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# VC in OC: Often Starts in Silicon Valley

## STARTUPS: Observers say stronger deal flow needed here

Udi Dorner consulted Wikipedia when he needed a list of venture capital firms in Orange County. The managing partner of Irvine-based startup Set-Schedule was looking to raise \$3 million in venture funds for a Series A round for the technology and marketing startup that connects real estate agents with homeowners and buyers.

He came up emptyhanded. Dorner said he looked to Los Angeles and then to Israel to work on the raise.

SetSchedule isn't alone in its search outside of OC for Series A funding. Many startup founders lament the lack of venture capital firms here.

The void isn't surprising, since OC's startup ecosystem is still in a relatively early stage. The prevailing sentiment among key players here says deal flow needs to reach a critical mass to attract more VC firms to establish offices here.

"VCs follow quality deals," said Ray Chan, a co-founder of Newport Beach-based early-stage venture fund K5 Ventures. "VCs have to earn and fight for good startups and good deals, as it is the good deals that will give them good [return on investment], better branding, better reputation, and ability to raise the next fund."

There have been OC success stories. Some local startups have done successful Series A raises with local venture capitalists participating along with venture capital firms outside of Orange County.

Qualaroo, which installs surveys on companies' websites to glean customer insights, and its sister company, GrowthHackers, raised \$7.2 million from VC firms, including Okapi Venture Capital in Laguna Beach, according to Sean Ellis, who acquired the business, ran it with his team out of Costa Mesa, and sold it in March to a company in Las Vegas.

Where Is the Money?

Ninety percent of U.S. venture capital money is in the San Francisco Bay Area, which includes Silicon Valley, according to Okapi Managing Director Marc Averitt. Los Angeles startups also have to make the trek up north to pitch to investors, said Erik Rannala, co-founder and managing partner of Mucker Capital in L.A. Mucker invests in early-stage tech companies with its venture fund.

"The majority of VC being invested in L.A. comes from outside of L.A.," he said. "The single biggest place is the Bay Area."

And a Series A round isn't what it used to be, Averitt said, because the stakes are much higher these days.

"Today's seed round is yesterday's Series A round, used to finish the product and get initial market traction," he said. "Today's Series A is yesterday's Series B round, used to grow the company beyond the initial \$1 million or so in annual revenue."

A traditional seed round formerly was funded by angel investors—affluent individuals who provide capital, usually in exchange for convertible debt or equity. Series A rounds typically were funded by venture capitalists, but now some angel networks fill the bill.

VC Players in OC

Venture capital firms historically haven't set up shop in OC because the area is best known for real estate and med-tech businesses, according to David Gosselin, a principal at Newport Beach-based accounting firm DBBMcKennon.

The local med-tech industry does have a VC following, though "it's not necessarily a high-flying or sexy industry," he said.

It's instead "fraught with regulation, high upfront costs, and long lead times to market," Gosselin said. "VCs are often attracted to high-margin, high-growth companies that have minimal regulation risk. Many young companies foster the idea of: grow quickly, figure out how to monetize and conform later. That is everything that real estate and medtech are not."

The venture capital firms in Orange County that are capable of doing Series A rounds include Okapi; Toba Capital, with its official headquarters in San Francisco but essentially based in Newport Beach, where founder Vinny Smith lives; and Miramar Venture Partners in Corona del Mar. Frost Data Capital in San Juan Capistrano, which creates and nurtures data analytics companies, does Series A rounds, but only for its own companies.

Aliso Viejo-based OCTANE, an organization that provides a network of resources, expertise and capital, is doing multiple things to get more VC money flowing in OC, such as starting its own venture fund for ophthalmology startups and pursuing the creation of a network of high-net-worth investors who can get early access to startups through OCTANE's LaunchPad accelerator, said Paul Symczak, vice president of entrepreneurship and director of the LaunchPad Small Business Development Center.

OC entrepreneur Jenny Q. Ta recently co-launched an international database of venture capitalists. Irvine-based VCNetwork, which lists more than 500 VCs, is intended to connect startups with those in the database. She said that only 5% of the VCs are based in OC.

