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Aircraft Carriers, Death Stars and Why "Seed is the New A" (Exec Version)

MAY 1, 2018 PETER WAGNER

A fundamental shift has occurred in the way startups are financed. Much of the progress companies used to make with Series A capital is now being accomplished in their seed phase. Meanwhile, Series A investors are applying investment criteria traditionally reserved for the Series B. To study this shift, Wing has developed a curated data set focused on the industry's higher quality startups and used it explore what's actually happening in early stage financing.

The result is Wing's "V21 analysis". It includes only technology companies financed by one of a select group of the industry's top venture firms. It is no secret that most startups fail, and that returns for the median venture firm often lag the S&P 500. The V21 data set represents more of the quality and less of the clutter. It captures the details of 5,600 financings at 2,785 companies invested in by one of 21 elite venture firms across 8 years.

When we analyzed the early stage financing patterns of the V21, 2010 thru 2017, there were some very clear trends:

Seed Financings

- **Companies are raising a lot more seed capital than ever before.** In 2017, the average company had raised a total of $6.3M prior to raising a Series A, up 4.5x from $1.4M in 2010.
- **The size and number of individual seed financings has grown considerably.** The average seed financing in 2017 was $3.3M, up 3.3x from $1.0M in 2010. There are also more of them, with the average company executing 2 discrete financings before raising a Series A.

Series A Financings

- **Companies are increasingly mature by the time of their Series A.** Companies completing a Series A in 2017 were 3.3 years old on average, up from 2.1 in 2010. 67% of them were

generating revenue, up 6.1x from 11% in 2010.

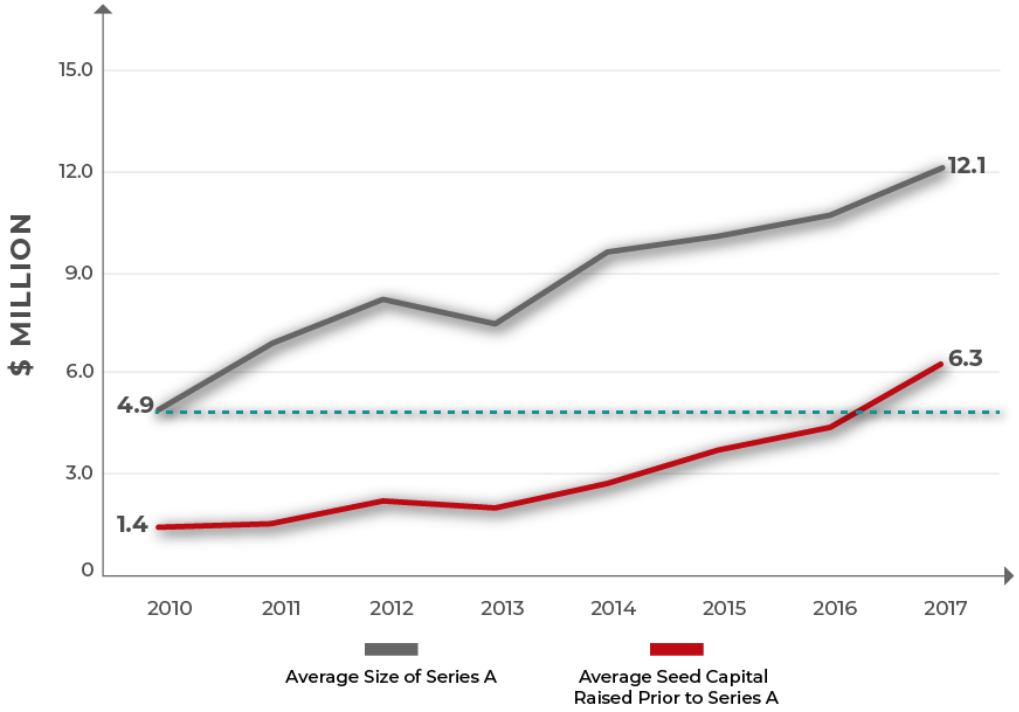
- **Series A financings are larger than ever before.** In 2017, the average Series A was $12.1M, up 2.5x from $4.9M in 2010.

