diffusetap
Virtual Event Series

Disrupting Venture Capital

Guest Speaker:

Oliver Libby

Managing Partner
H/L Ventures

Hosts:

Kenny Estes
CEO and Founder
Diffuse

Ayla Kremb
Chief of Staff
Diffuse

DiffuseTap: Disrupting Venture Capital

What's wrong with venture capital today? In our session featuring Oliver Libby, Managing Partner at H/L Ventures, we covered common myths around venture studios and explained why the power law does not apply anymore.

Want to make friends from the Diffuse Fund Ecosystem? Email contact@diffusefunds.com.

DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speaker

Oliver Libby is co-founder and Managing Partner at Hatzimemos / Libby Ventures, the New York City-based venture firm. Founded in 2009, H/L is dedicated to accelerating high-growth businesses with a unique Growth Catalyst model, which employs active and regular engagement by H/L partners and their network. Oliver also chairs the Board of The Resolution Project, a non-profit organization that identifies young leaders and empowers them to make a positive impact through fellowships. LinkedIn: @olibby

About Diffuse®

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds.

For more information, visit www.diffusefunds.com.

© 2021 Diffuse Inc

KENNY ESTES: Today's speaker is Oliver Libby. Oliver, would you mind introducing yourself?

OLIVER LIBBY: Hello, everybody. I'm Oliver Libby, managing partner and co-founder of Hatzimemos / Libby Ventures. I am currently in New York, and we've been running H/L Ventures for about 12 years. We are among the first startup studios. And I believe the first, if not very early on, to include impact and diversity in our core investment thesis. Over the last decade, we've built H/L ventures into an ecosystem that has, at its heart, a venture studio. But around it, we've also built managed services, opportunity fund, and just everything we would need to have a toolkit, a Swiss Army knife, to help build companies effectively.

It's been really fun to do that. I also started a nonprofit simultaneously about 12 years ago called The Resolution Project. We've been helping college kids launch social ventures all around the country and around the world. We're in about 25 states and 81 countries, with about 600 entrepreneurs coming out of that program, so I think I have an unusual perspective of the launch moment for entrepreneurs and how to get them through their entrepreneurial journey. And I'm delighted to be here today to speak with you all and answer your questions as well.

KENNY: Great. And I know we just scratched the surface, but I do need to compliment you on your virtual background. The game is strong there, so thanks for that. My partner in crime is Ayla Kremb. Ayla, do you want to take it away with the first question?

AYLA KREMB: Yeah, absolutely. The session is called disrupting venture capital, so this kind of warrants the first one. What's actually wrong with venture capital as it stands today?

OLIVER: It's a great question. And by the way, I realize the irony of there being a lot of venture capital funds represented on the call today. I think that there's a lot wrong with the industry. And I think probably, if you really walked it all the way back to the beginning, it would be because the business model that was selected for venture capital wasn't really selected because it was the best way to support and grow companies. It was selected because it was a widely accepted asset management model. And I think the question, the tension, really, for venture capital for years has been, are we asset managers where our customer is the LP, and our product the companies that we invest in? Or are we working with founders and helping them grow companies, and our shareholders are our investors, and if we do well with the companies, then the shareholders benefit. Or is it something in between?

And I think it's a really fraught question. I've always felt like the private equity fee structure of two and 20 is a bit like the asset management tail wagging the entrepreneurship dog. And what happens is it prefers things like, believing in the power law, and a certain set of mythologies that define how we think about entrepreneurship, certainly in America, and possibly around the world. And so, because of that, we expect certain things of the ecosystem as VCs that aren't really how we would naturally step back and try to construct companies. Like, the failure rate that we accept in trying to push every company to be a massive winner is not a natural failure rate, and certainly not for the talented entrepreneurs that we work with. We wouldn't expect them all to fail at nearly the rates that often are ascribed to venture capital portfolios. And so, I think there's a lot of myth-exploding that has to happen.

And I'll throw in two other kinds of quick thoughts. The first is, I think that the sector is only now turning back towards the idea of active engagement after many years because of the minute resources that are available when you're charging 2% fees. And again, the average fund size is sub-100 million, and substantially so. We're not talking about the multibillion-dollar funds. When you're managing a whole company with $1 or $2 million, you can't really afford a big platform team and a lot of other bells and whistles for your companies. But I do think active engagement makes a huge difference. And I think people are coming back in that direction.

And then, the last point I'll make is something very dear to our hearts at H/L, which is that impact and diversity are huge factors in our investment thesis. They've been way underrepresented in the venture world since inception. And I think some of the myths that I talked about exploding go directly to that. For example, just briefly, the idea of the glorious fail-forward, you know, just blow things up quickly. Well, if you happen to be, for example, (I'm just making things up), a Black entrepreneur from outside the Valley starting their first venture, and you raised your first few thousands from your neighborhood or the church community or whatever, you can't just blow up that cap table and start your next venture really quickly. It doesn't work like that. And you're not going to get a second chance. So, I think we need to be really looking at this question carefully and see what we can do to improve as a sector.

