowered excesses.

Peter: Sounds like you were looking from the sidelines at your fellow VCs clamoring for deals that have high valuations, what did you think?

Matt: Well, the first thing to note is that I wasn't generally looking at VCs, I'd love to hear the guesses from the audience, but if you had to guess what percent of all the venture capital last year was invested by VCs I suspect you would think a majority. But, no, 25% of all the dollars invested last year were by people who call themselves a VC or trained as VCs or anything like that, 75% were for people who discovered this new lovely activity (laughs). You know, look, I have no pride particularly about VCs, I don't think we're perfect at what we do, but we do do it for a living, like there's got to be

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something to it, right. We're not like cardiac surgeons, but it's also not exactly the perfect activity for tourists or amateurs and that came to dominate our field of endeavor.

Peter: Well, eventually, you have your track record that sort of speaks for itself in many ways,

Matt: Again, speaking on behalf of my profession, we should all be very humble, humble of our work, we are deeply imperfect, but there is a little something to it, there's a little something to it. And so, the fact that this explosion on our asset class was majority-driven by people who'd never done this before, I think should get our attention.

Peter: Right, that's a really good point. So, what do you feel like today, there's obviously the public markets, every fintech stock pretty much is down, some down a lot and do you look at the public markets as a good barometer for where the private market valuation should be? What's the interplay between the two?

Matt: I'm now in three public boards and my gut is that the current valuations and what happened, say more about the public markets than they do about the companies or about fintech, you know, just sort of living through it, like it was dogmatically true for most of the last 20 years that unprofitable companies shouldn't go public, that the public markets were, you know, may be good at a few things, but evaluating hyper growth, hyper dynamic unprofitable businesses, definitely not. You know, you look at the Russell 5000, it's just this index that tracks small caps, there's 3,200 companies in it because the public markets universe has shrunk so dramatically they can't even fill the Russell 5000 anymore. The number of public companies got cut in half over 20 years.

Peter: That's less than 5,000 public companies, right.

Matt: Yeah. So, that happened for a reason and not because the public markets are broken. The majority of the money is passive indices, that means very small sets of funds control the price and we're also just the price taker and so when those funds, those people get excited things go like this and when they get unhappy, things go like that.

Peter: Right.

Matt: Nobody is the big middle majority tempering ups or downs so I don't know if or when I'll ever take a company public again, but that whole system of funding companies and valuing companies is totally broken both ways and yet it does influence the private market.

Peter: Right, right. So then, when you invest in a private company and it goes public now, do you want to exit that company right then because it's now in a broken market?

Matt: First, I don't want to do it anymore. (both laugh) Again, judging by my track record in fireside chats of how we're doing another one in six months, but I think we should be very careful about what types of companies, what growth rates, what level of predictability, what level of profitability we choose to go public, but it's really just a financing event and fundamentally, if I think I want to exit, if my goal

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would be to sell the stock then ethically and otherwise, I shouldn't take the company public, you know what I mean. Foisting it then off on widows and orphans and, you know, retail investors, that's not how we'd like to do business so the answer is, no, we don't look to sell, haven't historically looked to sell, I'm not interested in selling out of any of my positions, but I think it is true for venture capitalists that it does start a clock, right, we don't actually get paid to manage public stocks, right.

So, we have to have a plan to get liquid and that, honestly, is not a happy pressure to have because companies are on a journey and I'd like to be able to, at my own discretion working closely with the founder, pick the time to exit based on where they are in the journey, not based on some public market dynamic. That's just another reason for me why it gets in the way of me doing my craft and when I want to do it.

Peter: Would say now then the venture capital......are we back to a more normal system where it's not just clamoring for terms sheets and now it's a bit more like pre-pandemic?

Matt: Well, we're back to something (both laugh), it's not pre-pandemic normal. The pre-pandemic normal was not a historical normal. The kind of like a 20-year average valuation for a software company is five or six times revenue, pre-pandemic it got to ten times, peak of the market of the public universe got to high 20s revenue multiple and then in the private markets it got to 100 times revenue, often more.

I think the fundamental question facing all of us is what is normal now and in my experience, you know, kind of history doesn't repeat, it rhymes, it won't look just like anything that we've been through. We have to draw on more fundamental analysis to say what is a fair price, fair to the founder, fair to the investor, where does that market settle and we have to do in the context of a lot of broken companies. The hangover will correspond to how good the party was to a certain extent, this is a really good party. (laughs)

Peter: (laughs) It was a good party because.....