Seed vs. Series A

- **The size of financings has escalated almost an entire "alphabet rung".** Average total financing prior to Series A reached $6.3M in 2017, *actually exceeding the average Series A* of 2010 ($4.9M). Similarly, the average Series A in 2017 ($12.1M) was comparable in size to 2010's average Series B ($15.4M).

On dimension after dimension, seed financing has assumed the role once played by the Series A, which in turn now looks very much like a "traditional" Series B.

Seed is the New A



	2010	2011	2012	2013	2014	2015	2016	2017	Growth Multiple 2010–2017
Average Size of Series A	4.9	6.9	8.2	7.5	9.6	10.1	10.7	12.1	2.5x
Average Seed Capital Raised Prior to Series A	1.4	1.5	2.2	2.0	2.7	3.7	4.4	6.3	4.5x

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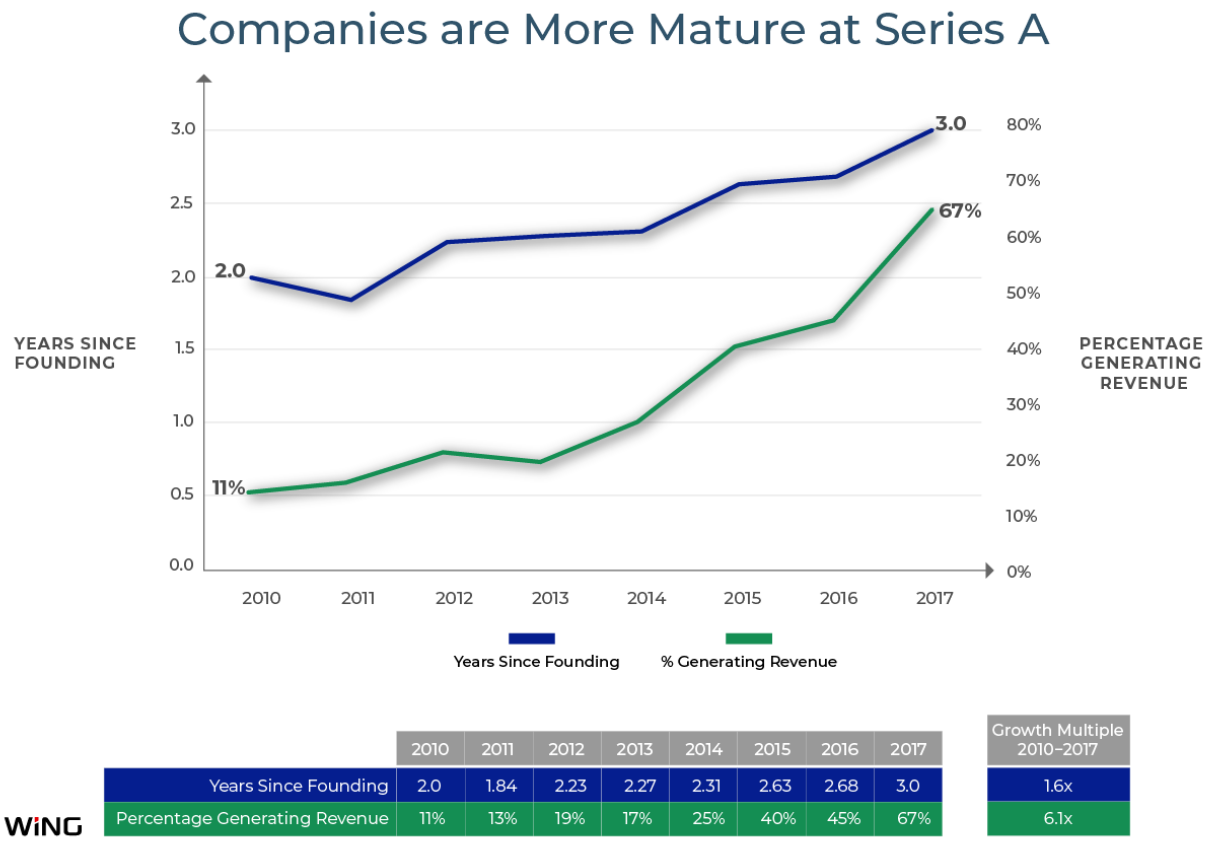

	2010	2011	2012	2013	2014	2015	2016	2017	Growth Multiple 2010–2017
Years Since Founding	2.0	1.84	2.23	2.27	2.31	2.63	2.68	3.0	1.6x
Percentage Generating Revenue	11%	13%	19%	17%	25%	40%	45%	67%	6.1x

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Why is this “venture capital grade deflation” occurring? What does it mean for entrepreneurs and investors? Where will this shift take us next?