KENNY: There is a lot to unpack there. And what you just said, one of them is a bit of a technical thing that is near and dear to my heart. You mentioned the power law, distribution, and I think you called it a mythology. Would you mind explaining a little bit about what that is, and how that influences investment decisions? And why do you think that's not necessarily true, or the right way to go about it?

OLIVER: Yeah, it's interesting. And actually, it looks like Joe (Milam) asked a question about risk management in the chat. Just while you're asking that, let me just be very clear. The power law numbers have worked out well for certain firms. I'm not trying to say that you can't do a high multiple fund that's very successful. If you have one or two unicorns, and the rest of the companies go under, my only point to you... Maybe I'll just analogize this: if you all remember, in baseball, the concept of 'Moneyball' was introduced not all that long ago. And it was the idea that it's not really about one massive home run hitter, but it's about getting on base as often as possible and winning as a team.

And I would just suggest that —remember, there's like 4,000 venture firms in America alone — it is very hard to think of an entire sector that depends on everybody having a couple of unicorns in their portfolio to make money. And the reason that venture capital firms underperform the S&P as a group, is because of this. Because the power law doesn't work for the sector, or sector-wide, because there just aren't enough of those companies.

And we're also pushing perfectly good companies that might have a $60 million exit and do great for everybody, to grow too fast in many cases, and be very damaging to their prospects in order to try to fit them into that world. And the converse of that, mind you, is that if you're in the power law mentality, when you have companies that get into trouble, you tend to think like, “I don't have the resources to work with every company in my portfolio. This one's probably not one of the ones, so we're just going to let it go.” And you know, some of the best stuff in my portfolio today is some of the stuff that's been in the worst trouble. And just being able to be there, to over-index on them and get them back in shape, is

really important. So, I think it's harder to make a judgment that stands for every single fund, but it is easy to say the power law doesn't work industry wide.

AYLA: And that kind of takes us to another question which gets popped here in the chat. I think you have a unique view, because you've been working in the venture studio space for so long. What's different about how venture studios interact with the VC world? What are they doing right, that VCs generally cannot do right in their own work?

OLIVER: First of all, I would say that we have a very good, positive relationship with many of the traditional VCs that we work with as co-investors. To Aaron (Winkler)'s question in the chat, we ourselves have about 35 portfolio companies. But the whole thing about a venture studio is you have to structure it differently. There's not just one structure that works. It's actually interesting, there's a lot of different structures.

We're set up as a holding company that raised independent money, and then it has also reinvested some of our proceeds. So, that gives us the opportunity to have a core team of almost 30 people, and then a bunch of networks that amount to a several hundred more folks that we can bring in as we need them. And only in that way can we be relevant day-to-day to all these companies. The corollary to that, Ayla, to your question, is we end up being really powerful partners for VCs that don't have nearly the infrastructure we have. So, if they can get over the fact that we have some common stock options, the VCs should actually want to see a powerful studio involved in a company, because they should know that that's like a group of Sherpas that are helping those entrepreneurs up the mountain every day.

But again, like some of the orthodoxies of venture capital, I'll tell you a quick story. Twelve years ago, when we were starting this business, we were told, pretty unequivocally, by some very well-known VCs that there would be a selection bias. That no smart entrepreneur would ever take a deal where they had to give up common stock options to join a venture studio. And in fact, the very fact that they were in a studio like ours would be a negative factor in the VCs' evaluation.

Thankfully, that's changed a lot over the last 10 years. But there's still some structural biases against entrepreneurs who have sought help. And that's silly, because the small amount of common stock options that a studio might hold I think is vastly outweighed by all the support that we provide to the portfolio company. To wrap up on this, the best thing to do is to have a great partnership between studios and supporting companies, and towards larger pools of capital that invest in them over time as well.

KENNY: That makes sense. And you touched on the stigma, or now, the lack thereof, for venture studios over the last 10 years. What else have you seen change in a major way in the last few years? In our private call, I know you talked about crowd equity funding, being a particular injury, geography — do you want to just touch on some trends you see?

OLIVER: Yeah. I mean, look. I think the rise of studios and let's broaden this to saying, the hands-on approach to active engagement… I always joke around that, by the way: people talk about "are you

hands-on or are you hands-off as an investor?" and then I'm like, "whatever we're doing is way over there on my virtual background." So, for us, I think the rise of the more "hands-on" approach — I'm sure you all know this, many of you probably have them now — five years ago, the idea of a director of a platform or a platform at a group within a VC was kind of very rare and kind of "what is that?" and "what do you mean by platform?" Like, everybody's got a page on their website for value add, and everyone's got a platform group, or otherwise is looking for one. But that's really great, right? That just means people are understanding that the entire thing with venture capitalists picking a bunch of good companies, and then hoping one of them works out really well and attending board meetings to try and nudge things in the right direction in every quarter, is not a dog that hunts industry-wide. And so, the idea that more and more VCs are now either partnering with studios or developing their own capabilities for hands-on work is really important.

