Venture Studio Primer

The Venture Studio category can drive venture returns higher faster. Venture studio structures are varied and create complexity in understanding investment opportunities; however, with adequate insight, investors are able to align allocation with talent and capital efficient ownership, producing meaningful outperformance.

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What is a Venture Studio?

A venture studio is an established organization that creates multiple startups either directly from ideas developed internally by the studio or by partnering with talented entrepreneurs that have an existing idea. They are often founded by serial entrepreneurs who want to make a deeper impact on a specific sector of the market through a portfolio of startups, rather than focusing on a single effort. Studios provide an initial team, strategic direction, shared services, and capital for the portfolio of startups and quickly decide which ones have the potential to succeed in the market.

Venture studios are NOT accelerators and NOT incubators. They are *founders* of multiple startups. Because of their role in idea formation, validation, and startup development, studios act as both founders and investors of startups. They generate outsized economics through common founders shares as well as preferred equity, typically driving 30-60% ownership in the companies they create. This is one of the only asset classes that allows LPs and investors to benefit from founder ownership, which is an important differentiator from traditional venture.

Venture studios came into existence in the 1990's with Bill Gross and IdeaLab. Since then, there has been an enormous expansion of the category from talented founders. One example is Atomic Labs, founded by Jack Abraham, who launched Atomic after exiting his startup, Milo, to Ebay. Atomic is responsible for the successful creation of HIMS, Bungalow, and Terminal as examples. Each of these startups have driven upwards of 100x invested capital for the studio. This is just one example of the power of venture studios. Venture Studios are a more vertically integrated approach to launching new companies when compared to traditional venture capital.

The venture studio market is still emerging. While there are currently over 350 venture studios around the world, many of them were formed after 2013 and the impact of inception level ownership is just beginning to be seen by recent exits. This creates strong opportunities for investors that have early insight into the factors that are driving success in this space.

Types of Venture Studios

For purposes of this analysis, we consider three types of venture studios: formation studios, commercialization studios, and early-stage incubators. While early-stage incubators can be considered a type of venture studio, there are several drawbacks to the model, and they are not considered a target for Vault Fund.

Formation Studios. Formation studios create ideas and companies internally. The partners of the studio are the initial founders of each company the studio creates. They provide significant control and influence over company development. These studios typically excel within specific categories such as consumer products, enterprise saas, or digital health. This model includes Atomic Labs, The Hive, Gemini, and IdeaLab. This structure generates higher average ownership levels and better overall economics than other types of studios or traditional venture.

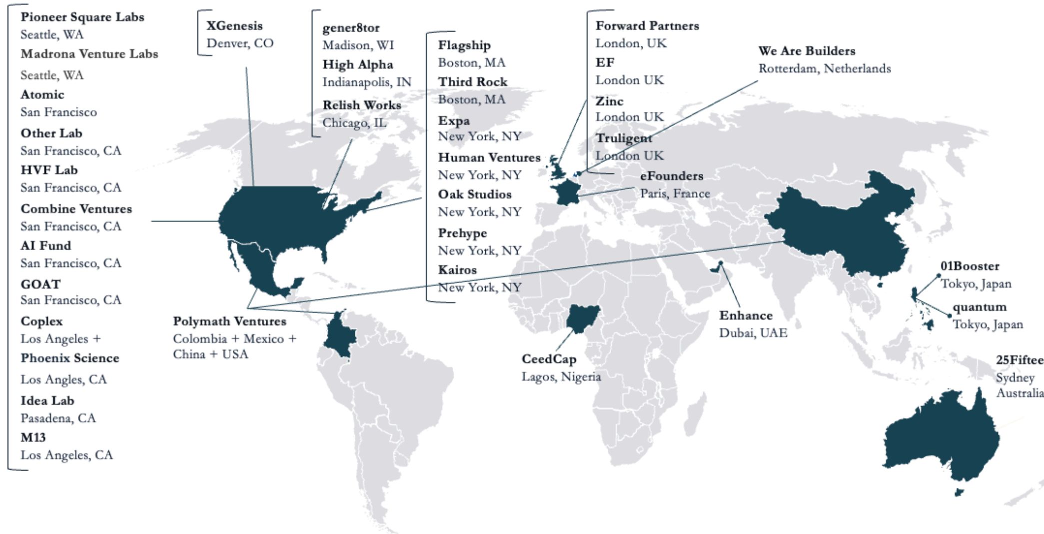
Commercialization Studios. Commercialization Studios selectively identify promising data and IP from research institutions and license it to conduct further testing and potentially launch new companies. This model is primarily applied in therapeutics, ag tech, and deep tech, where robust research is necessary to get to early proof points. Commercialization studios benefit from not having to bear the cost of early data and validation conducted by the research institution. They also benefit from favorable licensing terms and long-term relationships with the institutions that have the best data and IP. Examples of commercialization studios include Atlas Venture, Third Rock, and Flagship Pioneering. This model is less prevalent, but also results in strong ownership (generally between 40-80% initially) and control over exit pathway and follow-on terms.

