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# The Global Emerging Market Story

**Krithika Kumar**

Principal, Strawberry Creek Ventures  
Alumni Ventures

## Introduction

In this white paper, we outline the scope, challenges, and opportunities of investing in emerging markets. In summary, we think the opportunity is profound. In fact, it's the focus for Alumni Ventures' new Emerging Markets Fund, where we will invest in a portfolio of ~20-30 deals from outside the typical three-point VC market of San Francisco, NYC, and Boston — both in the U.S. and abroad. Here we explore the markets region by region and then summarize the pros and cons of venture investing in emerging markets.

## WELCOME TO THE EMERGING MARKETPLACE

In the bustling streets of Delhi, a chaiwala — or tea vendor — serves steaming cups of the milky concoction that fuels the people of India. In his little shack hangs a conspicuous white and blue sign that reads “Paytm accepted here.” Customers transfer the equivalent of 8 cents to the chaiwala's mobile phone, a transaction that was not possible a few years ago.

That is, not until Vijay Shekar Sharma, the founder and CEO of Paytm, bet part of his brand-new company on a non-existent market: India's internet wallet. Since its inception in 2010, Paytm has grown from a digital wallet to a fintech platform that allows its customers to pay utility bills, make trip bookings, invest in mutual funds, and more. Paytm's parent company, One97, has a speculated valuation of \$16 billion.<sup>1</sup>

Paytm's story is exemplary not only in its own success, but also in that of emerging markets. Long gone are the days when developing countries were wrongly viewed as distant lands with limited economic opportunities. Today, emerging markets are defined as rapidly developing countries that play an important role in the global economy. These countries have strong GDP growth, an ever-increasing middle class, and the potential for significant innovation and investment opportunities.

Interestingly, applying the definitions of emerging markets closer to home also reveals patterns for investment opportunities in the nation's fastest-growing cities. As entre-

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<sup>1</sup> [“The Complete List of Unicorn Companies,”](#) CB Insights, accessed March 2021.



preneurship spreads beyond Silicon Valley, Boston and New York, emerging markets — both within and outside the U.S. — make a strong case for venture investments. Venture capital in emerging markets had more than doubled in the time between 2014 and 2019, growing from \$12.6 billion to \$27.4 billion and showed no signs of slowing down during the COVID-19 pandemic.<sup>2</sup>

In this white paper, we will explore the trends, opportunities, and challenges of venture investing in international emerging markets. We postulate that emerging markets offer a promising venture investment opportunity of reasonable valuations, diversification across geographies, and leapfrogging into the world's fastest-growing areas, both technologically and demographically.

## Investment Thesis and Proof Points

Before the technology and connectivity boom, emerging markets were dominated by traditional businesses growing at a steady pace. However, access to the internet brought with it a new set of opportunities and the extraordinary ability to scale companies by reaching across geographies to customers around the world. To put the change in context, India's most successful IT pioneer, Infosys, took 18 years to

## Emerging Markets VC Investment by Geography

Dollar amounts are millions of USD

■ Record Year According to EMPEA Data

REGION/COUNTRY	2015	2016	2017	2018	2019	
China	\$ 12,071	\$ 13,925	\$ 16,652	\$ 24,918	\$ 15,007	595 deals
India	\$ 4,403	\$ 1,958	\$ 1,811	\$ 3,822	\$ 4,436	371 deals
Southeast Asia	\$ 430	\$ 517	\$ 716	\$ 1,631	\$ 2,574	256 deals
Africa	\$ 70	\$ 108	\$ 111	\$ 183	\$ 764	53 deals
CEE & CIS	\$ 219	\$ 103	\$ 164	\$ 181	\$ 259	39 deals
Latin America	\$ 230	\$ 548	\$ 599	\$ 1,412	\$ 3,242	242 deals
Middle East	\$ 276	\$ 656	\$ 94	\$ 61	\$ 153	45 deals
Pan Emerging Markets	\$ 24	\$ 45	\$ 95	\$ 118	\$ 192	3 deals
<b>EMERGING MARKETS</b>	<b>\$ 18,014</b>	<b>\$ 18,216</b>	<b>\$ 20,604</b>	<b>\$ 32,925</b>	<b>\$ 27,434</b>	<b>1,681 DEALS</b>

SOURCE: EMPEA Data as of 31 December 2019, via [Crunchbase News](#)

<sup>2</sup> Mary Ann Azevedo, "Report: 2019 Was A Record Year For VC Funding In Emerging Markets," [Crunchbase News](#), June 1, 2020.



become a unicorn. In contrast, Udaan, a recent Indian B2B trading platform, reached unicorn status in just under two years.<sup>3</sup>

