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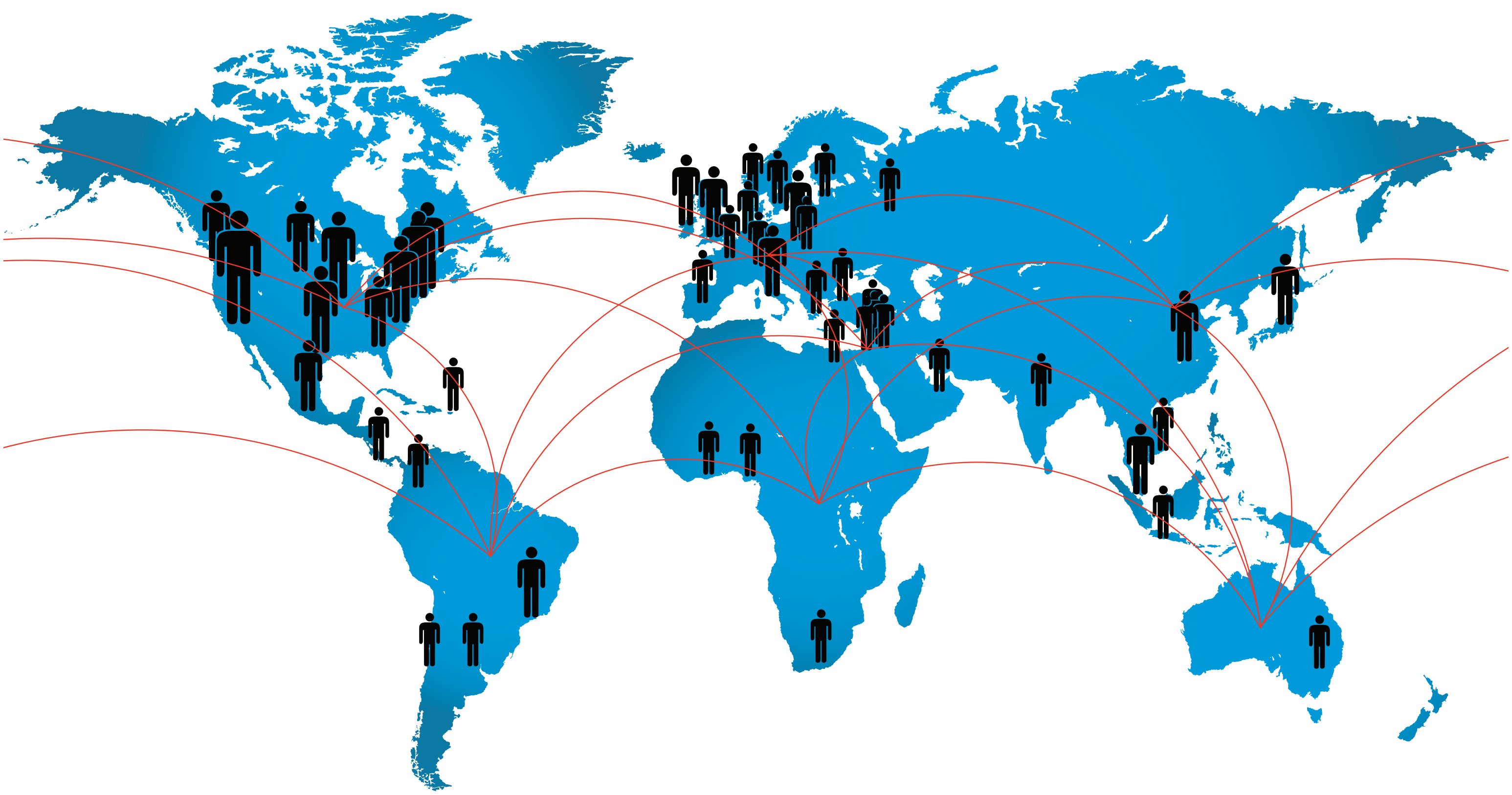

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Outside the (Tech) Box: Successful Non-Tech Venture

Trevor Thomas
Class 17

The media is full of stories about venture capitalists investing in technology companies—however, many of the companies that I find most exciting are *not* technology companies. I have in fact built a successful venture career working in "non-tech" and tech venture. After starting an airport lounge company, I worked for a consumer packaged goods (CPG)-focused family office fund, and then helped to build a fund dedicated to one of the fastest growing consumer packaged goods sectors, specialty foods. Today, I invest in both technology and consumer-product companies. In this article, I describe the shifts and factors that make non-tech venture possible and profitable.

