Podcast: Chris Farmer, SignalFire, on Venture Unlocked, w Samir Kaji

https://ventureunlocked.substack.com/p/building-a-next-generation-tech-enabled

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Sajith: Fascinating glimpse into an unusually-designed venture firm, structured like a company more than a fund, and one that is designed to look at sourcing and support not like the traditional venture fund, but more via analysing datasets and extracting signals from them, to both find (source), and then mind (support) these companies. Think Bridgewater but for venture. Reminded me a bit of 776 (Fund) founded by Alexis Ohanian, though the difference is that 776 doesn't source the way a SignalFire does, though 776 does build products, like SignalFire. The podcast episode has some fascinating passage. One which stood out was how, if YC = Stanford U, then SignalFire is like Stanford Hospital, which is both a treatment + teaching centre. Another one was how it is difficult for analog funds to transform themselves into quant-style funds like Signalfire, and how SignalFire designed principles such as equal status for everyone (both investors and tech), no deal attribution, etc., to reinforce their strategic approach. Finally, a fascinating tidbit: the data-led approach meant high costs on items that you don't seen in a traditional venture fund such as AWS (which was half its management fee on its $50m fund; likely $500k) and credit card data sets (which was more than the management fee; likely $1m)!

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Samir: Welcome back to another episode of Venture Unlocked, the podcast that takes you behind the scenes of the business of venture capital. I'm your host, Samir Kaji, and on this week's show, we're excited to be joined by Chris Farmer, founder of SignalFire, a firm that was founded nearly a decade ago with the goal of disrupting the way venture capital has done. Unlike traditional VC firms, the firm has been built more like a company than a traditional asset manager, as it leverages a robust purpose-built data platform to augment its unique service model to entrepreneurs. Before starting SignalFire, Chris worked as a VP at Bessemer before moving on to focus on seed investing at General Catalyst where he was involved with investments such as Coinbase, Stripe, and Venmo. Today, SignalFire manages nearly $2 billion in assets and has invested in companies such as Aura, Grammarly and RO. During a conversation, we spent a lot of the time talking about his views on building a next generation venture capital fund and the organisational design that goes behind it. I think you'll really enjoy hearing Chris's unique perspective on VC. Now, let's get right into the show. Hey Chris, it's great to see you. Thanks for coming on.

Chris: Thanks Samir. Appreciate you having me.

SignalFire's origin story

Samir: I'm going to start in a slightly different place. I mean, you've run SignalFire now, I guess it's been 10 years, but I was looking at your website, something stood out to me. It said we began our journey in 2013 as a bootstrapped startup with a goal of disrupting the way venture capital has done. Now there's a lot to unpack there, but ultimately I want to know what does that mean? What was that inspiration to start the firm coming from more traditional firms like General Catalyst and Bessemer?

Chris: The genesis of me applying data is I had run companies that had a data element to them as an operator early on in my career, and so when I got to Bessemer Venture Partners in the mid two thousands,

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I was covering wireless when the app store came out, it seemed crazy to me to try to monitor the app store completely visually, and this seemed like an awesome opportunity to apply data and algorithms to create a leaderboard, that type of thing. So, that was the initial wedge point, which is a narrow scope and then pretty quickly it was clear that you'd end up with all social and ad-supported gaming types and you'd miss the transactional businesses or the SaaS businesses, etc. So, it was very clear pretty quickly you need to cut it with a lot more data sets in order to filter through the noise and that that needed to be approached from scratch as opposed to trying to append that into an existing venture fund.

I started with a large research study of best practices and try to take a playbook from every permutation of investing and operating. We interviewed about 170 different funds and fund types, everything from accelerators to incubators to venture funds to quant hedge funds to corporate venture groups etc., and looked at how do you build systematic advantage through data, workflow software, etc. No different than an operating company would benefit their sales team, and we actually took a lot more pages out of the corporate playbook than we did out of the Venture playbook in the initial ideation. I refined a bunch of these things with General Catalyst in the early 2010s before spinning out in 2013 with enough proof points that I was willing to sort of move from experiment into full commit mode. And the rest is history.

Samir: What you're describing very much feels like a tech company, not a traditional venture, and we will get into what it means to modernise venture and how you do it. You and I have talked about this and you always tell me, I'm running a company that happens to invest and that is the big unlock that I saw back in 2013, but what does that actually mean that you're a tech company that happens to also invest in other tech companies?