Early-Stage Incubators. Early-stage incubators usually find or recruit external founders with an idea and bring them in to provide shared resources, insight, and capital. This model is less attractive due to the lower ownership profile (generally 10-20%), which makes it look much more like a traditional venture fund. In addition, early-stage incubators have less control over the subsequent funding rounds due to their marginal ownership, and typically do not provide access to founder's-level equity.

***Note: many studios employ different types of company creation, incubation, and commercialization. Studios are rarely purely one type or another.*

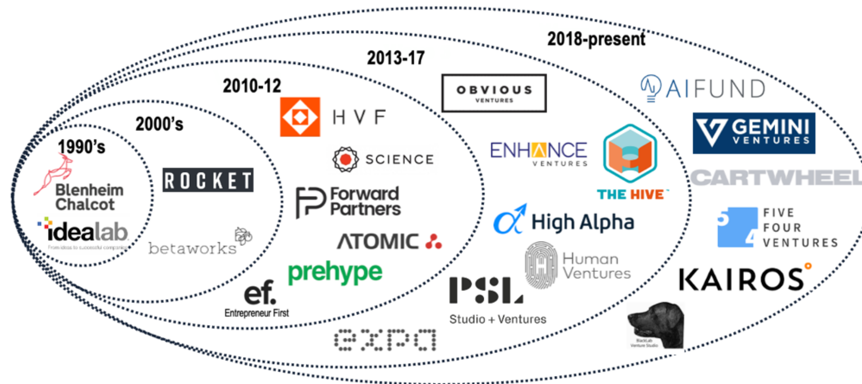
Market Landscape

There are approximately 350 startup studios around the world, as of December 2019, according to a report published by Enhance Ventures. The growth of the studio category is accelerating with >50% launched in the last 5 years due to the increasing attractiveness of the studio model. This is largely driven by three factors: serial entrepreneurs with interest in creating more, diminishing cost of startup formation, rise of the gig economy and increasing access to and flexibility of tech talent. Many of these studios executed on a combined strategy of internal idea formation and external founder recruitment, making them a mix of formation fund and early-stage incubator (as described above).



There is strong growth in studio formation internationally, especially in emerging markets where talent and capital are more dispersed. Studios can provide early support infrastructure (talent and capital) to get startups from concept to company in environments where there is less support of promising ideas and budding talent.

Of these 350 or so, there is a growing body of leading studios that have been driving newco creation for 10 years or more and have developed a track record for returns. Examples of these tenured studios Include Idealab, Rocket Internet, Betaworks, HVF, eFounders, and Prehype. These studios are followed by a long tail of emerging studios that have recently been formed, but starting to produce results, such as AIFund, Atomic, Pioneer Square Labs, The Hive, and High Alpha.



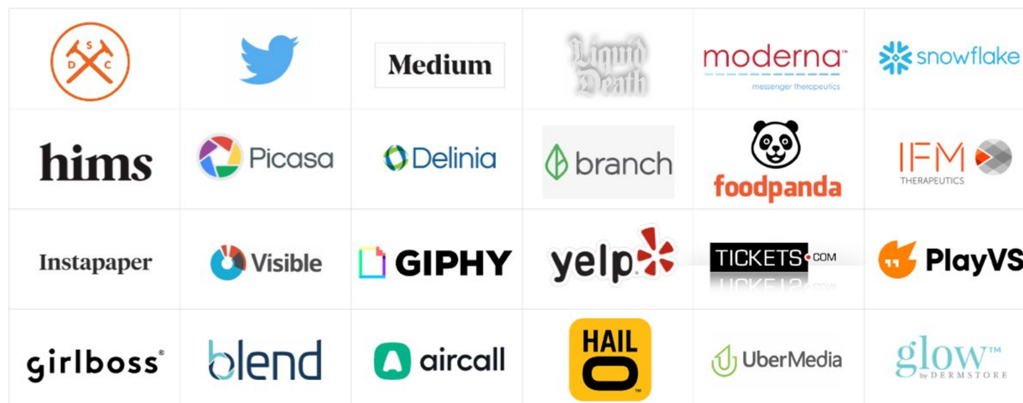
Industry Performance

Studios are able to drive higher returns faster. As the venture studio category continues to evolve, early data is showing strong performance. The Global Startup Studio Network, GSSN, recently came out with an industry report providing compiled data from 14 studios[(1)]:

	Traditional Startup	Startups Created by Studios
Average IRR	21.3% [(2)]	53%
Total Value/Paid In	1.6x [(3)]	5.8x
Time from Zero to Series A (mos)	56	25
Time from Zero to Seed (mos)	36	11
Time from Seed to Series A (mos)	20	15

This report also indicated that 84% of startups created within a studio graduate to an institutional seed round and 72% make it from seed to Series A, resulting in 60% of startups making it from inception to successfully raising a Series A round.

Many successful companies have either already exited or are showing incredible growth within the studio environment. Below are some examples of companies that have emerged from venture studios or have been developed in a venture studio structure:



Common Attributes of Successful Venture Studios

Regardless of structure or type of studio, there are three primary factors that drive successful outcomes:

- Talent
- Process
- Ownership

Experienced Talent. The most successful studios are led by serial entrepreneurs who have already driven a company to exit and were able to achieve high levels of scale along the way. These founders are now launching a new portfolio of companies within a related space, able to repurpose prior playbooks and utilize their existing network.

In addition to partner-level talent, founder and shared services talent is the backbone of idea validation and development. Having access to a strong network of executives and operators who are ready to run a company, have industry experience and insights, and are attracted to the offerings of a building platform determines how successful many of a studio's early companies will be. Venture studios provide speed to market, shared services, and financial support that is attractive to experienced and emerging talent and can help these founder build from 0-to-1 faster.

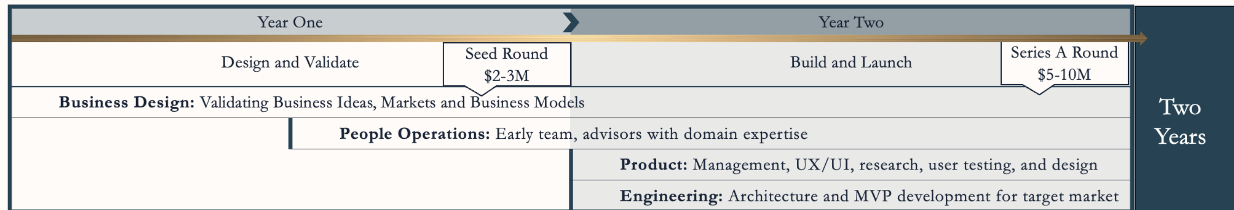
	Venture Studio vs. Traditional Venture		
	Example Investment Only	Venture Studio	Traditional Venture Fund
Inception	Initial Investment	$500,000	$0
	Common	$150,000 (30%)	$0 (0%)
	Preferred Convertible Note	$350,000	$0
Series A	Investment	$0	$1,000,000
	Ownership (Preferred + Common)	39%	10%
	Value	$2,070,307	$611,111
	MOIC	4.14x	1.22x
Exit	Exit Ownership	30%	7%
	Exit Valuation	$200M	$200M
	Return	$60M	$14M
	MOIC	120x	28x
	Gross IRR (assuming 6 years)	122%	55%

Significant Ownership. To provide meaningful returns at exit, a studio must own a significant portion of each company they create. Formation Studios and commercialization studios are able to own 30% or more of portfolio companies, including common equity. Since this ownership is created at the initial stages of company formation, the capital efficiency of the buy-in is significant. Entry ownership (and valuation) anchor the economics and life-cycle control from inception, driving higher multiples of return even at modest exits.

Repeatable Process. Studios employ a repeatable process with intense testing that is able to mitigate early-stage risk and has historically created greater success rates. For instance, when developing new consumer technologies, unit economics, price sensitivity, latent demand, and CAC are all factors that go through rigorous stress testing before capital is invested. The result is that a venture studio is able to reduce overall losses by quickly eliminating underperforming ideas and accelerating time to market for viable products, limiting funding needed to take a new startup from idea to product-market fit, as shown below.