Such examples are not uncommon in India, China, and Brazil. Together with Russia and South Africa, the BRICS (Brazil, Russia, India, China, and South Africa) nations could account for 50% of the global GDP by 2030,<sup>4</sup> spurred by innovation and high-tech entrepreneurship. Combined, Asia-Pacific, Middle East & Africa, and Latin America account for over 46% of the world's unicorns.<sup>5</sup>

## The Rise of Asia-Pacific as the Fastest-Growing Venture Market

### China leads the pack

For well over a decade now, Asia has been on an upward trajectory in key indicators of social and economic growth, piquing and necessitating venture capital investment in this region. China became the leader of startup growth in 2005 and has since maintained its position as the leader in Asia. Some reports estimate that there were 30 million startups in China at the end of 2019 and 204 unicorns in 2020.<sup>6</sup> The top two private companies in the world are Chinese: social media app maker ByteDance is valued at \$140 billion and ridesharing company Didi Chuxing has a valuation of \$62 billion.<sup>7</sup>

Consequently, China has the largest venture capital market in Asia, second only to the U.S. worldwide.<sup>8</sup> In fact, U.S. VCs have seen massive ROI from their investments in Chinese startups. Sequoia reportedly invested in ByteDance when the startup was valued at \$400 million — which has since grown 34,900% at current market value. GGV

## Most Active U.S. VCs in China

FIRM	INVESTMENTS IN CHINA	AUM USD, BILLIONS
Sequoia Capital China	1,015	\$ 23.6
GGV Capital	327	\$ 9
Sinovation Ventures	315	\$ 2
DCM Ventures	191	\$ 4
SOSV	177	\$ 0.8
Red Point Ventures	45	\$ 4.8

SOURCE: [Pitchbook](#) as of May 2017

3 Madhurima Nandy, "Udaan raises \$280 mn from new and existing investors," *Mint*, January 6, 2021.

4 Charles A. Kupchan, "The World in 2050: When the 5 Largest Economies Are the BRICs and Us," *The Atlantic*, February 17, 2012.

5 Jennifer Rudden, "Number of unicorns worldwide as of January 2020, by region," *Statista*, February 17, 2020.

6 Yusho Cho, "China startups race to commercialize new tech as culling looms," *Nikkei ASIA*, November 4, 2019.

7 Rudden, "Unicorns worldwide."

8 Canfei He, Jiangyong Lu, and Haifeng Qian, "Entrepreneurship in China," *Small Business Economics*, vol. 52 (2019): 563–572. doi:10.1007/s11187-017-9972-5.



Capital, a U.S./Singapore firm that has invested in some of China's most successful tech startups (including ByteDance and Didi Chuxing) closed a \$2.5 billion funding round — the largest in its 20-year history. These deals are part of a growing trend of foreign venture investors injecting funds into China's tech sector.

However, as impressive as these numbers are, it should be noted that VC activity in China has fizzled since 2018,<sup>9</sup> a trend exacerbated by the COVID-19 pandemic. Moreover, with escalating U.S.-China tensions, American funds are now more cautious, particularly about investing in high-tech Chinese startups that may be politically sensitive.

Nevertheless, there are good things that have come out of this “capital winter.” For one, there seems to be a correction of the investment frenzies into Chinese companies, resulting in fairer valuations, less volatility, and greater economic value creation. Second, VCs will have a more measured approach to funding, likely resulting in a stronger startup ecosystem and better returns on investment. The saturation of China's tech sector will open the way for investments in other industries that are expected to thrive in the near future, including AI, medtech, delivery and logistics, healthcare, and life sciences.<sup>10</sup>

### Most Active U.S. VCs in India

FIRM	INVESTMENTS IN INDIA	AUM USD, BILLIONS
Sequoia Capital India	440	\$ 5.4
Accel Ventures	257	\$ 20
Tiger Global Management	150	\$ 41
Nexus Venture Partners	138	\$ 1.5
Matrix Partners	22	\$ 4

SOURCE: Pitchbook as of June 2017

### India evolves into a top venture destination

With a reduced appetite for venture investing in China, VCs have diverted their focus to the untapped potential in Southeast Asia and India. India's startup scene is much smaller than China's, with an estimated 80,000 startups and 34 unicorns.<sup>11</sup> Viewed differently, however, the unicorn to startup ratio for India is significantly higher: one in every 2,300 startups in India is a unicorn, whereas one in 147,000 startups in China is a unicorn.