Chris: If you think of the venture industry in general, certainly from that era, you hand someone a cell phone and an internet browser email address and say, go hunt. I mean, there's no other industry that would ever run a sales process that way. And there's also no industry that would take the CEO equivalent and have them prospect and win deals and then do a decade of customer success and the odds that they're best in class at all of those things from sourcing investments, judgement and being the best possible board member builder for the company are low. And so you end up having to make a ton of compromises. And so we looked at it from a systems approach where if we have deal team members that are out hunting and trying to find the right entrepreneurs, why don't you give them qualified leads as a much more efficient way to focus their time rather than set up shop in this local Starbucks and say, I'm open for office hours, which just is insane to me.

And we wanted to build a firm with structural advantage. My vision was to build the absolute best platform for the next generation of great investment talent to have the most leverage and maximise their odds of success. And if you could do that, you'd attract the best talent because why would you start somewhere else that just had brand, historical network, etc. If you could build a true data advantage in a systematic way, you would attract the best talent and then if you could attract the best talent, you'd ultimately build something institutional, much more scalable and much more persistent in producing outsized returns. That was the philosophy going in. So, we broke the venture process into five core functions: sourcing, picking, winning, portfolio support and portfolio construction, and then systematically applied the first principles of how would you apply data, workflow collaboration, networks to each of those functions to do them sustainably in a better way than the venture industry had done historically.

How SignalFire looks at the different elements of VC
Samir: Let's go a little bit deeper. You've mentioned all the things that do matter. It is sourcing, which used to be what network did you have? Who do you know picking at the early stages, largely founder driven. Is the founder interesting? Have they done it before? Are they tackling a big problem in a big

TAM? It's the winning, which is what is your value advantage? Maybe you can break down each one of those pillars and how you've used data to drive these more consistent outcomes in each one of those.

Chris: So, on the picking side of it, it's what most people assume we're doing and we're doing a lot more underneath the scenes to understand these things, but on the sourcing side of it is we're tracking probably more data than anyone in the world on the startup ecosystem. So, it's everything from consumer spending behaviour to app stores to talent movements and clustering around companies, capital flows from smart money chasing deals, etc. as the same sort of lenses you would use as a human. You're just doing it at a massive scale for 80 million entities, whether it's an open-source project or a founder and stealth mode that hasn't even incorporated. You're tracking all of those, even pre-formation. And we try to do things that humans do well, we're decidedly human in the loop, we're quantamental effectively, data's not going to be great at understanding the vision of a founder or the magnetism of founder in the early days, etc. but humans are not great at tracking 80 million entities and monitoring them consistently versus episodically.

And so we try to use the best of each technique and blend them together into something that is scalable, sustainable, institutionalised, and very systematic that brings a persistent edge to what we do. And so on the sourcing side, it's taking the lenses of these are my tastes. These are the things that are the characteristics of something that are important for an e-commerce company, which is probably going to be more around frequency of transactions, repeat rates, upsell, all these types of things. Whereas I don't know, the AI team may not even exist let alone be important, whereas if you're building an infrastructure company, it's going to start with team, team, team, and that's going to be, and maybe there's some smart money that rolls around it or an open source project or wherever it may be. The characteristics are very different for each type of company.

And then we have put the team members into swim lanes and they're getting fire hose of leads alerts that are tracking from these millions of companies. So, it's like a human loop cybersecurity system in a lot of ways. It's scanning all the startup activity out there and then highlighting, looking for outliers, clustering of exceptional talent, exceptional traction or reviews or whatever it is that the community is, that's out there in the public domain. And then we're giving highly qualified SDR-type leads to those deal team members to then go pursue the companies in their swim lanes. And what I love about it is it gets rid of this sort of paranoia of, oh my God, I've got to be at every event and do all this activity because I could run into the next Zuckerberg or Elon Musk at some party and if I'm not there, I'm going to miss it.

And now it allows you to pull back say, what are the characteristics? Let me scan this at scale, and it's as much about what meetings I don't take as what meetings I take because everyone is putting their best foot forward, and if you're building an AI company and have no AI talent on your team, that's probably not something that's going to get prioritised and so on and so forth. Or if you have terrible retention rates with your customers, that's probably not something that's going to prioritise, but then you've got to bring the human in and understand the founder and the vision and where they're going because all you're seeing is a sampling of recent history of the company and then you bring that human venture judgement overlaid on top of the data, but you also then in the investment judgement piece have the benefit of being able to see the peers and benchmark, right?