Venture Studio Model

Traditional Model



Note: Provided for illustration purposes only. The facts and circumstances surrounding any individual investment will vary from the assumptions and projections employed in these hypothetical examples. Please see the Disclaimer on slide 28 below.

Importantly, any process employed by a venture studio must also have a focus on the **exit pathway** for each startup. Given the ownership and role of the venture studio, they regularly have more control than traditional investors in driving future funding terms and exit opportunities. The process of iteration, development, and scale must set up the conditions necessary to ultimately provide liquidity for the portfolio.

Benefits of the Venture Studio Model

Compared to Traditional Venture

LPs Gain Direct Access to Experienced Founders. Venture Studio partners are typically experienced operators with successful exit(s) who repurpose prior playbooks in order to launch a new portfolio of companies within a related space. By backing an entrepreneur-led studio, LPs gain the ability to invest directly in the top, proven entrepreneurs as they build out a portfolio of companies that will have an automatic network of talent and expertise, creating a portfolio of founder's equity. Founders who have had experience with scale and exit typically have stronger funding sources, a deeper network of talent, and a proven playbook they utilize to create new companies.

Lower Loss Ratio and De-Risking Early-Stage Investing. The studio model is a powerful de-risking tool for institutional investors through rigorous testing and diversified resources. Traditionally, a startup founder spends all capital raised on an idea that may or may not work. Whereas studios are continuously testing and iterating multiple ideas within their portfolio. Because of this, studios do not become bound to a single idea and a single effort that may or may not work. By experimenting with multiple ideas at a much lower cost, studios repeat the iterative business playbook at a rapid pace and eliminate less promising ideas before significant capital is invested. The shared infrastructure enables studios to launch new companies at a fraction of the cost.

Capital Efficiency. Intense iteration, category expertise, and shared services are intended to enable idea validation and company creation at minimal cost. As studio's repeat the creation and iteration playbook over and over again, they are able to optimize resources and shorten the time to product-market fit, continually reducing the cost of development and validation. As studios provide inception stage capital, they are also able to gain a major foothold for minimum investment.

Speed to Liquidity. Venture studios reduce the time it takes a startup to reach an institutional Series A round by up to 50%, typically getting to Series A metrics within 12 months. With this speed of creation and validation, startups developed by studios are much more likely to see faster pathways to exit. In addition, because studios come in at such a low entry valuation, they are well positioned to sell a secondary stake once a startup reaches a threshold valuation. This provides a faster baseline for returns to investors.

Reduced fee exposure. Studios employ many different structures, including holding companies, traditional 2/20 venture fund models, and a host of hybrid structures that fall somewhere in between. Because of this, on an aggregate basis, studios reduce the traditional management fee exposure that LPs would ordinarily pay to invest in a highly curated portfolio of startups. In many studios, 100% percent of LP capital goes directly into supporting the operations of portfolio companies, resulting in zero management fees and zero carry. Instead of paying premium management and carry fees to tier-one funds for access to top entrepreneurs, LPs are able to invest directly in diverse portfolios built by these entrepreneurs, something traditional VC intermediaries have never been able to offer.

Ownership drives control to liquidity and generates multiples at exit. Most studios target >30% ownership on average, including founder's equity, which anchors the economics and life-cycle control from inception. Due to the active role studios take as company founders or co-founders, they have a

greater influence on a startup's pathway to exit and liquidity. They also have more control over terms set in the follow-on rounds, reducing the risk to early-stage investors.

Inverted Valuation Risk. Studios are compensated as company founders both in common shares as well as preferred shares. Common shares are provided as founder's equity and with little initial value. Studios also usually provide initial capital, usually between $250,000 to $500,000, to support idea iteration and testing. This investment is what sets the initial valuation and provides the studio with preferred shares at a very attractive entry point. Any increase in this initial equity provides upside to the studio, inverting market risk as average valuations rise.

Higher Return Profile. High ownership and inception-level valuations coupled with lower capital loss ratios result in increased returns. Early industry data shows average net IRRs at 53% with an average TVPI of 5.8x.[(1)] The upper quartile of venture studios produce even stronger results. This vastly outperforms both public indices as well as traditional venture capital.