Furthermore, the startup ecosystem in India has remained robust despite the COVID-19 pandemic. Venture Capital funding in India has kicked off on a high note in 2021 with deals like SaaS startup Darwinbox, funded by tech giants like Salesforce; and Zetwerk, funded by GreenOaks Capital, Lightspeed Ventures, and Sequoia Capital.

Moreover, only about 8% of India's 80,000 startups are funded, leaving room for significantly more venture investments. In part, the low percent of funded companies is because venture capital in India is quite young, virtually non-existent prior to 2011.

9 “The future of venture capital in China amidst global uncertainties,” Venture Matters (blog), KrASIA, May 14, 2020.

10 Lai Lin Thomala, “Major industries expected by Chinese respondents to thrive after the coronavirus COVID-19 outbreak chosen in China as of February, 2020,” Statista, August 18, 2020.

11 Sandeep Singh, “Presenting The State Of Indian Startup Ecosystem Report 2020,” DataLabs (blog), Inc42, August 18, 2020.



However, it has grown steadily both in deal volume and deal size in the last few years.<sup>12</sup> These trends seem to have kept up through the COVID-19 pandemic, when leading VC firms like Accel and Sequoia continued to set up India-focused funds for SaaS, edtech, and consumer internet companies. The pandemic has also brought fintech, health, biotech, pharmaceuticals, and life sciences to the forefront.

### Southeast Asia is on the cusp of stardom

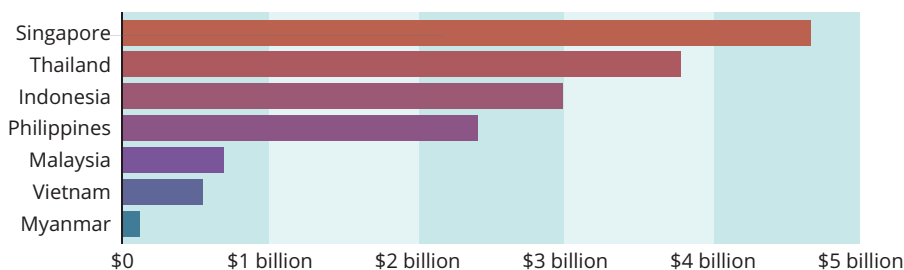
Combined, India and China account for about half the world's most successful startups.<sup>13</sup> But several other peripheral Asian markets have also seen a remarkable boost in the startup ecosystem. Southeast Asia is a dynamic economic zone with 650 million people and 360 million internet users.<sup>14</sup>

In particular, Singapore, Indonesia, and Malaysia have been hot beds for startup and VC activity, followed by Vietnam and Thailand. The region has had 10 unicorns since 2012, with a combined value exceeding \$34 billion.<sup>15</sup> Notable examples include Singapore's ride-hailing company Grab and consumer internet giant Sea, plus Indonesia's digital payment platform Go-Jek and travel booking company Traveloka. As the market matures and the number of exits increase, there are over 80 "soonicones"—companies that are soon to be valued at \$1 billion on the watchlist.

This exciting activity has not escaped venture firms, who have mainly bet on early-stage startups. More than 2,000 startups have been funded by venture capital in Southeast Asia in the last five years. While there was a dip in investments during the pandemic, Southeast Asian tech startups attracted \$5.5 billion in the first half of 2020.<sup>16</sup> VC interest is highest in sectors that have thrived during the pandemic: edtech, health-tech, fintech, remote work, and the digitization of small and medium-sized businesses.

### Deal Value by Country

January 2019 to July 2019



Includes private equity, venture capital, corporate investments in privately held companies, and M&A deals.

SOURCE: DealStreet Asia

12 Arpan Sheth and Sriwatsan Krishnan, "India Venture Capital Report 2020," Bain & Company, March 2, 2020.

13 "The Complete List of Unicorn Companies," CB Insights, accessed March 2021.

14 Stephanie Davis et al., "e-Conomy SEA 2019: Swipe up and to the right: Southeast Asia's \$100 billion internet economy," Think with Google, October 2019.

15 Yusuf Yu, "How many unicorns are there in Southeast Asia?," The Low Down (blog), Momentum Works, May 29, 2020.

16 Amit Anand, "Southeast Asia's Startups are Ripe for Investors Looking for the World's Next Generation of Tech Stars," Crowdfund Insider, December 7, 2020.



## Russia cools down

Whereas VC interest has been growing in APAC, there has been a dampening for Russian-based investments, largely because of political uncertainties and a complex business environment. In 2012, U.S. VCs backed nearly 50 rounds for Russia-based startups. By 2017, this number had plummeted to zero.<sup>17</sup> Investors are reluctant to deploy capital even in the lower-risk technology sector due to increasing threats to internet freedom.