Whereas if you are looking at company, their competitor, company B is not going to show you they're just going to open their books and show you all of their data because you're interested in investing in their competitor. Or if you're already investing in the competitor and then a subsequent follow-on round, they're certainly going to avoid you like the plague because they don't want to share any intelligence that you might use against them. And so having apples-to-apples comparisons that's independently generated from the companies gives you a sort of persistent advantage in just context and benchmarking for those investment decisions. And then ultimately winning is driven by founder MPS (?), etc. So we've built

scalable systems. If you think of Y Combinator's design like Stanford, you apply through an application and then run it through an algorithm, they then pull out GPA and test score equivalent characteristics of founders, put a human loop and interview them, buy a very cheap option, put them through a one to many support program, cherry-pick their best companies, bring in an optimised fundraising environment, and then let hundreds of companies go at that point to in a Darwinian type fashion with the venture industry supporting the strongest ones over long periods of time.

They're designed like a university to be one to in many ways we're designed. If they're Stanford, we're Stanford Hospital. We're a part teaching institution, part care institution. So we do hundreds of events a year for our portfolio companies as, but it's the grad school version. We have a sales mastery series, a market mastery series, a talent mastery series, A people mastery series, which is more the HR function and recruiting functions, etc. And then we have founder development programs and all sorts of things for scale, and then we have a network of a hundred plus advisors that are specialists. So, as a GP, I'm a general practitioner. I'm not the Swiss army knife to use to play that hospital analogy, but then I refer to a phlebotomist, pediatrist, echo cardiologist. We just have it all in network. So, you as a patient, as a founder, when something comes up either preventative or acute care, you go to Stanford and know that they're going to have great care teams in all the different sub-specialisations that you might need.

And we've done the same thing at a venture firm level. So, it's a very different architecture than your typical venture firm. I'm A CEO, we have a CTO, we have a chief people officer, we have a CMO, all the different types of functions you'd expect in an operating company, and we use the same sort of technologies that a founder facing developer tools or infrastructure company might use on everything from sourcing to support to onboarding to customer success except for we're doing that as a venture fund and the benefit it turns out we as VCs think we know everything and the reality is we don't. We're good surface level at a lot of things, but we're not excellent typically at many things. And so this hybrid generalist specialist model produces much better results for the founders. Our NPS has been between something like 88 to 96 over the last seven, eight years and over 85% of our founders would say we're the most valuable investor on their cap table, and that's not because I'm the smartest guy in the room by any stretch of my imagination.

It's because we have experts at the right time that we can introduce them to get the best possible judgement in that acute problem and that they have continuity of care from the deal team members and general partners, but they also get specialist care. And we found that that's much more scalable. It's much more systematic, and frankly, you can't get orphaned as a company that happens to a lot of venture firms. If somebody transitions out, you have multiple touchpoints and you're not just dealing with fire drills when something happens. You're able to support companies preventatively much more systematically before something happens versus like, here's something at a board meeting and then overreact. It is just, that we'd look at it fundamentally differently in the way that we support portfolio companies and that ultimately leads that NPS leads to a closing playbook and referenceability because we don't have decades of the brand to rely on that helps us close at a very high level over 90% of our term sheets we win. Because it's just clearly night and day in the level of support and quality of support in a super tangible way.

Then we use software as well to make these things scalable. We are able to use SaaS recruiting platform, a full lead gen platform for our portfolio companies using the same data sets to take your ideal customer profile and then give you all the doppelgangers or recruit candidate that you're doing and give you large scale lists of candidates that you can then pull into your ATS or generate leadless (?) that hands you recruiters and we can support an unlimited number of recruiters at an unlimited number of companies at the same time because it's built in data and software because, and you can only get it through us if you're a portfolio company.

VCs and data usage

Samir: I heard you say a few seconds ago that you have a CEO, you have a CTO, you have a CPO. In the early days, much of the team was engineers, not traditional investors. I thought we would've seen much more in terms of the use and application of data within venture firms. We haven't seen that much. I've seen it may be pulled back a little bit in terms of people that are looking to build these models and some of that has come because there's this natural tension point between does the data inform the decisions and the way the firm runs or do the people then inform the systems? How do you think about these natural tension points? Because traditional investors at VC firms, it is, I'm sitting across the founder, I'm looking into the future versus data often is backward looking.

Chris: So, there's a bunch of reasons why. Well, some of them we were very fortunate to anticipate. Some of them have been surprises or learnings along this journey. If you look at the top quant hedge funds, because of the way that they approach the business, the way that they recruit, the way that they construct a portfolio is radically different than a traditional analog hedge fund or mutual fund. There's only so many companies a human can analyse deeply in order to have conviction, and so they build much more concentrated portfolios and have a very different approach. The reason the hedge funds that are quantitative tend to persist over much longer periods of time is they're taking many more micro risks and taking advantage of many more arbitrages over a much larger portfolio because they're rules and data-driven as opposed to manual. So they may be in and out of a position in seconds, let alone by the end of the day, whereas many of the hedge funds are much longer duration because the opportunity cost of analysing that company deeply takes a long time.