Increasing Interest in Non-Tech Venture Value

In 2008 when I was a starting my first company, it was almost impossible to raise venture capital for anything that was not technology, or health care-related. My startup was an interactive airport lounge that served healthy, local food products, and hosted local bands for live entertainment. My plan was to bring the city into the airport and make getting delayed fun. I was turned down by a "who's who" of VCs—they appreciated the product and the traction my startup had demonstrated, but only invested in technology. We ended up having to raise money from a competitor, which ultimately limited our growth potential.

Getting funding and support for non-tech ventures is still tough today, but it is much easier than in 2008. VCs are recognizing that innovation and scalability are not necessarily linked to technology—as a result, more VCs have the conviction that razor blade companies, coffee companies, and even sock companies can be billion-dollar businesses.

Dollar Shave Club is a consumer products company that manufactures and markets personal grooming products. They have raised over $73 million from such stalwart tech funds as Venrock, Battery Ventures, Kleiner Perkins, and many others.[1] As of Q3 2014, the company had more than 1 million members and revenue of more than $60 million for the year.[2]

Blue Bottle Coffee is a brick-and-mortar coffee shop and roaster. Somehow, they

[1] CrunchBase, "Dollar Shave Club: Funding Received," 2014, http://www.crunchbase.com/organization/dollar-shave-club.

[2] Melissah Yang, "Dollar Shave Club's Membership Hits 1 Million," *Los Angeles Business Journal*, 29 September 2014, para. 3, http://www.labusinessjournal.com/news/2014/sep/29/dollar-shave-clubs-membership-hits-1-million/.

have raised over $45 million from funds such as True Ventures, Index Ventures, Google Ventures, and others.[3] Backers expect Blue Bottle's valuation to break $1 billion at their next funding event.[4]

Stance is an apparel company that manufactures and sells socks. They have raised over $25 million as of Q4 2014, mostly from athletes and entertainers but also from venture investors such as Shasta Ventures and QueensBridge Venture Partners. Its earliest stage investors have reportedly already reaped an 8x return.[5]

Porter's 3 (Three) Forces

One of the two factors behind this shift in mindset is that we are now experiencing what I term *Porter's Three Forces*. No, that is a not a typo.

In 1980, Michael Porter coined a theory that one can determine the strength of a strategy, market, or product by analyzing five key market forces: the bargaining power of suppliers, the threat of new entrants, the bargaining power of buyers, the threat of substitute products, and the rivalry among existing competitors.[6] Porter defined these forces in a pre-Internet, pre-globalized world when there were huge barriers to entry into vertically integrated industries, and innovation and marketing were prohibitively expensive.

In the last 34 years, the situation has changed—particularly for suppliers and buyers. Outsourcing, "making," and the commoditization of technology have made producing and marketing products much cheaper; the cost of the technology and labor necessary to produce physical things has dropped precipitously. As a result, supplier power is a much weaker force and pretty much anyone can get anything made without investment in capital.

Buyer power is also less relevant. For many products, the initial buyers or "users" are not the point—profit comes through the long tail of potential customers the product can influence. Google first demonstrated that products can be given away for free in the hope of garnering future revenue through advertising and data. This concept now extends into how physical products are marketed using consumer data to better target customers. Buyer power is now almost irrelevant in the face of sellers' sophistication in marketing—in many cases, buyers are not even aware that they are buying through their activities online.

While Porter himself has recognized some of these factors and updated his Five Forces article in 2008,[7] I take his work a step further and suggest that the Five Forces have dwindled to Three Forces: the threat of new entrants, the threat of substitute products or services, and rivalry among existing competitors (figure 1). In some ways, transactions are no longer between buyers and sellers but between experiences and information. Someone makes an excellent experience, customers flock to that experience, and that experience is monetized in various ways. This idea of product-as-platform is not limited to technology, and also includes non-tech innovators such as the Dollar Shave Club, Blue Bottle Coffee, and Stance Socks.

Savvy entrepreneurs have learned that it is possible to sell consumer products with the same reach and sophistication that Google or Facebook have through selling ads. When this commoditized, often free technology is coupled with low manufacturing costs, consumer

[3] CrunchBase, "Blue Bottle Coffee: Funding Received," 2014, http://www.crunchbase.com/organization/blue-bottle-coffee.

