Venture Capital in Colorado

Industry Outlook for Colorado and the Front Range

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KEY TAKEAWAYS

- *Cities which are pulling deal flow from California tend to be US college towns, like Austin, Boulder, Columbus, Durham and Provo, due to ample innovation and workforce composition.*
- *The number of venture deals in Washington, Illinois, Massachusetts and Colorado has been steadily growing since 2010.*
- *Colorado is the nation-wide leader in workforce education and STEM participation.*
- *The Denver metro area is the top place for women entrepreneurs in the nation.*

BACKGROUND

The venture capital (VC) community has seen strong investment numbers over the past three years, beginning in 2015 through Q1 of 2018. Most of this capital has been concentrated in the three main hubs in the United States - California, New York and Massachusetts. In 2017, 76% of venture capital money was directed towards companies in Silicon Valley, New York City and Boston.[1] This number is up from 72% in 2012 and 64% in 2007.[1] A portion of this capital can be attributed to mega-deals for large tech companies within these spaces. Investments in US startups in Q1 totaled $28.2B which was more than any quarter in the past decade, and all of 2009. Q2 of 2018 represented $23B in investments and if this level continues 2018 is on pace for the highest amount ever invested by about $20B.[2] Although we're on pace for the most dollars invested, the share of global venture capital activity within the United States has fallen from 95% in the mid 90's to under 50% today.[3] Some might paint this statistic as a gloomy picture, but with venture investing happening all over the world and the rise of megadeals both here and abroad, it can be explained why the US share has declined.

Focusing on actual deal makeup, the median deal size for all early stage rounds has grown by about 50% over the last six years.[1] This breaks down to $1.4M for angel/seed type deals, $9.2M for early VC deals and $15M for late stage VC deals.[1] Looking at who is participating, it is interesting that during Q1 of 2018, micro funds, defined as funds with less than $50M, made up 50% of the fund count for the first time since 2015. This is contradictory to a trend of new giant funds like Softbank' $100B Vision Fund. Making for an interesting dynamic, exits have been weaker in Q1 of 2018 than the year prior, partially due to the bigger investments mentioned above and longer runways of cash. This can lead to a decreased sense of urgency for VC backed companies to exit and longer timelines for an investor to receive their return.[1]

When assessing the sectors which have seen the most investment in recent years, it breaks down with the highest being internet-based companies then healthcare, mobile/telecommunications, software and consumer packaged goods (CPG). However, in 2018 financial technology (FinTech), artificial intelligence (AI) and cybersecurity startups all saw funding rise amid a decline in total deals indicating these sectors are trending as the next hot areas of investment.

It is becoming more expensive than ever to finance startups in the Bay Area and there has been an overall trend showing greater proportions of deals flowing into developing VC areas of mid-America. Bolstering this is the number of venture backed deals outside of both Silicon Valley, and California as a whole, have been on the rise for years with numbers likely to increase again in 2018.[4] As the total number

[1] https://www.forbes.com/sites/kurtbadenhausen/2018/10/01/the-top-10-rising-cities-for-startups/

[2] https://pitchbook.com/news/articles/13-charts-that-show-the-state-of-the-us-vc-ecosystem

[3] https://venturebeat.com/2018/06/26/pitchbook-colorado-and-utah-have-a-surprisingly-high-density-of- late-stage-startups/

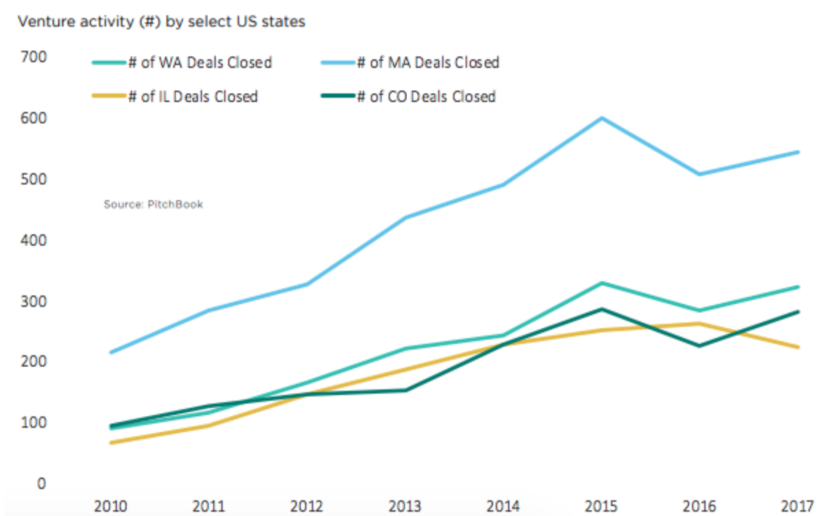
[4] https://www.inc.com/business-insider/venture-capital-funding-outside-silicon-valley-pennsylvania- colorado-florida-startups-vcs.html

