# GO BIG OR GO BOLD?

# HOW VENTURE CAPITAL IS RECALIBRATING

*Looking into niche strategies for significant alpha as larger funds pursue opportunities that look more like indexing.*

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## Insider innovation

Investing in innovation--that's what venture capital does. The whole industry is designed to source, find resources for, and release innovation--all in the interests of packaging a profit for customers like endowments, retirement plans and family offices.

Based on 2016 and other financial trends rooted in the last decade, this year promises a big, bold venture capital reboot. Let's take a walk through the core of venture capital so you can see why it's reboot time and what it means for you.

**1. From the few public markets to the many private markets.**

This is new: private markets are out-paying public markets. If you participated in one of the $46 billion in venture backed exits last year, 82% of the time, it was because a corporation acquired the firm.

Last year, for the first time in at least a decade, the median corporate acquisition ($90 million) was a lot higher than the median venture-backed IPO ($70.5 million). The rest -- buyouts and IPOs -- are the small print of the exit story. There were only 39 IPOs in 2016--half the number of 2015. Corporations have lots of reasons to acquire firms that aren't necessarily based on public market trends, so this shows the door to opportunity is opening wider.

*"It is the venture firms that focus on investments outside traditional sectors and geography (Silicon Valley, NYC and Boston) and are smaller (funds less than $500 million) that are delivering greater returns."*

*-Geri Stengel, Forbes*

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**2. From national toward local, niche strategies for maximum value.**

Venture capitalists had their best fundraising year in a decade, pulling in a new almost $42 billion for 253 funds even while experiencing six straight quarters of venture capital downturn. Over a quarter of the capital raised was for super funds: venture capital funds hovering around a billion dollars. Super funds like to write eight and nine figure checks--they can't usually look at early stage opportunities.

- While it has its strengths, the **follow-on finance playbook** weakness is that it undervalues innovators. The overall effect for investors and entrepreneurs is a concentration of capital rather than a diffusion into the increasingly diverse, increasingly broad innovation ecosystem. In fact, less than 10% -- only 22 -- of those were new funds from first time managers. There were only 2,300 first rounds last year. In bar chart form, it looks like first-time financing fell off a cliff back to around 2010 levels.

With 60% of venture capital already concentrated in a few square miles around San Francisco and Boston, these factors combine to make funding early innovation outside of Silicon Valley more of an opportunity than ever. With coastal venture capital pricing itself outside of the innovator's market, the young and emerging funds that are coming online with niche strategies like ours earn an even bigger mandate and opportunity.

**3. New settings on incremental versus net new innovation.**

VCs invested $69.1 billion last year, among the highest levels in the last decade and 11.2 times greater than the pace of venture-backed exits. 70% of

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the deals were follow on rounds, where VCs put more money in existing companies.

With the kinds of super funds the biggest venture capital firms are raising, perhaps more late stage VC capital will be deployed in acquisitions around platform startups--borrowing a page from the classic private equity playbook and bringing it down market. Startup founders who focus on operations and put a premium on cashflow should be in a good position.

If the startup pendulum swings between "go big" and "go home," the successful startup today is clocking "go steady." This may frustrate institutions and other investors in venture capital who are seeking the return profile of early stage innovation--so their own check sizes may have to come down to get it.

**Rebooting venture capital for stakeholders**

1. Startups: Raising round one is, by the numbers, far harder than ever. As an entrepreneur, you won't care about that, but smart strategy is to build customer validation and then make real good friends with early stage funds. These are becoming, now more than ever, the most likely candidates to invest in a first round.

2. Institutional investors: Venture capital trends are shifting. Know your funds' newer strategies, especially if you've been investing with the firm for a while. With check sizes going up, what you plan to allocate to venture may begin to have the return profile of a different strategy.

3. Angels are heroes on the frontline of innovation in the United States. Yet angel deal volume dropped 25% last year. For angels and private investors, with the check size and the valuation going up for angel and seed

investments and activity down, now's a smart time to focus on honest collaboration with the early stage or seed stage funds in your vicinity. Combining forces with professional seed and early stage funds can provide a meaningful opportunity for financially motivated angel investors and investing groups struggling with higher valuations and bigger rounds.

**What's VC 3.0 mean for you?**

The pace of innovation and the optimism behind "what's next" are ultimately what's driving record levels of investing, record VC fundraising, and stronger exits--like that 30% bump in the median exit size we had last year. The fact that private markets are outpaying public markets is another buy signal on the face value of innovation.

The venture capital industry was launched with the passage the Small Business Investment Act of 1958. It's not that old. Think about how many new types of lawyers and doctors there have been in the last 50 years, and you start to see my point. We're at the cusp of a time when VC is building out several playbooks to drive value instead of the basic, no-frills innovator-to-IPO one most are accustomed too. Creating more clear tiers of venture capital as the industry professionalizes is a function of the success and growth of venture capital as a professional service. This should ultimately mean more opportunity and more room up and down the innovation superhighway for all stakeholders. But that doesn't mean it's a smooth ride.

NOTE: Figures were drawn from the new 2016 Pitchbook-NVCA Venture Monitor--you can get a free copy of the report.

We believe the best way to predict the future is to be part of inventing it. We are an early-stage venture capital partnership of visionary investors that funds high tech, hypergrowth innovation.

**Valor Ventures V1 is a classic venture capital fund that invests nationally in hypergrowth technology companies with high corporate acquisition potential**. The current portfolio includes hypergrowth companies such as Aerobo, a drone company that operates in 30 states with clients such as Coach, Microsoft, Marvel and NBC; Kandidly, a photography marketplace expanding from Austin and Cincinnati into several key metros including Detroit, San Antonio, Atlanta and Houston this year; and MyAgData, a national crop insurance platform backed by ADM and others, leading the market of 250,000 major ag producers.

Headquartered in Atlanta, Valor Ventures is led by three partners with deep experience grooming new technology for enterprise acquisition. AT&T, Blackberry, GE, Google, Cisco, Hewlett Packard, Kodak, Samsung and Toshiba are some of the enterprise companies the team previously worked with on technology merger and acquisition opportunities.

**Robin Bienfait,** formerly Chief Enterprise Innovation Officer at Samsung, and prior to that, head of Bell Labs, runs the firm's technical due diligence and holds 15 patents. She has 20 years of direct technical due diligence experience to bring to her role as Partner/Innovation at Valor.

Firm co-founder **Sarah O'Brien**, who spent 12 years acquiring companies for GE before her role as CFO at a healthcare division of Kodak, is the partner who runs the firm’s financial performance and financial modeling and has 15 years of direct investing experience.

Serial successful entrepreneur **Lisa Calhoun** is General Partner and has 10 years direct experience positioning software startups successfully for global strategic exits to firms like Google, NCC and Eccova. She writes a nationally acclaimed innovation column in Inc. Magazine. She is currently on the Board of 80,000 member Women Who Code, the NVCA emerging manager subcommittee, and the board of Atlanta Women in Alternatives.

Learn more at www.valor.vc.