



How do early-stage investors diversify risk?

All investments involve some degree of risk. Early-stage investing can be particularly risky. Investors balance hopes of outsized returns against the possibility that many of the early-stage businesses in which they invest will fail to return even their initial investment.

To account for the risk that any single investment would yield a subpar return, many early-stage investors diversify their investment portfolio, investing in multiple businesses or products that vary in some way. If one investment loses money, the hope is that other investments will cover any shortfall.

Diversification is a strategy that can be neatly summed up by the timeless adage “Don’t put all your eggs in one basket.” Diversification can take several different forms, and many investors diversify both within their early-stage investment portfolio and by investing in different asset classes.

Key ways in which early-stage investors DIVERSIFY their risk:

D I V E R S I F Y

DIFFERENT ASSET CLASSES

Invest in different asset classes

Investors may view early-stage investments as only one asset class in a broader portfolio. Other asset classes could include, for example, late-stage private investments, public market investments, or fixed income investments. If investors determine that certain investments are sufficiently unrelated, they may use investments in certain asset classes to hedge risk of investments in other asset classes.

EXPOSURE

Assess their exposure to the broader market

Before investing in an early-stage company, an investor may consider the broader market—accounting for comparable valuations, potential competitors, broader economic forecasts, and other factors—and then structure its investment strategy accordingly.

STAGE

Diversify across investment stages

The risk/reward calculation for investors may vary considerably across investment stages (early-stage, later-stage and those stages in between). Early-stage investments are typically less of a “sure thing” than are later-stage counterparts, although the potential return from an early-stage investment may be higher.

INFORMATION

Gather information for diligence purposes

Information is key. To make decisions that are as informed as possible, investors often conduct due diligence on potential investments and may request to delve into the intricacies of an early-stage business’s books and operations..

YIELD

Assess the yield on any single investment

Early-stage investors will likely monitor the progress of their investments and may expect to be engaged in the management and operations of a business in which they invest. Investors may spend more time with those investments that they believe warrant their attention..

INDUSTRY

Diversify by industry

Investors may diversify within their early-stage investment portfolio by investing in different industries. Investing in multiple industries dilutes the risk caused by trends or events in any particular industry.

VARIETY

Make investments of various sizes and types

Investors may make investments of various sizes and types, such as debt, equity, or other assets. They may select investments for different reasons, such as to complement their current portfolio or to accommodate a business’s fundraising goals. Various permutations provide for a diverse investment portfolio.

RATE

Invest capital over time

Investing capital over time may help investors dilute risk tied to current market conditions. Private investment funds, in particular, often have a defined investment period in which to invest their capital.

FINE-TUNE

Fine-tune their portfolios periodically

To the extent that investors have diversified within or among asset classes, shifting valuations, acquisitions and/or divestments, among other factors, may warrant a portfolio “rebalancing”—or bringing an investment portfolio back to its original asset composition.

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