THE AIRCRAFT CARRIER EFFECT

The shift is happening primarily because all the investors involved believe it to be in their interests. Major venture firms (like those in our V21 sample) see an opportunity to manage vastly more capital and invest it with less risk, improving their General Partner economics in the process. Seed investors see an opportunity to expand their role in a company’s life-cycle and claim a larger share of future gains. The two groups of investors have built a symbiotic relationship, and the sunny economic environment since 2009 has helped both parties achieve their goals.

The Gravity of Capital

The top venture firms used to be focused on early-stage companies based in the US. Over time many of them added initiatives in growth equity and international markets, often at significant

scale. At Wing we call these large, multi-stage, multi-strategy, multi-geography firms “aircraft carriers”, a reflection of their massive size and desire to pursue several independent strategies from a common platform. We define an aircraft carrier firm in the following way:

- Raises $1 billion or more per fundraising cycle

AND...

- Pursues multiple distinct strategies and / or multiple geographies

Except for a handful of firms that have consciously chosen to stay dedicated to their early stage craft, the V21 today are all either fully operational aircraft carriers, or feverishly trying to become one. Capital has gravity, and it exerts an inexorable later-stage pull on investment strategy. Larger investments in more mature companies have to play a more prominent role for an aircraft carrier to deploy its rapidly scaling assets under management (AUM). Time-intensive early-stage projects become harder to justify.

Adoption is Everything

A lot of the incremental capital that has been raised by the V21 has poured into growth strategies. Growth investors use a different decision-making methodology than is typically seen in early stage venture, leaning on quantitative analysis of adoption metrics. Things like cohort analysis or sales rep productivity simply don’t exist yet for pre-product companies. This metrics-driven methodology has a lot in common with that of the consumer practices in the major firms. Realizing the difficulty of predicting consumer behavior, most of the top consumer venture investors have chosen to wait for measurable evidence of market adoption – the all-important “inflection point” – before committing, even though this means paying a higher price.

The fish out of water, methodologically speaking, has been early stage enterprise technology. Even though business buying behavior is far more predictable than that of consumers, pre-market-adoption investment decisions have become difficult in large partnerships filled with consumer and growth investors. Enterprise investors in these firms have increasingly adopted the methodology of their colleagues, and more and more enterprise companies looking for classic Series A startup capital are now told to come back when they have 10 customers or $1M in annual recurring revenue.

Series A is Now a Brand

The aircraft carrier effect has pushed the V21 toward later-stage investing where market adoption is already evident and large amounts of capital can be deployed. However, these are firms that pride themselves on their early stage chops. It would be very bad for their brands if they were redefined as Series B, C and D investors.

It is important to the V21 to hold the high ground of Series A branding, and a clever way to accomplish this is to change the definition of a "Series A-ready" company to align better with their new later-stage investment strike zone. Series A financings have become, by definition, whatever a "Series A firm" chooses to invest in.

Accomplices and Enablers

None of this would have been possible without the cooperation of seed investors. At first the major venture firms regarded them as a potentially dangerous disintermediating force driving a wedge between the venture capitalist and the founder. Eventually the V21 came to regard seed investors as useful proxy forces willing to take risks they were unwilling to and invest sums too small for their scaled-up business models.

Seed investors have been the willing accomplices of the V21. They have had relatively free-reign in the pre-market-adoption part of the venture market and are able to benefit from the resources of the V21 when it is time to scale the company. A financing life cycle has developed, in which seed investors carry a startup through its first phase of development before passing it to a major firm.