of investments have grown, the number of California deals have shrunk by 16% in the past two years.[3] However, other startup scenes are less well developed than in California, which may limit the amount of money venture capital firms are willing to put into these ecosystems. Joelle Sostheim of Pitchbook reminds us that “time is money and many VCs may see sourcing investments from external hubs as not worth the cost. [Additionally,] it may take time for ecosystems to develop, and some may be too undercapitalized or under-resourced to offer a substantial enough pipeline for investors to commit.”[4]

These other ecosystems beyond California, Massachusetts, and New York include Washington, Texas, Colorado, Utah, Illinois, Pennsylvania and Florida to name a few. In general, it can be stated that cities with the most venture capital deals per capita are dominated by US college towns like Austin, Boulder, Durham and Provo in addition to the Bay Area.[2] While these cities don’t have the highest density of startups as compared to more mature venture ecosystems, each has been developing companies despite access to fewer resources.

COLORADO

The state of Colorado, along with Washington, Illinois and Massachusetts has seen increased venture activity every year since 2010.[3] These areas have begun to see more activity due to the thoughtful investment in growth and innovation within each ecosystem. To understand how that has been playing out in Colorado, the tech sector contributed $43.4B to Colorado’s economy or about 14% in 2017. Specifically, 2017 saw the highest amount of venture capital infusion to Colorado-based companies since 2001 at $1.1B.[5]



All told, there were 154 deals in Colorado in 2017 with 43 of them invested in seed stage companies. Healthcare and telecommunications received the most investment with $271M and $113M, respectively.[4] Additionally, investors have sunk $336.9M into Colorado companies during the first quarter of 2018, which ranks as the 8th most funded state nationwide during this period.[6] Investors then stepped up in Q2 and contributed an estimated $448M in 41 local deals ranking Colorado 6th in the US.[7] Recently, in June of 2018, $101M was invested into Colorado startups and while relatively modest in total monthly funding, it translates to a year over year funding growth of 57%.[8]

In order to get to these numbers, a lot has been done making Boulder and Denver-Aurora-Lakewood the startup friendly ecosystems they are today. Sameer Dholakia of SendGrid has said that “for years, people have been calling the Denver/Boulder tech scene the next Silicon Valley, but Colorado has developed its own distinct culture and personality [... by] putting relationships, mentorship and education first.”[9] He goes further saying that even though he is from the Bay Area, Colorado has created “something special.” According to the Kauffman Institute, Colorado places 8th for growth entrepreneurship and 5th for startup

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[5] https://www.bizjournals.com/denver/news/2018/01/09/moneytree-report-colorado-vc-investment-was. html

[6] https://www.denverpost.com/2018/04/17/colorado -venture-capital-ranking/

[7] https://www.pwc.com/us/en/moneytree-report/MoneyTree%20Report%202018%20Q2%20-%20Final_ F.pdf

[8] https://www.builtincolorado.com/2018/07/03/colorado-tech-funding-june-2018

[9] https://powderkeg.com/the-denver-boulder-startup-scene-a-guide-to-the-front-ranges-givefirst-tech- culture/

activity.[10] This translates to a dense population of startups that have a comparatively high growth rate within five years. Additionally, the *American City Business Journal* named the Metro Denver area the 7th best metro for the creation and development for small businesses.[11] The Brookings Institute Study of high growth firms, which it defines as companies with the fastest three-year revenue growth rates of independent, privately-owned businesses meeting certain revenue thresholds, ranked Boulder as #1 and Denver as #9 for high-growth companies.[12] For comparison, Austin ranked 5th and San Francisco 7th.