Given these concerns, it's unlikely that U.S. venture dollars will be deployed to Russia to the same extent as the other markets in APAC. However, for investors who want to take the risk, focusing on globally oriented Russian companies (most likely in the technology sector) and smaller, locally focused consumer and service companies might present opportunities. Other sectors that are trending upward in Russia are transport and logistics, cybersecurity, edtech, and food tech.

## Active Early Stage: Environment in Middle East-Northern Africa

### The Middle East has a budding startup ecosystem

If the startup-VC community in Asia-Pacific is young, the one in the Middle East is in its infancy (with the exception of Israel; read more on the following page). To diversify their economic resources and reduce dependency on oil and gas reserves, governments across the region have launched a number of initiatives:

- Saudi Arabia announced a Vision 2030 initiative to drive economic, social, and cultural diversification, across the country and in parts of Egypt and Jordan.
- Oman has launched an accelerator/incubator Oman Technology Fund, as well as the Sultanate's first strategic VC firm, IDO Investments.
- Abu Dhabi's state investment company, Mubadala, has launched its venture arm with both local and Bay Area-based teams and is already a co-investor with AV.<sup>18</sup>

## Prominent U.S. VCs in the Middle East

FIRM	INVESTMENTS IN MIDDLE EAST	AUM USD, BILLIONS
500 Startups	78	\$ 1.1
Y Combinator	17	\$ 0.78
NEA	4	\$ 24
Pantera	3	\$ 0.45

SOURCE: [PitchBook](#) as of February 2021

<sup>17</sup> Joanna Glasner, "US VCs Steer Clear Of Russian Startups," Crunchbase News, November 15, 2017.

<sup>18</sup> Eric Burg, "Unlocking VC investing in the Middle East," Pitchbook News (blog), Pitchbook, July 8, 2019.



However, these developments have not led to more U.S. venture dollars flowing into the Middle East. With the exception of Dubai, which has had the most tech success, Western VCs have been noticeably absent in the region. Among other issues, VCs appear to be concerned about uncertainties in the political landscape, unconventional company structures, and different legal regimes.<sup>19</sup> As a result, most startups are funded by founders and family/friends.

Most transactions have been in early-stage companies, and there too, the demand-supply dynamic is unbalanced: local angels and VCs are clamoring for deals, though there are too few early-stage companies for quality deal flow.<sup>20</sup> That said, investors passionate about growth in the Middle East can look to the UAE and Egypt where most startups seem to be concentrated. Areas of interest include remote work, esports and gaming, telemedicine, and ecommerce.<sup>21</sup>

## Prominent U.S. VCs in Israel

FIRM	INVESTMENTS IN ISRAEL	AUM USD, BILLIONS
Vertex Ventures Israel	216	\$ 1
Sequoia Capital Israel	158	\$ 453
Bessemer Venture Partners	70	\$ 6.6
Norwest Venture Partners	12	\$ 10

SOURCE: [PitchBook](#) as of February 2021

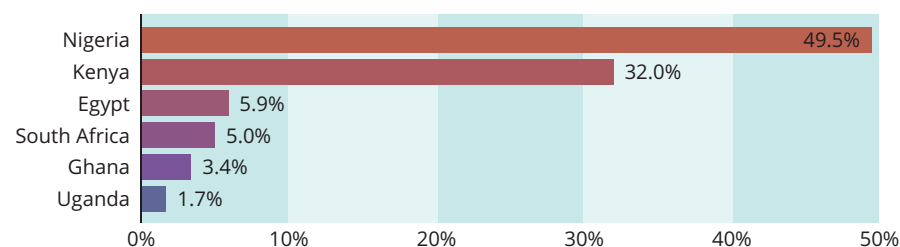
## Israel stands out as a hub

Israel is the most-established venture market in the Middle East. Over the last decade, the country has seen a continuous increase in the number of startups as well as venture capital money flowing into the ecosystem. In 2019, Israeli startups raised \$3 billion, over 6x more than the \$483 million raised in 2009.<sup>22</sup> Despite the pandemic, 2020 was a record year for the nation's startup ecosystem.<sup>23</sup>

Israel is also seeing an upsurge in larger investments of \$30 million and higher, marking it as a scale-up nation ripe for high-valuation exits.<sup>24</sup> In fact, there were 19 IPOs in 2020, valued at \$9.3 billion, up

## Deal Value by Country

African Venture Capital Investments in 2019



SOURCE: [WeeTracker](#) via [Quartz](#)

19 Ian Dillon, "How To Get Western Venture Capital Firms To Invest In Your Startup," *Entrepreneur*, March 1, 2020.

20 Burg, "Unlocking VC investing."

21 "Cross-Border Investing: The Most Active US-Based VCs in Africa," *Teck Experts*, June 2020.