#### What's Needed

Chan of K5 Ventures says it's all about the "talent." He's adamant that OC needs a more diversified startups labor force, including web developers, user-experience designers, and graphic designers.

"We can have many Ferraris, but we still need skilled drivers to win a race," he said, adding that the absence of that led K5 to cocreate The Portal in concert with The Beall Family Foundation in Newport Beach to foster talent in OC and keep it here.

Luis Vasquez, vice president of investor relations at Frost Data Capital, said a prerequisite of a strong local VC presence would be some large sales or IPOs of venture-backed companies based here.

"If there are many large returns, then VCs will consider setting up offices in Orange County," he said. "A more likely scenario would be that the founders and entrepreneurs that participate in these large exits will set up their own VC firms. That is how several Orange County VCs and other investment firms, including Frost Data Capital, were established here."

Gosselin at DBBMcKennon said Orange County needs an even more forward-looking perspective.

"For OC to make its mark," he said, "we will need to think about what the industry of tomorrow will be and make sure those innovators are cultivated here through our universities and supporting infrastructure and organizations."

#### Alternatives

The primary alternative to local VC funding of many OC-based startups for now is heading up north to pitch to VC firms in Silicon Valley or reaching out to East Coast venture capitalists.

Ellis, who acquired Qualaroo and later sold it, did both, getting commitments from Boston and Silicon Valley investors, then adding Okapi to the round in order to have someone local.

"I personally didn't know a lot of other potential investors in Orange County, so I didn't reach out to others," he said. "The important thing about Okapi is that while they are local, they have strong ties to Silicon Valley and a Silicon Valley approach to business. Overall, I think the access to local venture capital is pretty limited (in OC)."

Averitt explained that the approach of Okapi, as a seed and early-stage venture capital fund, emulates the Sand Hill Road venture capital firms in the Silicon Valley city of Menlo Park in seeking similar criteria, such as startups that incorporate multiple technologies. Industries it invests in include biotech, healthcare and software.

K5's Chan suggests an alternative: raising a Series A from unconventional sources, such as family offices and individual investors.

Richard Sudek, executive director of University of California-Irvine's innovation institute, Applied Innovation, agreed, saying that angel networks in Southern California are doing syndication deals that can provide VCtype money of \$1 million or more.

He said that last year OC Tech Coast Angels collaborated with Golden Seeds in closing a \$10 million round through angel groups and private offices for Pittsburgh, Pa.-based startup Cognition Therapeutics, which is developing drugs to fight the cognitive decline from Alzheimer's and other neuro-degenerative diseases.

OC Tech Coast Angels is a network of angel investors that sometimes partners with other angel investor groups. Golden Seeds is an early-stage investment firm at The Cove— Applied Innovation's physical space in University Research Park—focused on startups led by women.

Sudek said he anticipates The Cove will start bridging the gap between OC startups and Silicon Valley VCs by taking an active role in connecting them.

"The issue of geography will be less of an issue as The Cove grows and provides more connections for startups to VCs," he said. "Going to Silicon Valley is still the best option if [a startup] cannot close a round here in OC."

#### Another Idea

The startup SetSchedule received an initial investment of \$310,000 from angel investors in Los Angeles. Managing partner Dorner said it has no commitments yet from VC firms in Israel but has gotten nibbles from some "ultra-high-net-worth" angels and two VC firms there. It also recently won a "Shark Tank"-like competition in Los Angeles where it was the only company to get an offer, he said, receiving \$720,000 as a cash investment for pure equity.

He has some ideas of his own to help VC firms establish a more visible presence in Orange County.

"Some of the ways to make access to capital and VCs easier in the OC would be to promote special events using the National Venture Capital Association," he said, adding that he would like to see special events similar to those offered in the San Francisco Bay Area, including pitch meetings, investor speed-dating-style events, and pre-seed and post-seed mentorship meetings.

The association is a Washington, D.C.-based trade group representing the U.S. venture capital industry.

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