So, if you look at the quant hedge fund world, not a single one of the top quant hedge funds started as analog fund and converted. They all started de novo as quant funds because Fidelity is not thinking about how to run fibre optics from Chicago to New York to shave milliseconds off a trade, or how do I co-locate to the closest server to the exchange to shave another millisecond or how do I ingest that Goldman analyst report using NLP? So I can trade off sentiment before you can read the first sentence as a human. You build different structural advantages as a result of that it's very hard for companies to start transforming. We see in the technology industry all the time to move from one paradigm to a modern technology stack or an AI driven approach versus a sort of traditional SaaS approach, whatever it may be, it's very hard to reinvent yourself because in the quant hedge funds, the quants are the kings. In the traditional analog world it is the portfolio managers or the analyst or whatever it is, and if you look at the venture world, it's the founder facing deal partner gets all the heat and light.

And the data guys or the IT guy is in the broom closet. And they're looking at getting any light, let alone free lunch. This is why from day one, we made everyone at SignalFire on the investment team. Everyone on the entire firm gets carry. We tell everyone on portfolio support, you are a feedback Luke on these companies and can help inform investment decisions. They may not be deeply involved in the first investment, but they're very deeply involved in follow-up investments in those decisions. How are they building their team? How are they converting customer leads? What is their learning trajectory? Because those are all leading indicators of ultimately how a company will thrive and the engineers and data scientists are involved in the entire process. They source leads, they can help with diligence and they do consulting advisory work to the portfolio to keep it interesting, but also to elevate them to their deserved stature as equals within these firms.

From day one, we had no deal attribution. We did a lot of things structurally to make sure that they understood that this is a firm that deeply appreciated and cared about equally what they were doing on the engineering side as the deal team was doing on the founder-facing side. And all of that was critical, we have the same CTO that we had from our founding. Our two top data scientists have been with us for

close to a decade. The consistency is very different than other venture firms who churn through whatever engineering efforts they have over and over and over again. And you also have to have a conviction and a tolerance to go through the mess of, I mean we're seeing it in generative AI. The outputs on this stuff is not easy and you've got to do all the annotations and the editing and the training to get it better and better. So, we've been willing to go through that pain for a decade now, and that's very hard. No matter how much money you throw at this problem, it takes a long time and iteration to get it right. No different than the best LLM takes tons of time and capital to get them tuned to high fidelity. That's been something hard to do in a traditional venture construct. As a senior partner, you're not incentivized to make a five to ten-year investment in technology that may not yield anything or may have a negative yield in the short to medium term during your tenure, you're incentivized to throw bodies at the problem that will immediately pay dividends even if it's not the right move in long-term strategically.

Samir: When you look at all of those different functions we can go back to the earlier point of sourcing, picking, winning, portfolio support and portfolio construction, all of those things have what I see is a structural and systematic way of operating using both humans as well as using the technology that's purpose built for what you do. When I think about those things though, venture is a long feedback cycle. It takes a long time to know if you're doing well. At the same time, companies have OKRs, they have KPIs that they manage to. How do you think about the success of this model, which is novel in terms of, it takes a long time to get DPI, it could be seven, 10 years before you know directionally where the portfolio is going to go, so how do you think about KPIs and OKRs?

Chris: Yeah, I mean the book on OKRs was written by venture capitalists and yet almost no venture firms operate on that. We do of course and try to dogfood our thinking, but it's different for every function. On the sourcing side, you're looking at not necessarily the outcomes, but are these leads of companies that are high fidelity with companies that get invested by high-quality investors upstream? If they are, I want to see that lead. Even if we choose not to invest, I want to see that lead in a window of time that I could have invested and led the deal. It doesn't help me to get an alert after one of my peers has led the investment. That's a tombstone of a missed opportunity. That's not a helpful signal.

On the portfolio support side are what's the engagement? It's very much like a consumer enterprise app. Over 65% of our companies are on our platform on a weekly basis, so you can look at utilisation rates, this is product market fit. The same things that we look at for a SaaS company apply to ourselves and what is the output of this. We use humans to train our founders and their teams on how to recruit and best practices and interviewing and comm studies and all this kind of stuff and techniques of sourcing, but then we also give them sonar to make sure they're fishing in the right waters and give them leads on who's actionable right now, who's in market, who's showing signals of that, who's high quality, those types of things. How do I give them additional information on how to contact them so they're not trying to do it through some channel that they ignore like LinkedIn InMail or whatever it may be.

