Silicon Valley Venture Capital Investing – My Experiences & Tips for the Future"

Wes Raffel, 3 Oct 2023

We were indeed fortunate that Neil Martin enticed his Harvard classmate Wes Raffel to give up some of his Australian holiday to educate us so clearly on venture capital investments, drawing on his extensive experience in Silicon Valley. He is now a high level advisor in the industry, having had over a decade in the nitty gritty as a partner in a Silicon Valley venture capital investing firm

He first questioned why is Silicon Valley the epicentre for venture investing? Chief among the reasons for early growth was its proximity to Stanford and UC Berkeley, both outstanding centres of excellence in engineering, training and research at the leading edge of the technology development and related finance. Early majors to establish businesses there as early as the 1940s included Hewlett Packard, whose success in turn encouraged others such as Fairchild etc, so that support infrastructure of ancillary services built up, attracting other start-ups by entrepreneurs. Successes bred more success, and this has continued through to the present day. Other US cities have tried to foster similar environments, but none have near matched the San Francisco Bay area.

There are various types of venture firms, focusing on different types of technology. Wes was one of the partners in Advanced Technology Ventures, which focused mainly on both the IT sector and the Health Care sector (both new drugs and devices). Some other companies especially during last 20 years have focused on social networks (which did not attract Wes because of competitive risk). Some focus on the private sector, others on public or corporate orientation. Structures vary, eg some such as Wes' firm had a flat organisation (all 6 partners sharing the risks and rewards), whilst others are more on a hierarchy model (eg older founders get a higher share). Picking a suitable partner is critical.

Who invests in Venture Funds? The prestigious US universities have immense endowment funds, who provide a large source of investment funds in projects. In addition, funds may come from high wealth people (so called home offices, looking for some alternative non-standard investments in their portfolio), pension funds, wealthy individuals and/or corporations (notably Google and Meta/Facebook put massive amounts in such ventures).

Investors may inject funds at different stages in a start-up company life cycle. Some may provide seed funds to help develop an idea. Others may enter at an early stage, so called first round, to help the project off the ground (Wes' firm targeted that stage, which has high risk, but also rewards if successful). Others enter in mid stage as the project is expanding, yet others at a late stage looking for further growth.

Typically among 10 investments, only 1 project might make a lot of money. About 5 venture projects in 10 lose money. The other 4 might make mediocre returns.

So selection is critical. To assist with the choice, Wes' firm does due diligence of the project (incl detailed modelling using recent business school graduates), receives key information via a presentation, which would then be discussed among the partners. His firm decided by the partners voting whether to invest or not, with no fence sitters, with majority decision being final (ie not consensus).

Wes identified 4 key elements to look for in a new venture investment - people (incl track record of the entrepreneur), technology (incl potential roadblocks, patent protection, intellectual property, etc), market (>$US 1 billion to be of interest), and capital requirements to hit breakeven.

What are the key characteristics of successful venture investors? These days they have record of operational experience/success, willingness to see others do the operational work, have good relations with other venture capital firms who might join a syndicate (which is common). So networking is important.

If a decision is made to invest and another syndicate VC investor is on board, a Board of Directors is formed to provide advice, leveraging on their experience, be closely involved to support the CEO, review operations and provide feedback, plus find other external directors who can add value.

How does a venture create liquidity? Wes favours going public/floating when needed, but timing is important in floating. He considers market place wins against competitors are key. Selling out to the incumbent company could make sense, if the offer is right (in 90% of cases, liquidity comes from sale to another company, cf only 10% go public). An alternative might be to form a partnership (Google do a lot of this). Also bankers may facilitate this.

For the private investor, he noted a huge investment trend now is in AI (for which San Francisco has become a key centre). Another current focus is security, eg protection from hacking, software security. It seems worthwhile to keep an eye open for prospective investments in these two areas, including from floats in the next year or so.

After a lively Q&A (incl comments on Australian universities, government involvement, scams, plus comments on the concerns of AI), Richard Kaan thanked Wes on behalf of members for such a fascinating summary of venture capital investment.

PJ