22 Mike Butcher, "After a record year for Israeli startups, 16 investors tell us what's next," *TechCrunch*, January 16, 2021.

23 Shira Azran, Itay Frishman, Mike Rimon, and Marianna Shapira, *The Israeli Tech Review 2020* (IVC Research Center and Meitar Law Offices), December 21, 2020.

24 Ibid.



from \$2.2 billion in 2019.<sup>25</sup> Of these, Lemonade (\$319 million), JFrog (\$509 million), and Nano-X (\$165 million) were some of the most noteworthy IPOs.

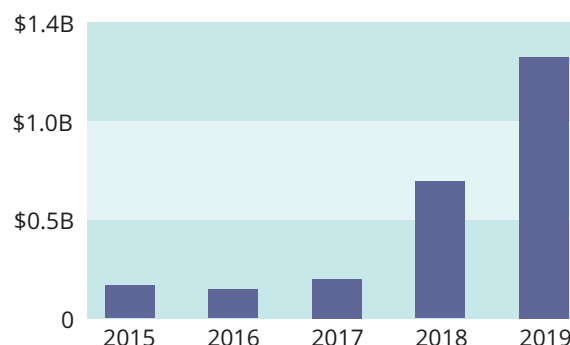
Israel also boasts a number of prominent investors, including some U.S. firms such as Bessemer Venture Partners, Norwest Venture Partners, Sequoia Capital Israel, and Vertex Ventures Israel, among others. Mainstay sectors like cybersecurity and high-tech continue to be prominent, especially as they mature. However, there is also growing interest in newer sectors like AI, fintech, and biotech.

### Africa holds promise for its people and partners

Bill & Melinda Gates might have been early “investors” in Africa, but more recently, Africa’s venture space has attracted global interest with the advent of specialized funds led by development finance institutions such as the International Finance Organization (IFC), Acumen, and Overseas Private Investment Corporation (OPIC).<sup>26</sup> In 2019, African companies raised over \$1.34 billion in venture funding; the largest deal was for \$200 million into Nigerian startup InterSwitch.<sup>27</sup>

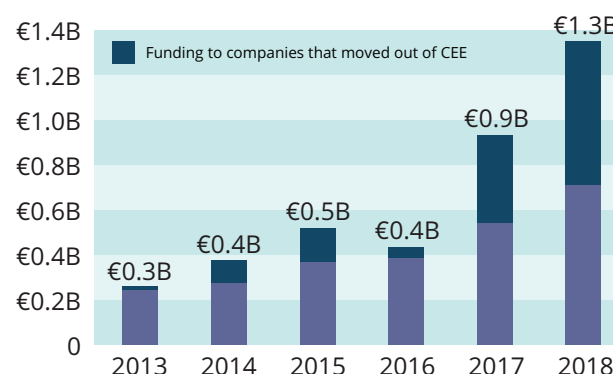
Nearly 82% of the deals in Africa were in Nigerian and Kenyan companies.<sup>28</sup> Most deals were in the fintech, energy, and health tech spaces. Fintech recorded the highest number of deals (11) backed by U.S. VCs, followed by logistics & supply chain (9), healthtech, and e-commerce (combined, 7). U.S. VCs, most of whom were corporate venture arms, showed the greatest appetite for early-stage deals.<sup>29</sup> U.S. institutional VCs who are actively involved in the African venture scene tend to be impact investors.

## Annual Venture Capital Investments in Africa



SOURCE: WeeTracker via Quartz

## Venture Capital Investment in CEE by Round Size



SOURCE: Invest Europe

<sup>25</sup> Reuters Staff, “Led by IPOs, Israeli tech exits jump to record \$15 billion in 2020 -PwC,” Reuters, December 22, 2020.

<sup>26</sup> “Cross-Border Investing,” Teck Experts.

<sup>27</sup> Alexander O. Onukwue, “For the first time, around 100 African startups raise at least \$1 million each in one year,” TechCabal, January 9, 2020.

<sup>28</sup> Toby Shapshak, “African Startups Raised \$1.34 Billion In 2019,” Forbes, January 7, 2020.

<sup>29</sup> “Cross-Border Investing,” Teck Experts.

