



Will Agencies be at the Centre of the New Venture Capital Landscape?

By Vincent Thome

How can digital agency networks take advantage of the new start-up generation?

The start-up environment has changed. It is cheaper and quicker to start-up today. The funding aspect is diminishing in favour of the ability to spot the right idea at the right time, and to bring this idea to market. The purpose of this paper is to explore how this changing environment creates opportunities for digital agency networks.

Why are start-ups changing?

- The rise of hardware standardization gives entrepreneurs high computer power at almost no cost compared to a few years ago. API and open code libraries are the norm, and allow developers to get web services off the ground much faster without high license costs.
- Start-ups can tap into the so-called global collaboration. With today's online collaboration tools, young entrepreneurs can access a worldwide pool of talent. This opens the market to non-technical individuals with great ideas who can easily collaborate with cheaper technical resources in India or China.
- With the word of mouth empowered by the Internet, marketing costs are falling. Today, if you have a good product, a blog, and know how to deal with search engine marketing, you can raise awareness and interest at a very low cost.

These factors made the creation of start-ups much easier. They allow to build and launch a web service in less than a year with, on average, a capital ten times lower than was previously possible. Hence, as the tech investor Mike Maples said, when it comes to funding “\$500,000 is the new \$5 million.”

What effects will these changes have?

More technology-based start-ups are created now than ever before, often without investor involvement in the early stages. There is also a corresponding change in the character of the modern entrepreneur. Back when it used to cost a lot to create a start-up, you had to convince investors to let you do it, which required very different skills from those you needed to actually do the start-up. Today technology-based entrepreneurs tend to be younger, more technical and able to get a product off the ground fast and without support.

The importance of the funding aspect is diminishing and hence it is no longer the sole responsibility of the venture capital firms to help entrepreneurs. In other words, more companies can fund early stage start-ups if they build a venture offering. This does not exclude the need for venture capital firms but they tend to enter later.

If there are more start-ups created because of lower barriers to entry, it means that the people whose job is to filter them is getting harder. In other words, if now you have to choose between more options, how do you make sure your choice is correct? In this new environment the ability to spot the right idea at the right time becomes more important than the funding aspect.

Founders are generally younger and more technical, which changes the type of help they require and venture capital firms have to develop new skills to go beyond the funding aspect. Providing help to these founders would include marketing, branding, product and service development, and distribution strategies. The ability not only to fund but also to incubate and take ideas to market becomes a vital competitive advantage.

Today, I can see at least two models trying to answer these challenges in the venture capital landscape.

Two models for success

The first model is Y Combinator, a new type of a venture capital firm. It is a “boot camp” for technical people. They help start-ups through what for many is the hardest step, which is that of turning an idea into a company. From hundreds of applications, the Y Combinator partners select the 30 most promising and then audition them to select a dozen of teams for the program. Each start-up receives \$5,000 plus \$5,000 per founder. This covers lodging, food and equipment during the program. In exchange, Y Combinator gets some equity (usually between 5 or 6 percent).

If the investment is not substantial, Y Combinator offers lots of hands-on mentoring. Other than for the money, young developers come here for the business planning, legal and exit strategy advice, and for the networking. This model is quite far from where digital agency networks are but it seems to fill the unmet needs of the young entrepreneurs and inspire imitators in the venture capital industry.

The second model, Adaptive Path, is a strategy and design firm. Their core business helps organizations to develop product concepts through experience strategy and to deliver on those concepts through design. This is much closer to the model of digital agencies than the Y Combinator model. Adaptive Path developed a new venture program offering product design and development services for start-ups in exchange for equity. If they do choose start-ups by themselves, half of them come from their venture capital partner’s portfolio, Sierra Venture. The partnering option makes sense because of Adaptive Path’s core offering deficiencies.

Adaptive Path chooses three or four promising companies each year and offers them help with working through ideation, design, implementation and subsequent iteration. As new venture projects require longer-term relationships than their traditional consulting engagements, projects begin with a two-month consulting-like process and a defined project outcome. Then, Adaptive Path acts as an advisor to help guide a product's development.

As Lane Becker, Director of New Ventures at Adaptive Path said, “Our partnership with Serria gives both firms a big strategic advantage. By combining our expertise with Sierra’s funding and impeccable due diligence we are giving companies and their products a better shot at success.”

The new venture landscape is moving from funding for equity to service for equity with incubation at the heart of the offering. These two examples show that there is a market opportunity for service led venture. The question remains: should digital agency networks also tap into this new venture landscape?

Building a venture offering makes business sense for digital agency networks

Digital agency networks have strong assets to leverage in this new environment and building a venture offering or a partnership with a venture capital firm would create value for both parties.

If venture capital firms have the business knowledge, digital agency networks can provide them with their consumers and market expertise, and help them cope with filtering by spotting better ideas to invest in. Digital agency networks can also engage in the incubation of start-ups by applying their expertise in marketing services, consumer insights, and creative skills. Lastly, during the exit period, they can potentially leverage their clients’ network and help the venture firms find potential investors or buyers.

But what do the digital agency networks gain?

Being closer to start-ups will foster in-house innovation. It will give them a larger footprint in technology and consequently a competitive advantage in the digitally led world. It will allow them to better understand the start-up collaborative culture, progressively change the way they work, and move them closer to collaborative product developments. As explained in the new study from Harvard Business School, Innovation through Global Collaboration: “The management of innovation is changing. No longer is the creation and pursuit of new ideas the bastion of large central R&D departments within vertically integrated organizations. Instead, innovations are increasingly brought to the market by networks of firms, selected according to their comparative advantages, and operating in a coordinated manner.”

Being closer to venture capital firms would develop digital agency networks' business knowledge, increase their networking beyond the marketing industry, and progressively change the way they get paid by better understanding equity based models. Lastly, a venture offering would add value at the holding level by allowing to make better acquisitions and strategic investments in companies that would improve the group's capabilities, specifically within the digital space. This would provide the group's companies, as well as their clients, with access to a new portfolio of digital expertise.