[4] Confidential interview with Blue Bottle Coffee investor, 15 July 2014.

[5] Confidential interview with Stance investor, 8 October 2014; confidential interview with Queens Bridge Venture Partners, 15 May 2014; see also CrunchBase, "Stance: Funding Received," 2014, http://www.crunchbase.com/organization/stance.

[6] Michael E. Porter, *Competitive Strategy* (New York: Free Press, 1980).

[7] Michael E. Porter, "The Five Competitive Forces That Shape Strategy," *Harvard Business Review* (January 2008), https://hbr.org/2008/01/the-five-competitive-forces-that-shape-strategy.

Figure 1. Porter's Three Forces. Graphic image adapted from Bob Zukis, *Social Inc.: Why Business Is the Next Social Opportunity Worth Trillions* (Palo Alto, CA: Kauffman Fellows Press, 2013), 109. Used with permission.

products companies can make tech-like returns on investment—and tech investors are diving in.

Early-Stage Non-Tech Ventures Deliver

The second factor behind the increasing interest in non-tech venture is the encouraging recent exit activity. The past few years have seen a potpourri of interesting exits outside of technology, as consumer products companies take advantage of Porter's Three Forces and commoditized marketing options.

Lululemon is the sports apparel company that made athletic leggings the new jeans for women; they went public in 2007, raising about $330 million in their IPO.[8] Early investors included Highland Capital and Advent who together invested about $93 million in 2005. In 2014, Advent invested again, purchasing 14% of the company for $845 million, valuing the company at $6 billion.[9]

Annie's Inc. is a specialty foods brand that led the charge for healthy snacks, founded in 1989 by Annie Withey. Solera Capital acquired a controlling interest in 2002 and took the company public in 2012, raising $95 million. General Mills purchased the company in September 2014 for $820 million.[10]

Snack Factory is the specialty foods company behind Pretzel Crisps. The founders received their flat pretzel patent in 2004, and sold a controlling interest in the company to VMG Partners in 2009. VMG then netted more than 8x ROI on their 2011 sale of the company to Snyder's-Lance Inc. for $340 million.[11]

Happy Family is a brand of high-end baby foods and products. The company was purchased by Danone in Q2 2013 for an undisclosed price, understood to be above $250 million.[12] Early-stage investors included the W.K. Kellogg Foundation ($4.6 million),[13] Bee Partners, and Demi Moore, for a total of $23 million. This suggests a cash-on-cash multiple of over 10x for early-stage investors.[14]

Prana is an activewear company inspired by yoga, climbing, and outdoor lifestyles. Columbia Sportswear (COLM) purchased Prana in

8 Jackie Sindrich and Mark McSherry, "LuLulemon's IPO Prices at $18/shr-underwriter," *Reuters*, 26 July 2007, para. 1, http://www.reuters.com/article/2007/07/26/lululemon-ipo-idUSWEN980820070726.

9 AltAssets, "Advent Buys Back into Clothing Maker Lululemon through $845m Deal," 8 August 2014, para. 7 and para. 1, https://www.altassets.net/private-equity-news/by-news-type/deal-news/advent-buys-back-into-clothing-maker-lululemon-through-845m-deal.html; see also Lululemon Athletica Inc., "Lululemon Athletica Gains Partners in Growth Equity Investment - Board, Management and Financial Expertise to Assist Expansion," 8 December 2005, http://investor.lululemon.com/releasedetail.cfm?ReleaseID=241303.

10 Nick Turner, "General Mills Adds Organic Foods With Purchase of Annie's," *Bloomberg*, 9 September 2014, "Rabbit Mascot" para. 2-3, http://www.bloomberg.com/news/2014-09-08/general-mills-to-buy-organic-food-maker-annie-s-for-820-million.html.

11 Michael Wursthorn, "VMG Snacks on Pretzel Crisps Exit," *The Wall Street Journal Private Equity Beat*, 15 October 2012, para. 2, 5-6, http://blogs.wsj.com/privateequity/2012/10/15/vmg-snacks-on-pretzel-crisps-exit/.

12 Jessica Pothering, "How 'Happy Family' Became Healthy Baby-Food Pioneers," *Entrepreneur*, 8 October 2014, para. 2, http://www.entrepreneur.com/article/238155.