## Eastern Europe: the Gem of Emerging Europe

### Romania, Poland, Lithuania, and Hungary are regional leaders

Emerging markets in Europe include Turkey, Poland, Romania, Greece, Hungary, and the Czech Republic. Turkey is a key economic hub as it has strong ties to both Europe and the Middle East. In 2019, a total of 94 startups received \$102 million in venture funding in Turkey. U.S. venture heavyweights like Y Combinator, Techstars, Index Ventures, Plug and Play, Insight Partners, and others have made investments in the Turkish startup economy.

But recently, a Bloomberg article painted a grim picture of Turkey as a country that has expanded its money supply and spent its foreign-exchange reserves faster than any other major developing economy, causing the lira to plunge.<sup>30</sup> This will likely lead to some apprehension for investors moving forward.

In Eastern Europe, the picture is more promising. Venture investments have historically been rather slow in the region owing to a lack of quality deals, network, and the difficulty of achieving successful exits. However, a closer look reveals that at least 10 unicorns have emerged out of eastern Europe, with most being founded in Romania and Poland.<sup>31</sup> In 2018, \$1.5 billion has been invested into the region, with Poland taking the lead for the most funding, followed by Lithuania and Hungary.<sup>32</sup> Hungary in particular has seen significant startup success, with companies like Ustream, which was acquired in 2016 by IBM and LogMeIn and valued at a \$3.5 billion in 2019.<sup>33</sup>

As with Southeast Asia, Turkey, and the Middle East, fintech seems to be a popular vertical; enterprise software and SaaS are also leading categories. Given that several of Europe's most successful venture capital investors are based in eastern Europe, we can continue to expect that this region will pique the interest of U.S.-based VCs.

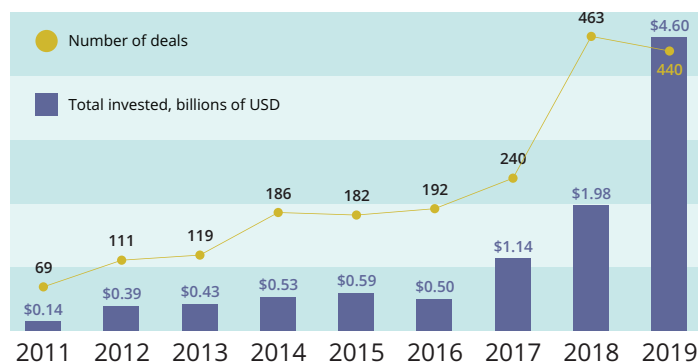
## Prominent U.S. VCs in Europe\*

\* Not Specific to Eastern Europe

FIRM	INVESTMENTS IN EUROPE	AUM USD, BILLIONS
Tech Stars	512	\$ 0.5
Index Ventures	384	\$ 6.63
SOSV	315	\$ 0.8
Accel	243	\$ 20

SOURCE: [PitchBook](#) as of February 2021

## Venture Investment in Latin America



SOURCE: [Latin American Private Equity & Venture Capital Association \(LAVCA\)](#)

30 Srinivasan Sivabalan and Netty Idayu Ismail, "Turkey Stands Alone in Emerging Markets as Economic Woes Deepen," Bloomberg, August 17, 2020.

31 Arnaud Terrisse, "What's up with the CEE? How Eastern Europe's tech startup ecosystem is booming," EU-Startups, November 29, 2019.

32 Ibid.

33 Ibid.



## Latin America Exponentially Growing, Led by Brazil

### Latin America breaks records

Latin America has developed as an important entrepreneurial base. Consequently, venture investments in Latin America have increased exponentially from 2015 to 2019, going from \$500 million in 2016 to \$4.6 billion in 2019.<sup>34</sup>

Brazil received the majority of venture capital (50.5%), followed by Mexico (22.7%), Chile, Columbia, Argentina, and Peru.<sup>35</sup> As the largest country in LATAM, it is not surprising that Brazil is the most talked-about venture market in the region. Its startup stories support the view that Brazil has the greatest potential for economic development. In early 2020, Brazilian prop-tech platform Loft, led by two U.S. VCs—Andreessen Horowitz and Vulcan Capital—became the country's 11th unicorn. According to CrunchBase, five new unicorns were created in Brazil in 2019, the third highest number of the year after the U.S. and China.