All these things we're constantly doing. Then we do surveys and we do quantitative studies and we use the same analytics systems on units usage that all of our portfolio companies would use on their own products. Which pages are people visiting? What's the duration on it? How many people are using, are they the right people in the organisation, etc. We brought in product leaders who had run these types of products at Facebook and had founded companies, and so we haven't had a product who runs it no differently. We're selling and marketing to founders that we brought in. The CMO of Stripe whose job on customer adoption was a freemium approach selling to founders as early as inception. It's the same source of techniques we bring in domain experts that are going to use the same best practises. I mean the irony is all these playbooks were written by our founders many years ago and the venture industry is just beginning to use any of them if they're using them at all.

So, there are very proven playbooks that we can use to make sure that we're making efficient higher ROI investments and we sunset products if it's not getting traction no differently than a company would and making sure that we then reallocate resources on things that are higher impact for our portfolio companies and then the world changes. It was all recruiting before the financial correction, but now it's on sales efficiency and the other types of things is companies have to make better use of the resources that they have. We have to adapt with the times and constantly be challenging ourselves and asking the hard questions. Are we getting the ROI? No different than the same sort of product review process would be at a tech company.

Why more VCs haven't adopted this model

Samir: Why do you think, I mean if you go back, I mean venture has been around for 60 years, I think seventies and eighties when it started to become a little bit larger of meaningfulness in terms of some of the big firms coming to market, but it hasn't changed too much in how it operates. There have been small changes around the edges, but fundamentally what you're describing as a tech company and you have your clients, which are your portfolio founders, you have LPs that are your shareholders, you have your advisors that are acting as maybe the third part of this marketplace that are fundamentally adding value to this nucleus of overall value that you have as a company. Why do you think we haven't seen as much evolution in the venture market toward models like this?

Chris: There have been lots of people who have tried. It's really hard to bootstrap. We had to do all sorts of unnatural things that caused us all sorts of headaches and problems in order to get off the ground. For example, on our first fund of $50 million, our AWS bill was half our management fee. Our credit card data set was more than the entire management fee and we hadn't hired anyone yet. And so we had to do corporate advisory and recruiting and all sorts of different things to have other sources of revenue outside of management fee and we had to raise money from day one. And so we went out and found the most important angels and advisors and technologists, etc. in the ecosystem that had massive angel portfolios across them. And we systematically cherry-pick them over a couple of years of one by one recruiting them to raise millions of dollars for the operating company itself in order to deficit spend (?).

In the early years at a five x or so multiple of management fee in order to take these losses on this bet that we were making, that we could build a platform that would be much more systematic and institutionalised than your typical venture fund. But then you have a chicken the egg problem because no LP wants to jump into some new quantitative approach to venture if you haven't built the platform yet, but you can't pay for the platform if you haven't raised the capital yet. And so how do you balance these two things? And so we had to be really creative and scrappy and the team did an exceptional job of having multiple jobs, VCs by day and management consultants by night to the Fortune 100 on. We did everything from merger and acquisition research to post-merger integration work to competitive intelligence to hedge funds, quant hedge funds, operating companies, etc.

We had many of the Fortune 100 as clients in the early days in order to keep the lights on in order to amortise the expense of the data. And most people that come into venture want to be venture capitalists. They don't want to do all those things. It's a really hard chicken and egg problem, but we somehow managed to get through it and I think a lot of other people haven't done that. You've seen Google Ventures or Coatue or people that were existing entities that had a quantitative orientation to them do permutations of this, but it's really hard to bootstrap from nothing. But then the irony is that if you don't start it from nothing and you try to append it to an existing organisation, as I've mentioned with hedge funds, it's very hard to make that transformation. And so the incumbents have really struggled to do it and unless you had other revenue streams that could deficit spend for a substantial period of time, it's hard to bootstrap off the ground. And that's what's constrained the amount of competition.

Samir: And I can imagine those early days, if you had gone out and raised that 50 million fund without any of the data and it was just a hypothesis, it would've been very tough. You had to show something thinking about the evolution of the platform, of course, you're collecting more data points, you're evolving it, it's becoming smarter. You're figuring out what doesn't and does work and that's great as you build more robustness in it. But at the end of the day, you're still adding people and you are adding people that are traditional investors who may not be used to this kind of model. So, were there cultural characteristics that you looked for when you were looking for traditional investors and what did you learn in terms of the right characteristics for these new types of models like the one you run?

