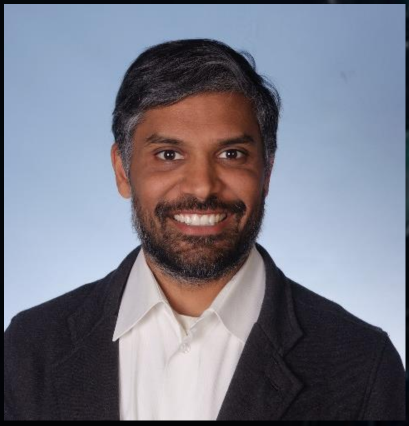
diffusetap
Virtual Event Series

VC in Legacy Industries

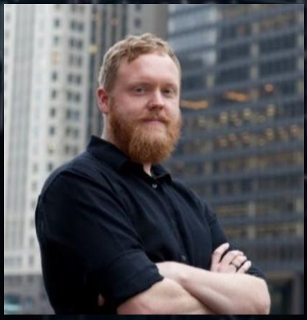
GUEST SPEAKER



Rohit Gupta

Managing Director
Future Communities Capital

HOSTS



Kenny Estes

CEO and Founder
Diffuse

Ayla Kremb

Chief of Staff
Diffuse

DiffuseTap: VC in Legacy Industries

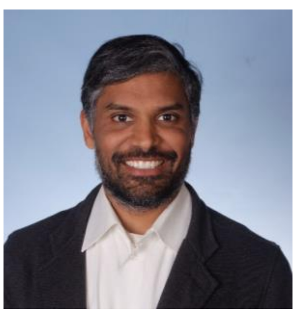
Last time on DiffuseTap, **Rohit Gupta, Managing Director at Future Communities Capital** talked to us about scouting for big opportunities in legacy industries, the reasons why some industries move at a slower pace than others, and the trouble of being too early to the disruption party.

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



ROHIT GUPTA is the Managing Director of Future Communities Capital, a San Francisco-based fund that invests in innovative teams which create solutions for problems in commonly overlooked and niche areas – from smart city infrastructure to managing disease outbreak. With over a decade of experience in VC, Rohit is constantly on the lookout for technology entrepreneurs aiming to disrupt legacy industries such as government, healthcare, finance, and real estate. LinkedIn: @rohit-gupta

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.

KENNY: Our speaker today is Rohit Gupta. Rohit, you've been here before. Do you want to do a little intro on yourself?

ROHIT GUPTA: Yup. Excited to be here.

I've been in venture capital for 13 years and was in another fund before that. I run two venture capital funds now, and I’ve seen the ups and downs of this industry. 2021 is probably the craziest year ever. We've got so many exits coming through this year. It's fantastic. A good problem that we’re facing right now is, what the hell are we going to do with all its capital?

Today let’s talk a little bit about legacy industries. That includes govtech, healthcare, transportation, and real estate. Think of it as industries with big open problems where it’s very difficult to innovate.

AYLA: Awesome. I'll kick it off right there. Maybe we'll start with a bit of a framing question. What's the difference between a standard venture investment in a mainstream, “moving-along” industry, and investing in a legacy industry where things have gotten a little bit crusty?

ROHIT: What we have seen in legacy industries for a long time is that they don’t necessarily use the best technology. The best product doesn't always win. The typical scenario is, you’ve got a team of five, and they build some technology and go to sell it to a hospital. Now, what hospital in their right mind is going to buy that? We’re talking about patient lives, patient data. It’s difficult for healthcare buyers to give startups they don’t know a chance.

Entrepreneurs are on this uphill grind of trying to sell a pilot program to a hospital or government agency. It will take them two years and between $100,000 to a million just to get a $50,000 contract. Everything's backwards. We found that we can help startups sidestep this issue and quickly secure early reference customers.

KENNY: Okay. So, you mentioned healthcare. When you’re looking at it at a high level, what do you look for? Because there is almost like a prima facie concern there. Before you say “Okay, now here's an industry prime for disruption,” what are you looking for in that underwriting? And then do you find startups? Or do you do it the other way around: You find a startup first, identify an approach you think is really innovative, and work backwards if you think the industry is ready for it?

ROHIT: We've done both. As a fund, we source entrepreneurs in our network that are thought leaders in a specific problem area. We help source initial customers. Other times, often in areas where we know we can drive sales, we’ll fund a founding team of strong operators.

AYLA: Got it. This may be the most boring part of this conversation, but what is the technology that's actually driving the change within these companies? Which industries are being affected in what ways, and what technologies are emerging in each industry that are changing? Obviously, it's not the same in a hospital as it is in a manufacturing company, so how does it work?