Matt: Well, 12-year long extremely good party and the last two years of which were, like I said, I was watching from outside the window, but it looked pretty fun,

Peter: They were doing jager shots at 3 in the morning. (laughs)

Matt: So, I think that tells you what you need to know, but the next 12 to 18 months which aren't going to feel normal, they're going to be like a reaction and a lot of the people, the actual human beings whose job it is to make these investments are pretty busy worrying about the stuff they did last year so that's a big factor.

Peter: Right, So, if there's a founder in the audience who's thinking they need to start on their Series B or Series C or even Series A, what advice would you give them today that would maximize their likelihood to get funding at a valuation everyone's comfortable with?

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Matt: Facts and circumstances matter a lot, hard to give general advice, but I do think we have a couple of months here where there's still some business-as-usual activities going on where people are going to have a sharper pencil on valuation, but if your last round wasn't crazy, you do have a chance to do an up round, you know, because you've made progress, etc. And so, the iron is cooling pretty rapidly, I would go to market immediately and target people who know you already because by the time someone gets to know you in the new normal timeframes, the market's going to get worse before it gets better.

So, right now, there's a four/six/eight-week window where you can get up rounds done by new investors and I suspect by mid-summer that won't be happening anymore which will lead us to the more likely scenarios, your insiders where you say hey folks, we'd prefer to be raising money in 2023, ideally 2024, we, the company, are doing the right things to make sure we get there, but, in fact, we need $5 to 15 Million or $2 Million or $18 Million or whatever it is to get there in good order and that will be good for all of us.

Peter: Right.

Matt: So, do you really want to lead an inside round right now? No, but should you? Yes, because that is the right answer to preserve your old equity and this new money will be quite valuable because we're going to do it at the last round price or whatever the structure is. So, that's a very constructive conversation that you want to have now in parallel with the new outsider conversations because in two months that'll be the only conversation that's available to you and your insiders will be more scared then than they are now.

Peter: Interesting. So then, are you saying like latter half or the second half of this year there's going to be very little new rounds with new investors being done in an up round kind of environment?

Matt: Yeah, seed and A will keep happening, you know, people have funds, put to work in new companies, but nobody wants to deal with messy situations. This is the thing, like this isn't happening yet so we'll get to some optimistic parts in the remaining six minutes, but I will say just until I keep a for this topic. What happens in the mind of an investor is they look at the company and they say, okay, you've raised $60 Million, now you're raising a Series B, your last round valuation was $350, but really you should raise $20 Million now at a hundred post, that's really what this looks like in a normal time because the last thing you did doesn't count. (Peter laughs)

It was totally crazy, it was 2021, everything was nuts, but your $5 Million revenue business, $7 Million revenue business should be 20 at 100 or 30 at 150, but I don't want to spend time on that as a new investor. I don't want to have to break that news to you or go to talk to your existing investors who are going to have to cram into a much smaller percent of the equity, give up their preference, do all these horrible things, like I want them to come to that conclusion on their own. I don't want them to go to likely my friends who are on your cap table and say, oh, by the way, that company is great, I love that founder, she's awesome, we want to get involved, but you have to write it down and do all sorts of horrible things. I don't want to have that conversation, I want to work on a clean one.

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Peter: Right, right.

Matt: So, founders have to do that work themselves and boards, etc.

Peter: So, let's switch gears. I want to go a different topic completely and I want to re-visit the….last year, you wrote a Forbes column on The Future of Money and you talked about decentralization, decentralized finance, we've obviously had a lot of tumult in that space in recent weeks, do you still view what your thesis from last year, maybe you could just repeat it briefly and do you still feel it holds weight?

Matt: The nutshell thesis is that over like a 50-year period, starting 20 years ago, financial services is going to be entirely re-invented. The first chapter was just simply about analog to digital, you know, here's your bank account but it's on your mobile phone kind of stuff, here's your loan but it's available on the web. Now, we're in the embedded financial services space where people are going to buy and experience financial services through software they use every day, both consumers and businesses, we're just in the first or second inning of that, that's extremely profound.

And then, the final chapter will be the way financial services are manufactured, not just the way they're presented digitally or purchased and experienced through software, but the way they're manufactured will be done in a decentralized way versus currently which is wildly centralized by banks, by Visa and Mastercard, by insurance carriers, etc. So, I will note to give myself 50 years, right. (cross talking).

