Who's on first?

Analysis of the recent increase in first-time venture funds

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Key takeaways

- First-time venture capital funds raised $5.9 billion across 59 new vehicles globally in 2017. While nowhere near the highs of the dot-com boom, this represents a 21% increase in capital raised and 37% increase in the number of first-time funds from 2016 totals. 2017 was also the fourth consecutive year of growth in limited partner commitments to first-time managers.

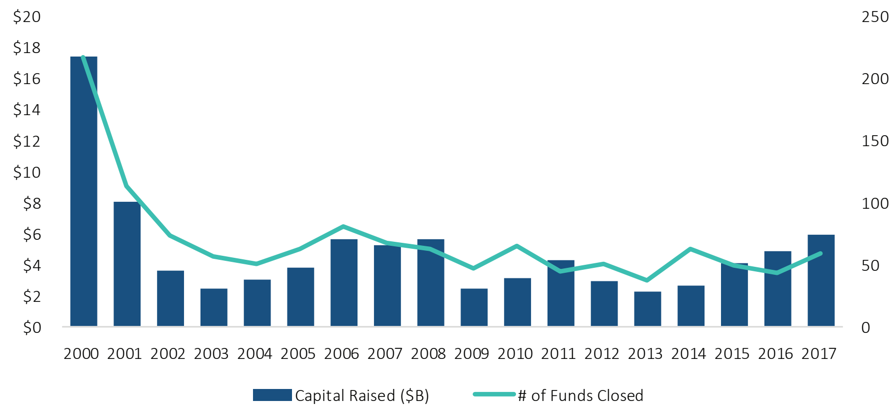
- First-time VC investment teams whose members have experience both founding companies and working at VC/growth equity firms go on to raise a follow-on fund 66% of the time—more often than investment teams with less experience.

- Recent first-time VC investment teams are more experienced than they have been historically. Until 2010, at least 50% of first-time VC investment teams had neither VC/growth equity experience, nor founded a company. By 2013, the proportion of first-time managers without this experience had shrunk to just 27%, and subsequently has hovered between 26% and 41%.

Trends in first-time VC fundraising

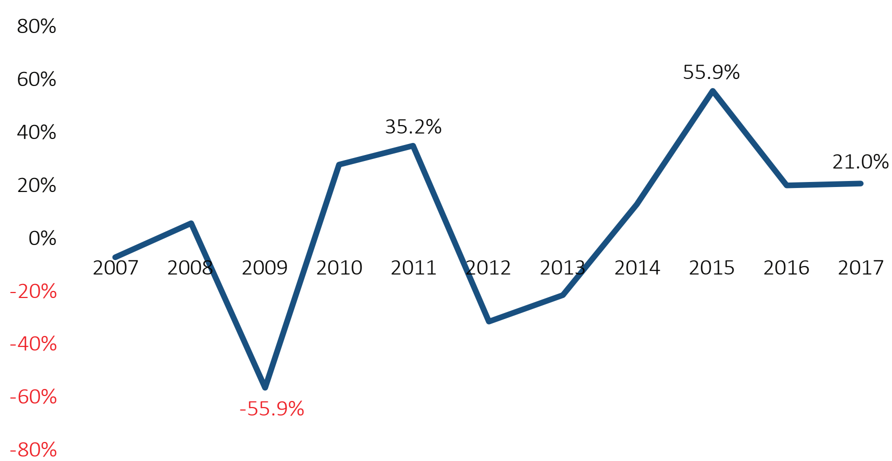
First-time VC funds raised $5.9 billion across 59 new vehicles globally in 2017. While nowhere near the highs of the dot-com boom, this represents a 21% increase in capital raised and 37% increase in the number of first-time funds from 2016 totals. It also represents the highest level of capital raised in first-time VC funds since 2001 (though each year from 2006 to 2008 also saw at least $5 billion in commitments).

Global first-time VC fundraising



Source: PitchBook

Year-over-year growth in first-time capital raised (%)

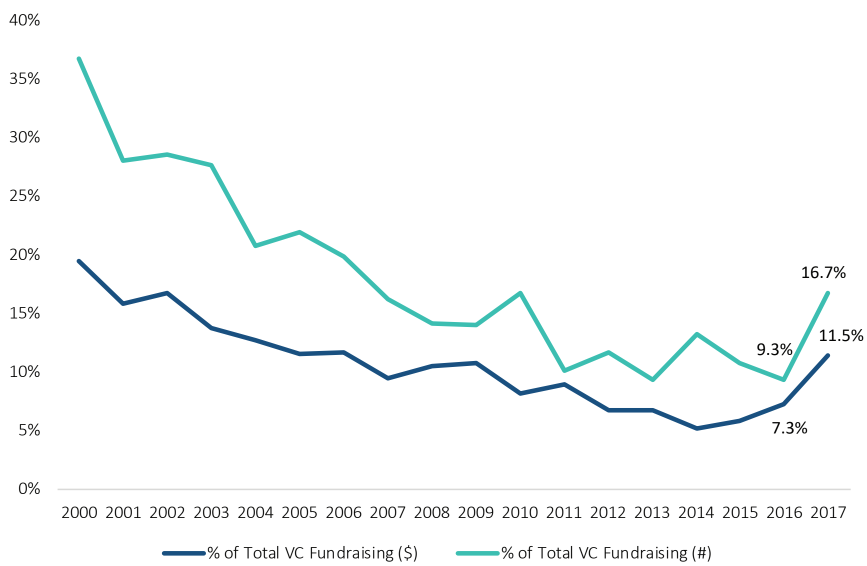


Source: PitchBook

We believe that would-be first-time VC managers are more likely to strike out on their own in the current capital-abundant fundraising environment.