ROHIT: I think the technology differs very widely across industries. But a lot of what we invest in, are startups digitizing pen and paper processes. Technology at the foundation of startups driving digital transformation is similar across industries.

It's crazy to think that in 2021, a lot of operations are still done manually, or at best, in Excel. They don't even share these documents. They just email stuff back and forth.

KENNY: So then, why? The '90s were a thing, and these were things 30 years ago. Just, why? Why are these industries so slow to adapt? And that might be a good chance to talk about some politics or behavioral concerns with what's going on there.

ROHIT: I mean, look at health care. Where's the incentive to innovate in healthcare? You can't just go to a doctor and say, "Okay, now you're going to change everything about how you treat patients." The adoption rate is incredibly slow. Regardless, if change is approached top-down or bottom-up, it's always going to be messy and delayed in industries where end users have little incentive to change.

Not to mention data security or patient lives. Who's going to risk that over untried technology? The last thing any hospital wants is a breach. Hospitals can't even prevent ransomware attacks, let alone innovate.

KENNY: Why are they backwards? Is it government protection? Because obviously, healthcare is effectively a monopoly. It's a very complicated system, and it's very much government-based. Financial institutions and financial services also tend to be backwards. Is there a high correlation between how much the government gets involved and this backwards mentality?

ROHIT: There are regulatory moats. That's for sure. But I think in this case, we're not seeing enough regulatory pressure. Given where we are in an industry like healthcare, government incentives to drive adoption of certain technologies can be a very powerful and necessary force for stimulating a culture of innovation.

AYLA: One of the fears in some of these industries is that you might be a bit early to the party, in terms of changing them and digitizing them. Some of these industries might not be ready for change for another 10 years. As an investor, how do you look at these bullish startups who are saying "Yes, this industry is ready for change right now", but they're slightly four to five to 10 years early on the industry they are trying to disrupt? How do you have a handle on what the horizon for cracking that market is, when you look at them from a Western perspective?

ROHIT: Every slide deck is hopes and dreams, and unicorn exits. Anybody who thinks they can reverse engineer a unicorn is probably delusional. And not the good, “I'm a crazy founder who’s going to change the world” delusional, but more along the lines of, “I don't know what it takes to get there, but I'm saying it anyways.”

When we’re evaluating an opportunity, we most importantly try and get a very concrete understanding of the first segment they’re going to sell to. And part of what we do in our diligence, and in our value add for these companies, is we go and find potential representative customers in our network and ask them, “Who would buy this? What are we looking at here? Does this fit into anybody's innovation schedule?” And if there's no good answer there, then that's probably where it's going to die.

KENNY: So that's a good segue. Hugh was mentioning before we started that he used to work in a CVC. Extensively, it's there to drive that innovation, to be that innovative customer in some sense, or investor, however we end up putting it. What's your experience with those? Do CVCs generally work? There's certainly politics there, which I think might be really interesting for you to touch on. But why is the innovation happening outside of corporates?

ROHIT: Can you explain CVC?

KENNY: Sorry, corporate venture capital. It's a venture capital arm that is combed underneath a corporation. The idea is, it's a sandbox for you to invest in startups, and it helps you partner with them and shepherd them into the corporation.

ROHIT: Right. CVCs are challenging. Because more often than not (and if anybody's in that world, I'm not trying to step on any toes) from what I've seen, they're often not playing the same game. You can call it outsourced R&D, or a way to find companies to acquire. CVCs will get into deals by claiming that they’ll open doors, but more often than not, they fail to broker meaningful access for startups. The network we have actually opens up doors for startups.

AYLA: I'll pick this one up. Somebody who led a $110 billion bank innovation team asked a question. He says that at the top level, the senior executives don't really want innovation. They want things to remain the same. How do you work with founders specifically as they're looking at their own business model, for them to get an understanding on whether they’re going up to the right customers? One of the special things about your team is that you play the business development door opening role. How do you and your team guide these startups in the right direction, and to the right individuals that don't hate innovation and just want to sail into retirement?

ROHIT: It sounds tougher than it is. I think most startups, when they first get a taste of trying to innovate in a legacy industry, it's more difficult than they think it will be. Most times, they think, "This is not what I signed up for." The barrier to entry is a lot higher than they anticipated.

I'm not saying I'm a rainmaker, but our network is specifically qualified business leaders who actually want innovation. We're very direct about it. We say "Look, this is what we do. This is how we take early stage startups and get them an anchor customer, data partner, or distribution deal." That starts a flywheel for them, and they get super interested. They often end up selling to me, saying "Hey, we really want to work with your fund."