Chris: One of my early learnings in recruiting was looking for people who were already doing the job on their own as a side hustle or whatever but didn't realise that this even existed. And when they found that this existed, they were all in, they were predisposed to do it even before I had to sell it. So for example, my Co-founder and CTO Ilya Kirnos had spent a decade at Google and one of the things in addition to doing all the search and infrastructure engineering types of stuff, his 20% project was a prediction market using all of the sort of wisdom of the crowd of Googlers to predict which products were going to be successful and come out on time and all these types of things. So, he already was predisposed to this, how can data be applied to the real world in order to predict eventual outcomes?

I was introduced to him by the founder of Google Trends. I was going out to very specific people who had already shown a predilection. Other people, like one of my partners, Wayne Hu had tried to build his own bootstrap version of this. And we've had a number of people over the years who have been at venture firms that said, oh, I want to create my own competitive advantage and try to do it on themselves in a boot strappy zero budget way, and then got frustrated. I'm like, oh my God, someone's going to build this for me to give me this advantage. And they were quick to jump on board and had pre-sold themselves. I didn't even need to do the hard work was done. The hard work was finding them not convincing them that the data could give them advantage in this world. And the same was true of LPs.
A lot of our early LPs had come from where technology had given them an advantage ultimately in their own business, whether it was a technology business or the investment business or whatever it was. And so we had a lot of people who were new to Venture but were very quantitative by nature, quant hedge fund founders or technology company founders. And then we were very fortunate to get some big fund-to-funds as well that had a very quantitative orientation to how they screen managers and were predisposed to believing that data would give you an advantage in the long term. And what I said is if you believe in the judgement of people, the judgement of a person with a data advantage is going to win consistently, and that's what you've got to believe. This is not some black-box AI thing.

Even though we were using AI from day one, we downplayed it because people were afraid of the black box. Is the algorithm going to pick it? It's like no, the algorithm's going to help deliver better leads to people and drive more efficiency in filtering and sourcing opportunities, giving them more coverage than they'd be able to do manually, and then we're going to bring the best practices from that world. And so we also brought in Walter Kortschak who'd run Summit Partners prior to that, which themselves used Data and Advantage from their founding in the 1970s. Their version was subscribing to every newspaper looking for job listings as signs of growth. And we did that at a massive scale using data and search like technologies, but he immediately recognised how you could uncover hidden opportunities that as a result weren't in front of all of the venture capitalists, etc. But unlike Summit, which were finding hidden gems in off-geography places because we were getting in very early, we focused in the most overcapitalized markets and said, we want to get to things before and then get paid for the risk we're taking by having so much capital upstream that we get good markups for the traction that we're getting as opposed by in later stage companies that other people don't know about.

Operating in the 2018-21 ZIRP market

Samir: You mentioned something there that probably is a good segue, having some discipline, what you pay up for getting that outsized return in a time period that we've seen pre-2022, we were in the Zirp market for a long time, 2018 - 19 particularly 20 - 21. Everyone is overpaying. And I think we had this conversation just a few weeks ago where your actual valuation entry price decreased during that time, which is almost antithetical to hype cycles. What did the data show? How did you resolve your own investing sell during a time where you had capital to deploy is really difficult to say no to deals?

Chris: 2018 and 2021, we got very concerned about the untethering evaluations from relative traction. It's no different than looking at the public markets and saying, what are the PE ratios that companies are trading at? They fluctuate and sometimes they're under historical norms, they're way over historical norms or they're all time highs and we were effectively at all time high territory. I'm a big believer in gravity. It's an immutable force and eventually it sets in. Now it may take longer than you expect, but it's pretty hard to stop. So, we were just looking at the uncoupling of traction, which we would have quantitatively relative to pricing and just saw that we were at relatively all-time highs that made me nervous and then wanted to trade risks. And so we traded down risks, so we lowered our cost of entry into companies by a little over 20% between 2018 and 2021 when our peer group was paying somewhere between 180 and 300 plus percent more for the same company.

And so if you had a 9x portfolio, but you're paying 3x what you were historically that became a three x portfolio, A three x portfolio becomes a one x portfolio, right? And the math is pretty simple unless something has fundamentally changed and there are some arguments to it, the technology industry is bigger, it's now every industry, etc. but at the end of the day, things tend to regress to sort of historical norms one way or another, and then it's upside if there is some structural shift. And so we said we're going to trade execution risk, we're going to trade financing risk, technology risk, etc. and go earlier. So, we had seed through B and we stopped doing 80 B's in one earlier when we did pre-seed, we added a pre-seed program, so pre-seed, post-seed, a aggressively layering up into companies, got higher ownership, and then we were willing to take dilution versus dollar cost averaging up with each subsequent round at disproportionately high follow on rounds.