At first glance, it may seem that first-time VC fundraising is simply following the trend of the broader VC market, which has exhibited an increase in median fund size and, therefore, capital raised amidst growing LP interest in private markets. But one longstanding trend has begun to change. After falling nearly every year since 2000, the proportion of VC fundraising made up by first-time funds increased considerably in 2017. First-time managers accounted for 12% and 17% of capital raised and the number of funds, respectively. Similar to the trend in private equity, we believe that would-be first-time VC managers are more likely to strike out on their own in the current capital-abundant fundraising environment.

Global first-time VC fundraising as YoY% of total VC fundraising



Source: PitchBook

Why commit to a first-time fund?

Committing to a first-time (or "emerging") manager can a be risky proposition. Many LPs dismiss the idea out of hand, while those who are willing to invest often only have a few slots allocated to first-time funds. But there is plenty to gain from investing in these funds. Emerging managers frequently build their strategy around specific regions or sectors to target less-crowded segments of the market, providing opportunities for LPs to diversify their private markets exposure. Since many first-time funds pursue novel investment strategies, it can also be easier for LPs to detect if and when style drift may be occurring.

Due to the smaller size of VC funds compared to other alternative investment vehicles (such as buyout, infrastructure, or real estate funds), much of the capital for first-time funds has traditionally come from family offices, friends and family, or other high-net-worth individuals. Institutional investors with hefty balance sheets are limited in their investment scope by necessarily large check sizes. This creates opportunities for accredited investors who may not be able to allocate to larger, often over-subscribed alternative vehicles, but are willing to take a chance on a first-time manager.

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There are structural benefits for LPs investing in first-time funds, mainly through beneficial provisions in the Limited Partner agreement. LPs that commit large sums early in a fundraise, called "anchor investors," are often able to negotiate preferential terms such as co-investment rights, management fee breaks or reduced carry. If the manager is successful, anchor investors may also be more likely—and sometimes have a contractual right—to get a preferred allocation in the second fund.

Investing always comes with risks, but there are some unique considerations when investing in a first-time management team. First, even if the fund's investment professionals boast solid investment track records elsewhere, they may not have experience collaborating on the same team. Second, they may lack operational infrastructure for and experience with the many back-office functions, such as compliance, reporting, and hiring, that come with running a fund. Finally, first-time VC funds have higher "capital risk," meaning a higher likelihood that the fund can't raise its targeted amount. In this case, a fund may be delayed in deploying capital, have difficulty executing on its original strategy, or give up entirely and return capital to its LPs (though these outcomes are less common in today's market, in which most managers exceed their targeted fund size).

Does a manager's level of experience affect the fund's chances of success?

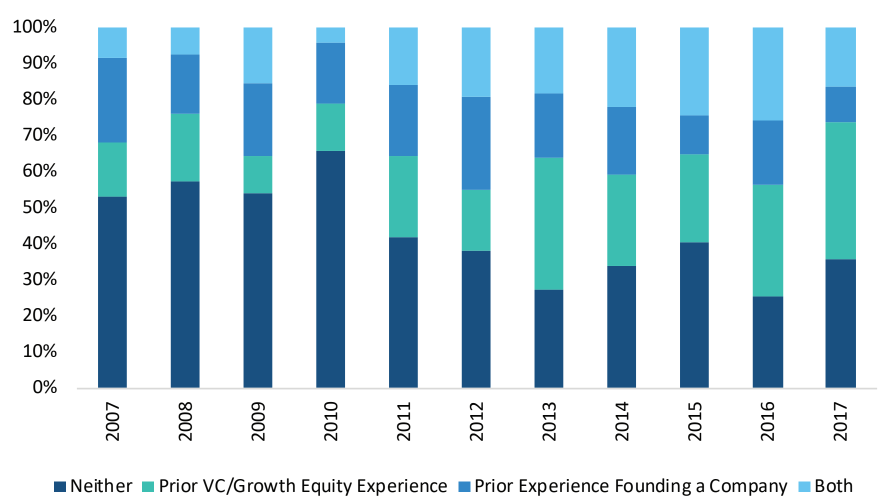
The experience level of first-time VC management teams has increased over time.