13 Mission Investors Exchange, "W. K. Kellogg Foundation to Make Mission Investment in Happy Family," 23 October 2012, para. 1, https://www.missioninvestors.org/news/wk-kellogg-foundation-to-make-mission-investment-in-happy-family.

14 Confidential interview with Bee Partners, 14 June 2014; *Forbes*, "Happy Family," February 2013, "Profile" para. 1, http://www.forbes.com/companies/happy-family/.

2014 for $190 million,[15] for what is believed to be a 4x multiple for its lead early-stage investor, Steelpoint Capital Partners.[16]

All of these products are low-tech, and all benefited from Porter's Three Forces and commoditized marketing options to achieve venture returns. Annie's Inc. and Snack Factory benefited from an extremely efficient natural foods co-packing (outsourced manufacturing) environment, eliminating the need to invest in expensive capital equipment until well into their growth curves. Lululemon capitalized on creating a great purchasing and user experience—they also benefited from outsourced fabric production in Taiwan.[17] Happy Family and Prana benefited from commoditized marketing options maximizing the use of social media and customer engagement to position as a more authentic alternative to more mainstream products.[18] All of these companies extensively market and sell their products online.

Non-Tech Venture: A New Sector Benefiting from Market Shifts

These funding trends, changes to industry dynamics, and exits suggest that the praxis of venture capital being exclusive to technology is a thing of the past. If anything, a more sector-inclusive approach to venture will be critical to capture value in future market shifts.

The United States is going through a massive demographic transition that will see the ethnic majority shift from White to African American and Latin American within the next 28 years. Naturally, the consumer spending power of these groups, estimated to be about $2.5 trillion annually, is expected to rise[19] and will affect the nature of the core early-adopter sector. The new innovative products being created by entrepreneurs to capture this spending will surely not be limited to the technology sector—and VCs will be ready to support them.

Trevor Thomas

Trevor is a partner at Cross Culture Ventures, along with Marlon Nichols (Fellow, Class 18) and Troy Carter. He is a Kauffman Fellow (Class 17) and was mentored by Berton Steir at Roll Global. Trevor holds a BS in industrial engineering from Morgan State University, an MEng in logistics from MIT, and an MBA from the University of Virginia.

trevor@crossculturevc.com

15 Nick Turner, "Columbia Sportswear to Acquire Yoga Brand PrAna for $190 Million," *Bloomberg*, 29 April 2014, para. 1, http://www.bloomberg.com/news/2014-04-29/columbia-sportswear-to-acquire-yoga-brand-prana-for-190-million.html.

16 Multiple determined using data from Turner "Columbia Sportswear" and David Gelles, "Prana Living, Yoga Gear Maker, Is Sold to Columbia Sportswear," *The New York Times DealBook*, 29 April 2014, http://dealbook.nytimes.com/2014/04/29/prana-living-yoga-gear-maker-is-sold-to-columbia-sportswear/?_r=0.

17 Kim Bhasin and Ashley Lutz, "Here's What's So Special About Lululemon's 'Luon' Fabric," *Business Insider*, 19 March 2013, http://www.businessinsider.com/what-is-luon-2013-3.

18 Both companies have been managing near-daily Tweets and Facebook posts; see https://www.facebook.com/HappyFamily, https://twitter.com/HappyFamily, https://twitter.com/Prana, and https://www.facebook.com/prana.

19 William H. Frey, "Census Projects New 'Majority Minority' Tipping Points," *Brookings Institution*, 13 December 2012, table "Year When Whites Become Minority, by Age Group," http://www.brookings.edu/research/opinions/2012/12/13-census-race-projections-frey.

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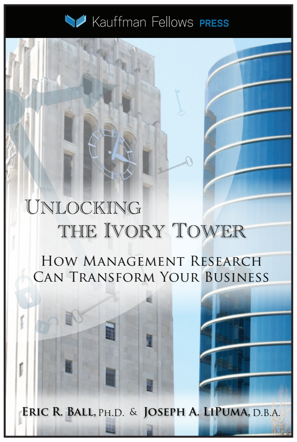

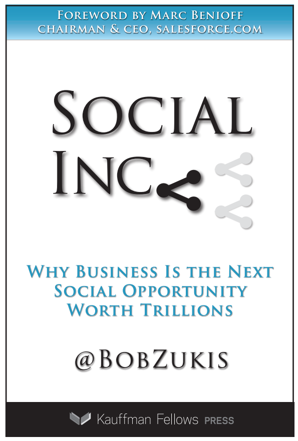

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