The risk adjusted as you started to get into these high revenue multiples on companies just felt detached from the true risk return profile of these companies. And so you can't leave the market and get out of it, but you can say if the market's going to overpay for things, I'm going to bring net new companies in as opposed to be a price taker. We had a number of things including adding different strategies to what we were doing to try and maintain as much discipline as humanly possible in a market where there was a lot of Kool-Aid drinking and focus. And then we also shifted risk profiling. We looked at which were the most resilient sectors in economic downturns and we heavily overweighted to defensive sectors and underweighted to sectors that we thought were going to get clobbered.

So, specifically, we overweighted to SaaS infrastructure, cyber, health-tech, etc. underweight D2C ad-supported companies, R&D projects that were highly relying on the capital markets in order to fund these projects and had no real bridge to revenue, quantum computing, autonomous driving, those types of things. And so you can't just be like, oh, I'm going to cut costs and get to profitability when it's a massive R&D project. But these are companies that can be like massive wipe-outs. And we were underweight crypto because we struggled to see the actual utilisation of these things. We love the vision and the story and there was incredible talent going into it, but we ended up massively underweight in that sector as well, which hurt us in that period. So, it took a lot of conviction to stay there, but helped us a lot in 22 - 23.

Samir: One of the toughest things obviously to do is market time. Anything, it's very difficult to know where you are in a market cycle. You can feel heat or you can feel maybe times like this where things

have maybe been oversold to a certain degree. What has happened in venture, at least historically, is during these hard times, you don't know when it's going to end. Many times at the very tail end of a cycle, you do have people that think we're maybe in a need paradigm, things have changed. Multiple expansion is here to say, now history shows us that's not the case and things will eventually go back as you mentioned to gravity. But during that time, you also took risk as an organisation that you were foregoing deals. And if this 2022 didn't happen and this continued to 23, 24, 25, you may look poor relatives to your peer cohorts who got into deals who paid slightly more. How did you reconcile that risk calculus in your head?

Chris: It was hard. It was hard on the internal team side. Some of the younger principals felt that we were being too cheap and weren't competitive and they went to larger platforms that were going to be more aggressive, and we had LPs that were looking at our performance, we started dropping out of the top quartile on things and because we were underweight some of the hottest sectors like FinTech and crypto and whatever, that hurts you on the way up. But then when the market corrects and we're up in quarters on in '22 or '23 or whatever it is, then you're getting backs slapped and congratulations from the same people that were kicking your teeth in two years ago, which I always find interesting. So it takes a lot of conviction, but I learned this lesson early on in life as a former semi-professional blackjack player, and these are situations I was a professional card counter was keeping track of the deck and what is, it was a very common issue in blackjack in particular because you'd sit down at the table with 50 bucks and you'd just go on a run and you take that 50 bucks and you turn it into 500, now you feel like Superman, it's impossible for you to lose.

You just got so good and then you just cannot hit anything. The dealer's gone from busting to hitting twenties and you're doubling down on your 11 and getting a five and you're like, what the hell is going on? Why did my luck change so badly? And what happened was the Aces of the face cards, the great setup came out on the first half of the shoe and then the back half of the shoe is inherently a bunch of small cards that are going to mean you're not going to hit your 21's and the dealer's not going to bust. And so you get back all the money, then you're going to hit the ATM to try and replenish and win it back. And the reality is you should walk from the table when the count moves against you. And if you look in 2010, there was scarcity of capital.

You had three macro trends in mobile social cloud that were massive technology disruptions. You could get in a really attractive pricing. Everyone had smaller funds that were two small by comparison, and so you could get plant the seeds for fantastic returns and then as you got to sort of mid-decade in 2015 - 2016, the returns look so good that capital piled into the market and now everyone's trying to deploy a multiple of the capital at much higher prices. Now you're paying three times for the same company thinking that this party's going to go on forever when if you look at some of the best angels, you'll see them with their own pocketbooks. They just angel invest and you're like, but you were so good at this. But what made them good was the fundamentals were no longer there. And so we just try to be cognizant of that as an institution.