As demonstrated, there are many stats that point to the high growth potential of startups within the state, but there are a few forces that are driving this. One is the simplified corporate income tax structure which allows companies to pay taxes based solely on their sales within the state. With a few other regulatory burdens, the corporate income tax rate of 4.63% makes it one of the lowest and most competitive tax structures in the nation.[10] Another element is the presence of local research labs which helps establish a culture of innovation. The state of Colorado is home to 33 different federal research labs with Boulder accounting for 17 of them.[13,11] Another way to measure innovation and R&D is through intellectual property in the form of patents. In 2015, Boulder had 260 utility patents granted per 100,000 residents.[11] For comparison, San Jose ran away with 739, but San Francisco had 209, Austin had 135 and Denver had 43.[11] These kind of innovation statistics demonstrate that the environment within the Denver Metro and Boulder areas are on par, if not more robust, than traditional innovation and venture capital hubs. For tech hubs between the coasts, it’s imperative to not emulate Silicon Valley, but rather cultivate a unique tech ecosystem that fosters growth and innovation which the state of Colorado is well on its way.

WORKFORCE

One of the most integral pieces to sustaining a competitive startup ecosystem is being able to provide companies with an ample talent pool. Because the vast majority of venture investments incorporate or run on web-enabled applications, tech-based employees are the highest in demand within this environment. On cue, tech employees make up 9.7% of the workforce in Colorado making it one of the highest concentrations in the nation.[8] Specifically IT-software employees make up 2.5% of the Denver/Boulder employee base, the highest percentage since the early 2000s, and has been rising for 7 consecutive years.[10] Overall, Denver/Boulder represented 45% of the total IT-software employment in the region alluding to a vibrant, strong and growing technology community.[10]

Although these workers are making up an increasing share of the Colorado workforce, there are still 3,500 more tech jobs than graduates, indicating that the ecosystem is growing faster than anticipated.[10] Overall, the workforce is poised for all positions within a startup ecosystem with nearly 40% of Coloradans having attained at least a bachelor’s degree, second only to Massachusetts.[10] Additionally, Bloomberg speaks highly of the Front-Range ranking Boulder #1, Ft. Collins #4, and Denver #10 in their Brain Concentration Index.[10] This index measures business formation, employment and education within STEM disciplines.

Lastly, a diverse workforce ensures that Colorado will not suffer the same fate as the tech scene in California highlighted by sexual harassment allegations against top executives at Uber, Sherpa Capital, and 500 Startups, among others.[14] Colorado has addressed this head on with Boulder ranking #1 and the Metro Denver area #3 for of top metro areas for female entrepreneurs.[10] Denver, specifically, is rated #8 as a ‘Top 15 City for Women in Tech’ with women occupying 24 percent of technology jobs available.[10]

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[10] https://www.kauffman.org/kauffman-index/profile?loc=8&name=colorado&breakdowns=growth|overall, startup-activity|overall,main-street|overal

[11] http://www.metrodenver.org/industries/it-software/

[12] https://issuu.com/boulderchamber/docs/innovation_venture_report_v26?e=33607933/61913820

[13] http://www.metrodenver.org/mile-high-advantages/innovation/federal-laboratories/

[14] http://goodtimes.sc/santa-cruz-news/sexual-harassment-silicon-valley/

CONCLUSION

Colorado is hitting its startup stride and is on the rise, indicating the culture has been established and there have been successful investments and exits made within the ecosystem. Through the Downtown Denver Partnership and other initiatives, Colorado has "become a bona-fide tech hub within a potpourri of art districts, unique cuisine and vibrant events."[15] The startup scene has begun to shape the workforce of the city and has attracted numerous tech talent evidenced by the influx in population between 2013 and today. The sector overall is continuing to grow at a rapid pace and has even drained the local talent pool. Denver Startup Week is the largest free entrepreneurial event of its kind and will ensure continued attention drawn to the activity taking place in Colorado. As cheaper business costs remain (currently 4% above the national average) companies will continue to see strong investing activity, making access to capital and therefore growth easier.[1]

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[15] http://www.cobizmag.com/Companies/Why-Colorado-Vibrant-Tech-Community-Offers-Innovation-at- Elevation/