These signs have encouraged participation from global investors: nearly \$1.7 billion of venture capital invested in 2019 included a global VC as a co-investor.<sup>36</sup> Bay Area-based investors Riverwood Capital, Andreessen Horowitz, Lumia Capital, TCV, Sequoia Capital, Dragoneer Investment Group, and Thrive Capital have invested in Brazil's startup space. As with the other markets, the fintech sector attracted the most investment at 31%, followed by logistics and distribution at 26%, and proptechs at 9%.<sup>37</sup>

Like Brazil, Mexico has also seen a sharp rise in VC investments, even during the 2020 pandemic. VC investments in Mexico grew 132% in the first half of 2020, compared to the same period in 2019. Three out of four VC-backed operations were cross-border investments with the U.S. and other countries in LATAM.<sup>38</sup> Adding to the excitement, used car platform Kavak became Mexico's first startup unicorn in October 2020. The deal was backed by several U.S. investors, including General Atlantic, DST Global, and QED Investors.<sup>39</sup>

## Prominent U.S. VCs in Latin America

FIRM	INVESTMENTS IN LATAM	AUM USD, BILLIONS
Riverwood Capital	27	\$ 3.5
Redpoint Ventures	10	\$ 4.8
Andreessen Horowitz	8	\$ 16

SOURCE: [PitchBook](#) as of February 2021

<sup>34</sup> LAVCA, [Lavca's Annual Review of Tech Investment in LatAm](#), August 27, 2020.

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

<sup>37</sup> Sisi Peng and Jose Rodriguez, "An Intro to Brazil's Dazzling Venture Capital Landscape and Unlimited Potential," Polymath Ventures Blog, February 5, 2020.

<sup>38</sup> José Escobedo, "Venture Capital Investment in Mexico Sees 132 Percent Growth," Mexico Business News, June 17, 2020.

<sup>39</sup> Entrepreneur staff, "Kavak becomes the first Mexican startup to become a 'unicorn,'" Entrepreneur, October 1, 2020.



Success in venture investing in Brazil has also set the pace for Chile, Columbia, and Argentina. The outlook for U.S.-based venture investments in Latin America look promising. International VCs can make up for the scarcity of local growth capital in many of the booming countries and accelerate growth to create opportunities for quality late-stage deals.

## U.S. Emerging Markets Everywhere, with Texas and Florida as Front-Runners

### Beyond the U.S. East and West Coasts

While we don't expect to see the U.S. in a list of emerging markets, it is noteworthy that much of the country's venture capital money flows in and out of three hubs: Silicon Valley, Boston, and New York. More recently, though, the venture world is recognizing that talented entrepreneurs are located all across the U.S. Part of the reason that entrepreneurial talent is no longer concentrated in the hubs is that it is becoming increasingly unfeasible for startups to set up shop in Silicon Valley (or Boston and New York), with its soaring costs of living and conducting business. On the flip side, it's becoming increasingly feasible to launch a startup, thanks to advances in technology, the availability of remote talent, and decreased costs.

VCs may follow. In any case, if investors continue to use teleconferencing software to source, diligence, and invest in nonlocal companies, a large amount of capital could be unlocked for businesses headquartered outside of traditional investment hubs. The motivation and means are also there for some entrepreneurs who, freed up by new remote working policies and tech connections, are moving to smaller metros to enjoy more livable, affordable spaces. Local governments have welcomed them with open arms, investing time and money into attracting and keeping top-level talent.<sup>40</sup>

So where are people going? Among 515 U.S. cities analyzed by WalletHub for economic growth within the last seven years, the South and West came out as winners, with Texas and Florida as front-runners.<sup>41</sup> In a study conducted by Inc on "surge cities" in the U.S., Austin, Miami, Los Angeles, Boulder and Denver, Provo and Salt Lake City (UT), Seattle, Chicago, St. Louis, Detroit, Nashville, and Atlanta ranked among the top budding cities for startups and entrepreneurs.<sup>42</sup>

If investors continue to use teleconferencing software to source, diligence, and invest in nonlocal companies, a large amount of capital could be unlocked for businesses headquartered outside of traditional investment hubs.

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40 Peter Ward, "A Brief History of Austin's Technology Scene," Culture Trip, October 11, 2018.

41 Adam McCann, "Fastest-Growing Cities in America," WalletHub, October 12, 2020.

42 "These Are the 50 Best Places in America for Starting a Business," Inc., accessed March 2021.



## General Investment Challenges and Opportunities in Emerging Markets

As with any asset class, there are risks and rewards. Venture capital is a high-risk/high-reward class, where often a few home runs pay back your base hits and strikes. Venture investing in emerging markets has even more incomplete information — higher risk and potentially higher reward — which savvy investors can use to their advantage. More than ever, timeless investing principles apply: adequate portfolio size and diversification, avoiding adverse selection, being process-based and disciplined, and importantly, having this fit within your broader portfolio objectives. Investing in this space requires committing with your eyes open, considering both the challenges and opportunities.