And sometimes you're much more aggressively risk on, and these are ____ in the financial word, when there's blood in the streets, that's where you have your opportunity. And when everyone feels invincible and everyone's rushing into the market, that's when you should be a seller or sitting on the sidelines. It's really hard to execute in reality and you can't sort of pull in and out of the venture market like that for structural and operational reasons, but you can rotate your orientation earlier, more price discipline, you can shift to more defensive sectors, etc. that are more likely to weather the storm just like you might shift from consumer discretionary to consumer durables. And there's lots of learnings across the investment world that we just try to apply in our own backyard.

Samir: Yeah, it is tough. And look, there's a lot of incentives that lead people to raise bigger funds to deploy very quickly. We saw many funds deploy over a 12-month span and almost vintage year funds. And there was a time where funds were, or firms raised new funds every three or four years and then it almost felt like it was every 12 months, every 18 months new products. During that time we went into this world where venture became mass finance, lower hurdle rates, AUM gatherers and things have changed. We've seen that in 2023, so it'll be interesting to see how this next era, of course we've talked about generative AI. I think there is a lot of heat there, but fundamentally it is a big platform similar to what we saw in 2010 with mobile and cloud. Tying this all together, I'd love to hear just where you think we are right now and ultimately what are some of the things that you think you'll see over the next 12 to 18 months in terms of how you operate as a business relative to maybe what you mentioned in 18 to 2021?

Chris: I see there are a few areas, that people are very high conviction on as sort of major macro-structural technology shifts. One of them is climate, which is not an area of our particular expertise. Another one is crypto, which was an area that we personally didn't have huge conviction on a lot of the use cases that we continue to monitor it, but AI obviously is one that's gotten a lot of hype or we do have incredible conviction, particularly that we're an AI native fund from day one, investing in the application of AI into myriad use cases. We have very particular views on where you're going to build defensibility in moats, and it feels like the market has been indiscriminate very quickly because it is probably the fastest sector to get to consensus across the entrepreneurial capital and corporate ecosystem simultaneously. I've had one VC that's a legend in the industry in his eighties today, and he said in his entire career, he's never seen the convergence of those three groups, lot of like the internet or crypto, all these things took many more years to move from sort of fringe into the corporate mainstream and for the capital allocators to recognise it as an opportunity.

And it's pretty stunning how quickly that has happened. But that doesn't mean that a lot of these things are going to be defensible over time and are not going to commoditize. And a lot of the sort of foundational NLM pieces of it will accrue to the massive capital sources that can invest in the infrastructure like the Googles, the Microsofts, the Amazons of the world, but there are going to be tons of opportunities for startups who can build data network effects and moats and workflows, etc. that use AI as a wedge but ultimately have a lot of stickiness to what they're doing. It helps them disrupt the last-generation companies, but because of the workflow elements or whatever, they have more sustainability to what they're doing. So, you have to be very selective in these things. Our data is super useful in helping to filter through the noise because just like everyone was a dot com back in the two thousand, now everyone's an AI company and you have to see as a plus AI talent behind it because that's pretty foundational to this.

But you need to bring together different groups. And so we started an AI lab for example, to get in on the sort of ground floor bringing corporates together, entrepreneurial talent from specific domains and AI talent who's typically coming out of the consumer side of things. Then they all come from different ecosystems. So we want to be the nexus of them coming together to create these next-generation companies using the data sets that these corporates may have as pilot customers to train models, etc. to bring some sort of sustainable advantage versus everyone trying to create the same apps built on top of OpenAI, which is phenomenal as a product. It doesn't lead to enough differentiation for the upstream apps to likely have something sustainable unless they're fortunate to build that in.

Samir: Yeah, it goes back to a lot of companies I think are being funded at unbelievable valuations without really a defensible moat, and we will see some follow-up. But I do agree with you in the fundamental premise of AI as a major sort of platform where we are going to see maybe some of the biggest changes. I think has at least the potential to be bigger than mobile and cloud. I think it's just in the early days.

Chris: I agree. It's going to be as big as any technology shift, if not larger than all of them combined that we've seen in human history. I mean, its impact is on every industry simultaneously and tons of workflows within it. So, we're very high on conviction on the future of venture and of the technology industry. And if you look at the market caps of the world, that's more of the consensus view than a contrarian one. But I think we just need to be disciplined in how you navigate. It's very early innings and it's a marathon, and you've got to pick your battles as smartly as you can and hope that we get a little luck as well.

Samir: Yeah, it just goes back to you can have a great technology that is truly paradigm shifting, but doesn't mean the investment case is always a good one. And that's what we'll see. But Chris, really appreciate you coming on. This has been a lot of fun. Congrats on all the success so far at SignalFire.

Chris: Thanks, Samir. It's great to chat and I appreciate you having me on.