KENNY: That makes sense. And then, I guess it's a matter of knowing the right people, which is a lot of work. Kevin has a very meta question for you. How backwards is the VC industry itself? Do people still invest by checking random numbers in an Excel spreadsheet? What does that look like?

ROHIT: There are a lot of funds that have done business the same way forever. "I'm the smartest guy in the room, you should invest in me", and they all look the same. They all talk the same. The Patagonia vest joke is a stereotype for a reason. We're a little different. And we're excited about that. We think it's a cool place to be.

AYLA: One bit that leads into that is about how to be vigilant as a venture capital person. What check sizes do you usually deploy, and what do the exits look like? Especially, looking at the last year with COVID. I'm sure a lot of things accelerated on the digitization front of things. Have you seen the volume of companies increase in Texas? Or have the returns increased? What are you observing?

ROHIT: Yeah, it's all of that. It's been a wild year for everybody. When we looked at venture capital, we wanted to reverse engineer the exit cycle. When I first started in this game, it took seven years to IPO. And then it became 10, and then 12. And SPACs may have disrupted that, but some say it's on the way out. We've looked into that timeline, and it doesn't work for us. We don't want to be in these deals for over a decade.

We provide a value add that nobody else can because of our strong network, let's tell founders two things. One, we're going to be the most expensive investor, because we're going to slash the valuation when we invest. And two, we're looking to get out of this early.

We usually invest in pre seed or seed, and when a company gets to series A, we're happy to say to the founder, "You know what, take us out. Have your Series A lead buy our interest, because they probably want more concentration, or we sell on the secondary." We don't need to be in these deals forever. We're happy to take a 10x and walk away.

KENNY: That's really interesting. You talked a little bit about your chance to market there, so what's your check size? If a startup wants to come to you, what are the things that you require where you say, “Hey, don't even bother unless you have x, y, z out the gate”?

ROHIT: With regards to check size. we're targeting $250 to 350k seed and pre-seed companies. We have some money for a follow-on, as well. We do recognize that there are some deals we're not going to want to get out of, and we're going to want to stick around forever. We’re happy to be in them. We're looking for teams in spaces like gov tech, health tech, or real estate. If you're in those spaces, we'd love to talk to you - if you have something different, something compelling. Just trying to sell more SaaS is not moving the needle for anyone.

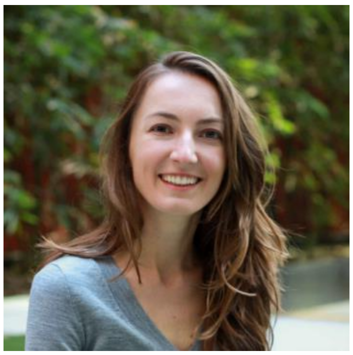
But also, we invest in some of the strangest stuff. We invested in a sleep apnea company, for instance. It’s finding these hidden niches that nobody else is looking at. Sleep apnea is 80% undiagnosed, and the long tail is practically every chronic disease, including the final one, death.

AYLA: One question that came through from Joe is that, if the venture process could be adapted to take on some of the public market’s practices, what would you port over? And especially, if you're talking about niche deals that are invisible to everybody else in the market, what's driving returns? Is there maybe a data transparency thing here somewhere? What are your thoughts?

ROHIT: I look at it the other way. We've made our money where there's asymmetric information. We’re an outlier in terms of performance and behavior. We're looking at stuff that nobody else wants to touch, because we understand things at a different level. If venture was more like public markets, I'd have to find a new strategy.

Thank you for downloading this DiffuseTap event transcript.

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



DiffuseTap:
Investor Relations Strategies

Luba Lesiva
Founder and CEO
L4C

If you're a new VC fund seeking investments for the first time, how can you avoid the most common rookie mistakes? Find out from Luba Lesiva, former head of investor relations at Palantir, as she shares 5 great tips. Read on

DiffuseTap:
Litigation Finance

W. Grant Farrar
Founder and Managing Director Arran Capital

Litigation Finance promises a stunning return on capital potential and the light 3-year investment timeline. Dig deep into this new asset class, which has proven to become an effective investment model. Get behind for profit and also for the greater good. Read on

DiffuseTap:
Investing in Movies

Roger Welp
Director, Alternative Investments RCM Alternatives

We all love going to the movies, but ever wonder what actually goes on behind the scenes? There is a mystery surrounding the finance side of the business of entertainment, but according to Roger, it's really not much different from funding a startup. Read on

JOIN US