Biggest Challenges for Venture Studios

There are several challenges for new studios to overcome as they develop. The main ones include:

- Talent
- Equity distribution
- Early Customers

Access to Talent. This is one of the hardest challenges facing studios and factors in two separate needs:

Entrepreneur Talent. Finding entrepreneurs that can pair well with an existing idea is hard. It is even harder to continually try to find entrepreneurs across different categories, such as consumer wellness versus new food brands. It is important that new entrepreneurs come to the table with experience, both in the specific category of the startup as well as in getting a startup to scale. Many studios are hyper-focused on building their networks of talent and finding new sources of entrepreneurial talent.

Technical Talent. Studios employ teams of technical specialist from web development and software programming to user experience and digital marketing. This talent provides the backbone of early idea validation and optimization. Strength of these teams is important in executing the studios development playbook.

Equity Structure. Studios that act as founders create a unique dynamic on a new startup's cap table when they, as an entity (instead of an individual founder), own over 30% of the initial equity (and upwards of 80% in some cases). Downstream investors tend to be less familiar with the studio structure and may push back on what they view as a disparity in ownership. Their concern is that the individual entrepreneur is not properly incentivized to manage the company through scale and exit. The balance in equity ownership is largely dependent on the role of the studio. The more involved the studio is from the idea to product-market fit, the higher the ownership holding of the studio. If a studio acts largely as an incubator to help with shared resources, the ownership levels are generally lower to ensure the founder is incentivized to scale and develop through those early stages.

Access to Early Customers. Studios are continually testing new ideas and need access to multiple customer types to understand pain points and potential solutions. This is a primary reason that corporate studios have become so influential; they provide a captive customer base for the studio to test and iterate ideas. Access to a diverse set of customers is equally important to ensure that studios are focused on big picture market problems and not just point solutions.

Common Questions

1. *What is the difference between venture studios and pre-seed venture?*

Distinct from the venture capital approach, venture studios are intimately involved with the idea creation and execution early in a startup's life. They act as founders or co-founders and receive founder's equity in the form of common shares with additional preferred shares resulting from capital allocation. Venture Studios provide inception level capital to provide resources to iterate and test ideas. Given this stage of investing, venture studios invert market valuation risk by setting a modest initial valuation as an entry baseline, prior to a pre-seed investors participation.

After the startup shows traction and passes a series of rigorous testing, venture studios bring in a professional management team to continue to execute and scale the newco. The newco may seek to raise capital from outside investors, including VC's. Outside capital from studio-developed companies usually begins at the institutional seed or series A round depending on the studio. The venture studio's employees can decide to stay in the portfolio company or return to the studio to work on a new startup.

2. *How do studios come up with ideas?*

There are a few strategies studios use to come up with new ideas:

- Strategic Partnerships. Studios regularly work with early customers often, gaining insights on pain points and common needs across industries.
- Entrepreneurial Talent. Many studios have a bench of entrepreneurs that are scouting for new ideas and new environmental needs.
- Studio Partners. Most studio partners are serial entrepreneurs, who have gained insights from past company development efforts. They apply these insights to creating new ideas and capabilities.

3. *How can founders have enough passion for an idea they didn't formulate?*

The venture industry has a pattern of bringing new management teams to an existing startup after the original founder(s) are no longer a good fit. This may be due to the founder's inability to or inexperience in scaling a startup, a toxic team culture, or lack of founder motivation to continue. Founder replacement or transition happens approximately 20% to 40% of the time [(3)] and has happened with some of the largest startup in recent years, including Andrew Mason at Groupon, Jack Dorsey at Twitter, Garret Camp at Uber, Parker Conrad at Zenefits, Phil Libin at Evernote, Ben Werther at Platfora, and many more.

While founders and entrepreneurs need to believe in the work they are doing and the solution they are building, professional management teams have significant upside potential in successfully building and exiting a company, whether it's one they created or not.

4. *Why would good talent give up so much ownership to a studio?*

Talented repeat founders are typically creating their own studios, in order to capture more ownership across a diversified portfolio of their ideas and startups. In order to manage promising startups, these partners look to emerging and serial talent to come aboard and continue to build a newco. Professional managers or co-founders that work with studios benefit from the resources that studios provide, including:

- Funding
- Shared resources
- Proven process
- Validated ideas

With the ability to work with proven, serial entrepreneurs at a venture studio, good talent has a much better chance of identifying the right solution, bringing their idea to fruition, and utilizing a bench of talent as needed.

END NOTES:

1. Source: Internal analysis from a survey GSSN conducted with participation from 258 studio startups. Disrupting the Venture Landscape. GSSN Whitepaper. November 2020. https://www.gssn.co
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