As the V21 got comfortable with this arrangement, they demanded even more hard evidence of traction from potential investments. This created both an obligation and an opportunity for seed

investors, who now had to carry a company further. The result is more seed capital invested in more rounds, with the Series A reserved for further-developed companies. The seed investment universe itself segmented and developed its own handoffs. The most common of these involves the growing role of accelerators, who hand off companies to seed investors, who then lead the charge to the Series A.

Limited partners have been an important enabler of the shift. You can't have an aircraft carrier without large amounts of capital, and since 2009 institutional investors around the globe have been eager to fund the growth of the V21's AUM. Seed firms have also received a warm reception from LP's. Sometimes these are the very same institutions behind the V21, perhaps through an emerging managers mandate. Other times they are wealthy individuals, often successful entrepreneurs in their own right. The influx of capital into the seed investment community has been critical in enabling it to fill the vacuum created by the V21's retreat.

WHAT THE SHIFT MEANS FOR FOUNDERS AND INVESTORS

If Seed is the New A, What is the New Seed Firm?

Looking forward, we expect to see at least two trends in the seed community. First, some seed investors will seize the opportunity presented by the expansion of the seed phase. They will do more of the foundation-building work that the V21 firms used to do and help guide their companies throughout their later stages. The seed firms that make this transition (and some of the best are already well down the path) will have the opportunity to dominate a big segment of pre-market-adoption investing, establishing themselves as the founders' go-to partners for the long haul.

The second trend is increasing segmentation. Sub-specializations will develop as the seed territory expands. The stunning rise of accelerators provides an already obvious example. As seed segmentation plays out further, the result may be an increasing number of specialized investors each taking a turn at the wheel, with accelerators and "pre-seed" firms focusing on de novo investing while larger, more established seed firms aim to intercept companies once they have made more progress.

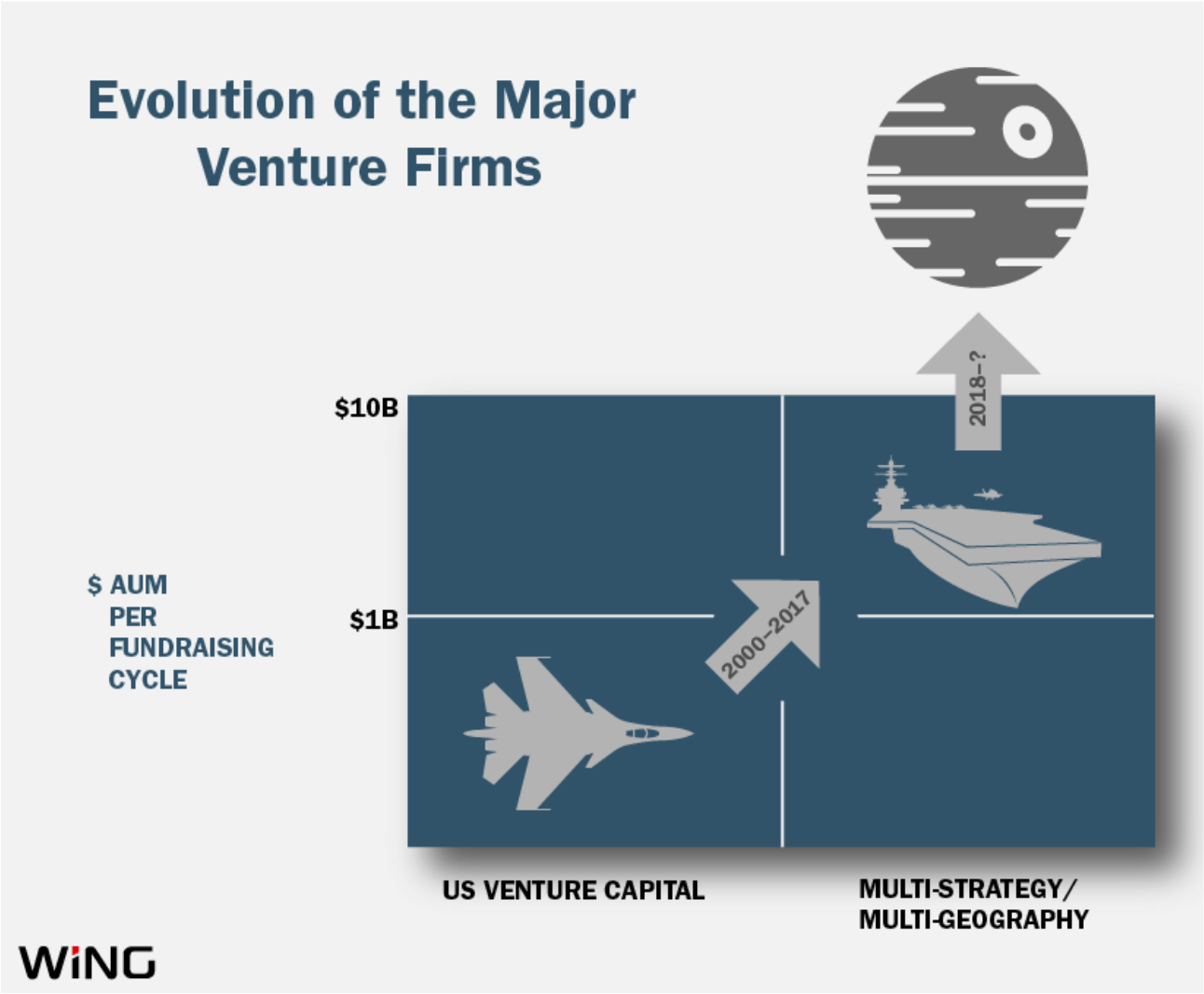
These trends are certainly not mutually exclusive. We expect to see both (and more) at work simultaneously in a very fluid environment over the next several years.