Peter: Less than a year.

Matt: A good 20 years, it used to be 27, it used to be 29, yeah, I have a totally full conviction. I mean, I really…….everything in my life has been an extremely bumpy road and this will be no different, this path to decentralization and by the way, not least because government hate it.

Peter: Yeah.

Matt: This one in particular is going to be a nasty tussle. The incumbents always hate all of these, but founders beat the incumbents over time, I'm fine with that, you know. Now, we're planning against the referee too, it's going to be rough, but, you know, we raised a crypto fund last year, we've been investing in crypto for the last nine years. It has been one of the most fun, interesting and rewarding chapters in my investing life and it remains just that. I think the talent in the space, the inarguable logic of it is only growing more and more compelling.

Peter: So, what is inarguable about it, what is inevitable about the move to decentralization?

Matt: Look, the argument for analog to digital that founders made was like, you know, in 2009/2010, like download the M&T Bank app, look at it, it's garbage. Look at my app, it's fantastic and that was true, I mean, look at the Chairman of Simple, like I'm an old school neobank guy, but it's pretty thin, pretty thin in terms of like…by the way, the M&T bank app is awesome now.

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Peter: Right.

Matt: It's like perfectly acceptable if you're going to market against an incumbent based on the quality of your app and that's why you look at Lemonade stock, you know, the whole like we're digital, we're better thing was never a durable, competitive advantage against the incumbents who is competitive against them is to remove them from the market altogether. So, we have a company called Compound, it's not even a company, actually it's really a protocol where you can lend and borrow money, post collateral, entirely managed programmatically and they charge ten basis points for extremely complex loans and, yes, they have breaches and they go out time and it's messy, but all startup activities are messy.

What's interesting about it is that it's actually disruptive, token-intermediated, protocol-driven. lending and insurance and payments via Stablecoins are a decade away from prime time, but it's just, to me, the lack of comparing their ten basis point NIM to a 300 basis point NIM of a bank, that's actual disruption. In a way, that's sort of the peer-to-peer lending folks had in mind, but had no chance of……they just did a different version of centralization, never decentralization.

Peter: Right, right, okay. So then, maybe we can close with you could paint a picture for us, if you will, of how you feel like, you know, you could go out 29 years, what do you think it's going to look like in the finance space. What are the big banks going to look like, who is going to be the winners?

Matt: As I said to my partners in our offsite this week, there's not going to be a fintech practice at Bain Capital Ventures in ten years because it's like an Internet practice, it's an ingredient, what we all do is an ingredient in building an amazing software company. And so, banks will either have an important role in trying and regulation to orchestrate and custody assets or they will lose it, but they will not be manufacturing products.

And so, whether they can, on the strength of their brand and mostly on the strength of their government relations, keep themselves in the mix, which I suspect they will, most of this work will be done by technology and the winners, ultimately, will be the software companies that realize how to best incorporate these financial services which at that time will be manufactured decentrally and so, therefore, actually will be easier to incorporate into code. And so, I think most of us are going to innovate ourselves out of a job and I'm here for it. (laughs)

Peter: Well, on that note, we'll have to leave it there. Matt, it's always a pleasure chatting with you.

Matt: My pleasure, really great to see you.

(applause)

Peter: Wow, so much to process there, so much to unpack and to think about. Obviously, the next 12 to 18 months are going to be challenging in fintech, we're not going to see anything like the environment we had in 2020 and 2021 where huge up rounds, massive valuations just became the norm and if you weren't raising several million dollars you really weren't at the top of the heap or

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anywhere close to it. But, you know, there's still innovation that's going to continue to happen regardless of valuations and those companies that have raised a good amount of money, hopefully, will be able to tough out this winter, still innovate and create new products and be just fine.

The good companies will be just fine, the companies that probably shouldn't have raised money at the valuations they did, there's going to be a culling of the herd, there will be lots of down rounds, there will be acquisitions that will happen, but I just wanted to touch on his predictions for the future because I feel like when I hear Matt talk about this I get super excited about where finance is going. We've had a great last decade or so with a huge amount of innovation in financial services, but the next decade is going to be very, very different and I'm excited to see what happens.

Anyway, on that note, I will sign off. I very much appreciate your listening and I'll catch you next time. Bye.

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