To better understand the drivers behind the recent wave of first-time funds, we took a deeper look at the background of the professionals launching these firms. We begin by segmenting the sample of first-time funds by the experience level of their investment teams (partner-level or above): those with at least one person who had prior experience at a VC/growth equity firm, those with at least one person who had prior experience founding a company, those that had both, and those that had neither.

In the chart below, we see that the experience level of first-time VC management teams has increased over time. Until 2010, at least 50% of first-time VC investment teams in any given year had no prior experience at either another VC/growth equity firm, or founding a company. By 2013, the proportion of first-time managers without this experience had shrunk to just 27% and subsequently has hovered between 26% and 41%.

The reasons for this change are obvious. First, with the VC industry having matured over the last 20 years, there are more professionals with prior VC/growth equity experience than ever before. Second, the number of people who have successfully founded and exited companies through the last two cycles continues to build. These founders are more likely to be able to convince LPs they have the early-stage investing acumen necessary to run a venture firm.

First-time VC funds by prior experience of investment team



Source: PitchBook

Note: This analysis considers first-time VC managers' prior experience at growth equity firms, but growth equity funds are not included in our definition of venture capital.

Given the relative lack of performance data for first-time VC funds, it is difficult to compare their returns to those of follow-on funds. However, using a firm’s ability to raise a second fund as a proxy for “success,” which admittedly is a less-than-perfect assumption, we can examine some of the characteristics that make first-time fundraisers “successful.”

The data suggests that more experienced investment teams are more likely to raise a follow-on fund—though not by much. 60% of first-time VC investment teams with prior VC/growth equity experience proceed to raise a follow-on fund, about the same proportion as those that have previously founded a company (58%). Similarly, 58% of first-time VC investment teams with neither of these characteristics went on to raise a follow-on fund. However, investment teams whose members have experience with both founding a company and working at VC/growth equity firm go on to raise a follow-on fund 66% of the time, suggesting that the combination of operational and investment experience leads to a higher likelihood of a second fundraise.

Percentage of first-time VC funds that go on to raise a second fund (by experience of investment team) between 2007 to 2013

Prior VC/Growth Equity Experience	60%
Prior Founding Experience	58%
Neither	58%
Both	66%
Total	59%

Source: PitchBook
Note: Vintage limited to 2013 to allow sufficient time for follow-on fundraise. n=348

Moving forward

Thus far in 2018, nine first-time venture funds have held final closes, totaling $832.9 million in commitments. An additional 30 first-time funds are currently in the market, suggesting that 2018 will be another strong year for first-time VC fundraising. We expect first-time VC fundraising to grow (in terms of capital raised, if not the number of vehicles) for as long as the broader VC fundraising market continues to expand. First-time fund managers are also likely to become more experienced—as they have in recent years—due to the maturing VC ecosystem referenced above.

First-time VC funds in the market

Firm Name	Fund Name	Target Size ($M)	Location
Space Angels	Space Angels Venture Fund I	50.0	United States
Resolute Venture Partners	Resolute Venture Partners I	25.0	United States
Iron Pillar	Iron Pillar India Fund I	31.0	India
Innosphere	Israel - Colorado Innovation Fund I	-	United States
ScaleUP Venture Partners	ScaleUP Ventures Fund I	75.6	Canada
One Way Ventures	One Way Ventures Fund I	50.0	United States
Kasikorn Asset Management	Beacon	158.0	Thailand
Equanimity Investments	Equanimity Investments Fund I	29.4	India
Newark Venture Partners	Newark Venture Partners Fund	50.0	United States
IrishAngels	IrishAngels Venture Fund I	15.0	United States
Marathon VC	Marathon VC Fund I	-	Greece
Optum Ventures	Optum Ventures	-	United States
Medical Technology Venture Partner	Medical Technology Venture Partners I	60.0	United States
Dymon Asia Ventures	Dymon Asia Venture Capital Fund I	50.0	Singapore
Amplo Venture	Amplo I	100.0	United States
Indian Angel Network	IAN Fund	66.1	India
Health Velocity Capital	Health Velocity Capital I	150.0	United States
Pi Ventures	Pi Ventures Fund I	29.9	India
Questa Capital	Questa Capital Partners I	250.0	United States
Stellaris Venture Partners	Stellaris Venture Partners India I	100.0	India
Elsewhere Partners	Elsewhere Partners I	-	United States
Axeleo	Axeleo Capital I	-	France
KdT Ventures	KDT Ventures Fund I	30.0	United States
NXT Ventures	NXT Ventures Fund 1	-	United States
Fitz Gate Ventures	Fitz Gate Ventures	10.0	United States
Rokk3r Fuel	Rokk3r Fuel ExO	150.0	United States
Grand Ventures	Grand Ventures Fund I	30.0	United States
Unicorn India Ventures	Unicorn India Ventures Fund I	22.0	India
Genesis Innovation Group	Cultivate(MD) Capital Fund I	10.0	United States
Firstminute Capital	The Firstminute Capital Fund	60.-	United Kingdom

Source: PitchBook
*As of 3/1/2018