The Death Star

Have the major venture firms been getting a free ride? They have outsourced early stage risk and effort to a coalition of the willing without paying much of a price. However, venture capital is a cyclical business, and the question is not whether a correction will occur, it is when, and how deep. Access to aircraft-carrier-class capital may become tight, and some firms may seek to reoccupy their old early-stage territory. Will they still have those people and skills? And will they find that territory occupied by an entrenched force of grown-up seed firms who aren't in a hurry to give it back?

Looking forward again, we expect to see some of the more farsighted V21 firms wade into seed investing in a larger way in order to reassert their relevance in pre-market-adoption phases. Indeed, there are signs of this already, such as Sequoia's recently announced $180 million seed fund. What remains to be seen is whether most firms will treat this as more than a positioning effort. Will the best, most experienced General Partners be leading the seed investing initiative? Will this be their single-minded devotion or occasional vanity project? What priority will seed investments enjoy versus later / larger companies? The effectiveness of the strategy lies in the answers to these questions.

At the same time, we expect that other V21 firms will continue their march towards larger, later-stage financings. The basis of competition will change in this evolved segment of the business, emphasizing access to capital, scaling expertise and firm brand. Softbank is not in the V21 but its impact is certainly being felt. Sequoia is raising many billions in its current fundraising cycle. How many other aircraft carriers are now hard at work building their own Death Stars in response?



Facts on the Ground: The Founder's Reality

Founders face a shifting landscape. Their seed phase is elongating while the Series A goalposts are receding. Seed investor choices are evolving quickly just as the seed phase is growing in importance. Founders must decide what kind of contributions they want from their early-stage investors and shape their financing trajectories to make sure they get it. Some ways to do this:

- *Be intentional*. Decide what roles you want your early investors to play. Experienced strategic consigliere? Timely tactical help? Cash and a smile? Think long-term.
- *Be proactive*. Identify the investors that can help your company achieve maximum success. Don't settle for whoever finds you or who someone else decides to introduce you to.
- *Be relentless*. Do whatever it takes to win the support of your ideal investors. These decisions will reverberate throughout the life of your company.

The early-stage financing world is changing rapidly. But what won't change is what it takes to build a great company, and the absolute priority and intense difficulty of laying the foundation right the first time. The very best entrepreneurs will be extremely thoughtful about what sorts of partners they seek out and who they choose to listen to.

Want to learn more? See the full analysis here (http://wing.vc/blog/seed-is-the-new-a) , and read Connie Loizos's TechCrunch interview with Peter Wagner here (https://techcrunch.com/2018/04/24/new-numbers-illustrate-how-fast-fundraising-has-changed-for-young-startups/) .

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