### Challenges

- **Negative feedback loop:** For VCs interested in emerging markets, key challenges in the market (perhaps with the exception of China, India, and Brazil) are centered around the space being young and unproven. This creates a negative feedback loop between fundraising for the VC, lack of a network for deal flow, and limited experience of venture investors in these markets. Perhaps of equal importance is the concern that entrepreneurs and startups are often not “investment ready.”<sup>43</sup> Most investments are also made in early-stage companies; scaling dollars are limited, and startups struggle to find follow-on investments.
- **Uncertain exit opportunities:** Furthermore, exit opportunities are still rare and unclear for many of these markets.<sup>44</sup> In some emerging markets like China, Russia, and the Middle East, geopolitical concerns paint pictures of cybersecurity issues, volatile markets, and government interference that inhibits growth potential.
- **COVID challenges:** Finally, the COVID-19 pandemic has thrown a wrench in venture plans across the world. The global economy is likely to face headwinds from disrupted production and supply chains, bankruptcies, and unemployment, though we have started to see a semblance of regularity that makes a case for cautious optimism.

Once specific markets have been narrowed down, the best way to explore investment opportunities is to build effective venture/co-investor partnerships that are mutually beneficial.

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<sup>43</sup> World Bank Group, *Building Early Stage Funds In Emerging Markets and Developing Countries: Insights and Learnings from the Market Place* (February 25, 2020), accessed March 2021.

<sup>44</sup> Ibid.

## Opportunities

Weighing against those concerns are considerable opportunities for investors.

- **Late-mover advantage:** Investors are leveraging the learnings of companies from the mistakes of their more established peers. By folding in lessons learned from venture investments in the West, VCs can avoid adverse selection too. For example, Traveloka learned what not to do from Uber and WeWork, avoiding the troublesome path of burning through cash with no clear profit in sight. Specifically, venture investors could gravitate towards countries with proactive governments that are conducive to legal and regulatory policies that foster cross-border investments. In general, such governments create a startup milieu that is centered around innovation and growth. Late-movers are also less invested in designing for existing and perhaps archaic technology. Instead, they are leapfrogging to next-generation solutions.
- **Co-investing relationships:** Once specific markets have been narrowed down, the best way to explore investment opportunities is to build effective venture/co-investor partnerships that are mutually beneficial. Local partners who understand the geographic, cultural, and economic variables in the space offer valuable insight that U.S. VCs are unlikely to obtain from several thousand miles away. Alumni Ventures has an exclusively co-investor strategy.
- **Growing supply and demand:** Investing in emerging markets is also investing in countries where the young and middle-class population is on the rise, with increasing strength in both entrepreneurial and consumer segments.
- **Enjoy greater diversification:** Alumni Ventures is a strong proponent of portfolio diversification. Seeking opportunities in new markets is another way to diversify investments to minimize risks due to a downturn in any single economy.
- **Regional outlook:** Ambitious startups in smaller countries often start with a bigger scope, considering cross-border opportunities.
- **Valuation “discount”:** Emerging markets often offer a chance to invest in promising ventures at better prices than in markets where venture is more concentrated.

## Final Reflections

The first half century of venture capital was largely an American story; our thesis is that the next fifty years will be told globally. Riding on the waves of digitization, leapfrogging technologies, and venture investing in emerging markets offer unprecedented potential





for value creation. Urbanization of developing nations and younger demographics, with more people entering the labor force, will favor economic development, startup launches, and venture growth. In fact, many countries with the fastest population growth are not listed among emerging markets, but this is where frontier investment opportunities may lie. Remember, it was just a few decades ago that China was but a blip on our radar.

When it comes to specific deals, tech-based startups that have a cross-border vision and a business model that is set up for global reach, or startups in locally oriented products and services industries, can be prudent choices. Among sectors, leapfrog technologies such as fintech, IoT, health tech, and cloud computing, etc., will benefit people in emerging markets as much as, if not more than, in the developed world.

The bottom line: technology is dispersing value and we believe geographic investing arbitrage is an opportunity, offering sophisticated investors another means to diversify their portfolio.



## About the Author

**Krithika Kumar**  
Principal, Strawberry Creek Ventures

Krithika is a member of Strawberry Creek Ventures, where she brings experience in venture capital, entrepreneurship, and scientific research to the team. Krithika has led diligence and sourced deals as a Venture Partner at Humboldt Fund and a Senior Venture Fellow at Castor Ventures. Prior to venture capital, she co-founded a cognitive fitness company to enhance brain performance across the age spectrum. She also served as the Director of Business Development at Prime Biologics where she established strategic partnerships in the U.S., EU, and emerging markets. Krithika did her post-doctoral research studying the gut microbiome at Cornell University and has a Ph.D. in biological sciences from Texas A&M University.

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