A couple of other notes. geographic diversification of the sector is crucially important. No other successful industry in the history of the world has had one city globally that was the hallmark of the whole thing. And so, one of the weird effects in the aftermath of COVID we're going to see is that entrepreneurship is going to be more geographically democratized, which is good. That's not to say that there's not immense strength in places like the Valley and New York City, of course, where I am. But we are delighted to have portfolio companies all around the country. And frankly, one of the reasons we never bring them in-house physically and drag them to New York is because we wanted them to stay benefiting from their local environments.

Two other quick things I'll share. I do think crowd equity is really interesting, but frankly, sometimes a little worrisome. I won't lie, I think we're in a really risky industry. And we need to be very careful about what speed bumps we put in place to make sure that retail investors —you know, Reddit, public markets fever— aren't throwing all their net worth into startups. Because we all know that, even though I think the failure rate is artificially high, it's not going to be zero, right? So, we just need to be vigilant. I'm all for democratizing the sector, but we just need to make sure that we're not allowing people to blow their entire 401k on crowd equity and seed funding.

And then the last thing that I'll share is, I think one of the best things we've seen is the massive increase in focus on ESG impact and diversity. Our Growth Fund is working with 100% female and minority founders. Our venture studio is 72% diverse founding teams, and every single company tracks to the UN Sustainable Development Goals. And by the way, I'm not going to talk about performance, but I can tell you that this is not a concessionary model. But the fact that the sector is moving more in the direction of impact, diversity and ESG, is really heartening.

AYLA: And that speaks to one bit that was mentioned in the chat as well. As with all the work that you're doing, it seems like you would need a massive team. And of course, on day one, that's exactly what you don't have. Could you speak about the evolution of the studio itself, and how you started out with a couple of people, and how it's grown to this full-service capability?

OLIVER: So, a defining factor of the venture studio, in my opinion, and what differentiates it from accelerators and incubators that also have their valuable place in an ecosystem, is that we don't go away. We're there for the whole journey. But I will say my partner Eric (Hatzimemos) and I originally thought "we'll take a few companies a year, and then once they're past maybe a big seed round, or certainly a

series A, we won't be all that useful to them anymore, and so we'll be able to kind of fade on those and go work on the early guys." But the fact of the matter is, that is totally not true. Certainly, the types of things we're working on with our Series B and later companies are different, but they still really rely on their relationships with us in healthy and, I think, productive ways. So, what's interesting is that you can build a studio team over time, as long as you take a stepwise approach to building the portfolio.

So, we took in one or two companies a year for the first few years, and now we've hit a pace of four to five new companies yearly. We're in a situation where I think we grew the team commensurate to the growth of the portfolio. But yeah, I mean, ultimately, you have to find a way to make your business model work, whatever it is, and the studio approach doesn't have only one business model. We have a holdco, but other people are spinouts of other funds, or they're corporate venture studios, or stuff like that. There's a lot of ways to get to the economics of making it work and hiring a larger team. But the last thing I'll say on this is you're right. It does take a larger team to do this properly.

KENNY: Okay. And then kind of knocking on that, I'm going to use Joe Milam's question in the chat for inspiration. Resources, especially where you are now, it's just the sheer number of portfolio companies and geographic diversity. How are you managing the portfolio company reporting, and information? What do you get exposed of? That process is a bit of are we throwing bodies at the problem? or is it actually something that has a good technical infrastructure that you put together and spent a lot of time developing?

OLIVER: There's totally a technical infrastructure for that. Absolutely. I mean, we used to run it off of a spreadsheet five or six years ago, and that was not scalable. The good news is in the VC industry, whether it be CRM systems for deal sourcing, there are many options. We happen to use Kushim, for example, and there are other solutions as well. We use them because they're pretty well-developed for deal tracking and portfolio reporting. We use Carta as well, which has been great. And then, we also have a needs tracker, if you will, for our internal portfolio company, which is really important because every company has 20 things that they need any given time. We have a pretty sophisticated built-out AirTable that Galina (Ozgur), our VP of Platform, put together. So yes, we have a tech stack; 100% you need a strong backbone. And then on top of that, you need a really capable team, and I'm very blessed to have that. But yeah, there definitely is a technology backbone to this to make it scalable.

Thank you for downloading this DiffuseTap event transcript.

Sign up for upcoming sessions and check out past features and event transcripts.

Dennis Chookaszian
Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis discussed how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan talked about the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

JOIN US