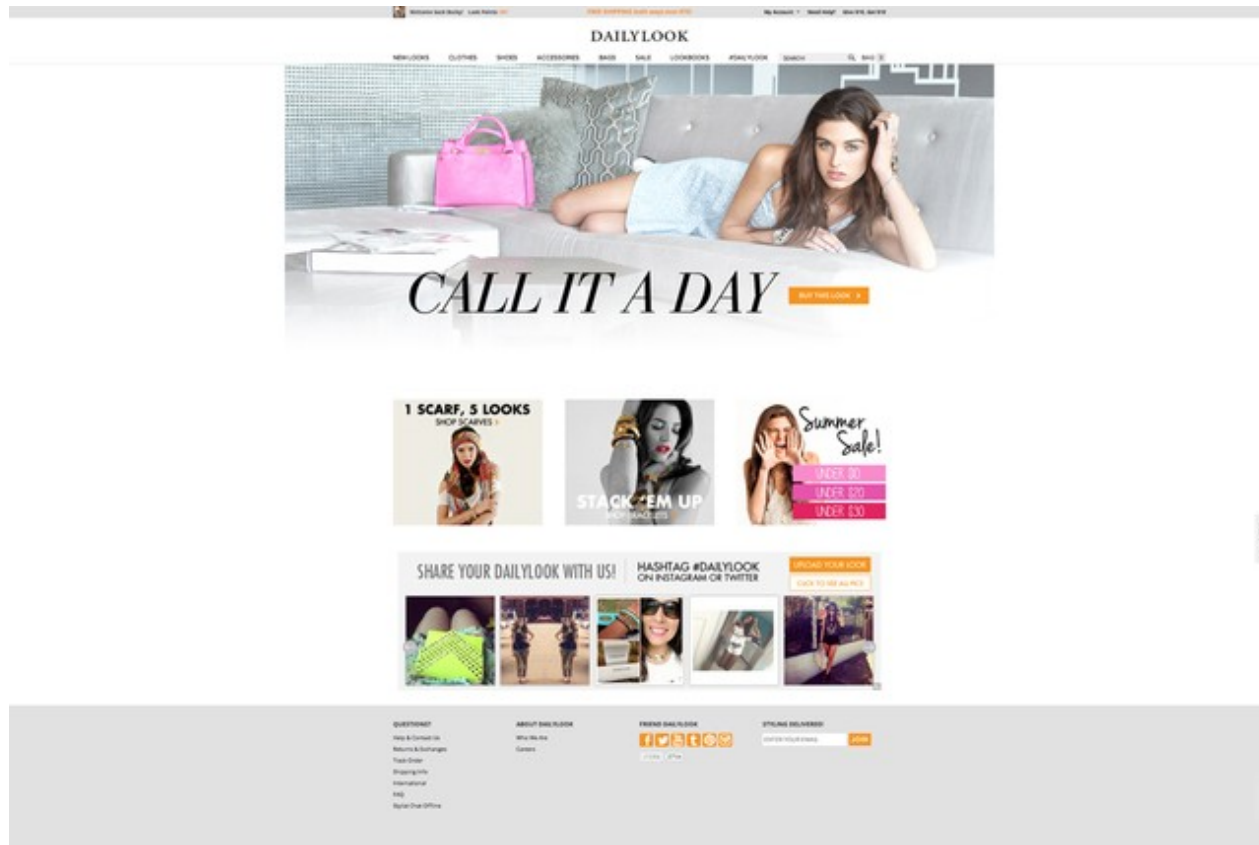


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L.A.'s Digital Scene Begins to Percolate

By RACHEL BROWN



DailyLook's Web site.

Photo By Courtesy Photo

LOS ANGELES — Even as Silicon Valley and New York overshadow it with billion-dollar exit sales and whiz-kid technology executives, Los Angeles is coming into its own as a hub for digital start-ups, especially in the fashion, entertainment and media sectors that are the city's traditional strengths.

Like all start-up communities, L.A. is hit with bipolar surges of hype and substance, but it seems to be in a substance cycle now in which many companies, e-commerce ones in particular, are trying to prove themselves to be long-term performers. The uncertainty hanging over the city's digital sector is whether it can deliver the results that will put it on the map as a unique, lucrative technology capital and not merely a Southwest ticket away from Silicon Valley.



A view of the JustFab Web site.

Photo By Courtesy Photo

“Clearly, L.A. is rapidly evolving. If you think about L.A. two years ago versus today, there is a dramatic difference as far as the start-up community in the opportunities to create a start-up and to get funding,” said James Berger, chief executive officer of Uncovet, an online accessories and home design destination that recently raised \$1.3 million. “I would argue that two years from now, it will be different in a more positive way.”

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A noteworthy change on the L.A. digital scene is that companies have grown to significant sizes, suggested Mike Jones, ceo of technology incubator and investment firm Science Inc. “Previously, we have always had a healthy set of early-stage businesses. I would have said we had companies in the \$10 [million] to \$100 million bucket, and now we have quite a few in the \$100 million-plus bucket,” he said. ShoeDazzle, JustFab, Revolve Clothing and Nasty Gal are in the mix of Southern California companies getting up there in revenues.

Greg Bettinelli, a venture partner at GRP Partners, estimated, “Collectively, there is well north of \$1 billion in fashion e-commerce in L.A.” More specifically, he continued, “We are clearly not Silicon Valley in terms of creating the next eBay or Google, but I would argue that some of the hottest investments are here. Snapchat is one of the hottest companies out there. Nasty Gal is arguably the hottest e-commerce deal in the last three years.”

Furthering the “not Silicon Valley” side of Bettinelli’s statement, L.A. hasn’t been the magnet for venture capital that some of its big-city rivals have been. In the first quarter of 2013, City National Bank’s Venture Capital Report found that the amount of money raised by L.A. companies decreased to \$178 million from \$236 million, reflecting a national trend of dwindling venture capital. There were 28 L.A. companies that received funding in the quarter — the same number as Seattle — while the San Francisco Bay Area had 229, New York had 82 and Boston had 71.

“L.A. has been two or three years behind New York,” said Dana Settle, founding partner at venture capital fund Greycroft LLC. “Entrepreneurs pop up when there are big opportunities to disintermediate or disrupt incumbents. The financial crisis in New York shook things up....It unstuck a lot of people who had been working in the financial services industry and all of a sudden realized that there was an opportunity to do something entrepreneurial either by interest or necessity. That’s why we have seen a burst of entrepreneurialism since 2008. The seeds were there and that event accelerated things. In L.A., the seeds are there, but there hasn’t been one specific event.”

Still, there are a slew of start-ups in fashion, media and entertainment, all industries long rooted in the L.A. culture. The city has an infrastructure to make inexpensive fashion merchandise unparalleled in the country — and e-commerce start-ups feed off that infrastructure. “When it comes to the lower price point design and manufacturing, I don’t think L.A. can be beat. You couldn’t do this from Silicon Valley,” said Brian Ree, founder of DailyLook, an e-commerce site centered upon offering its customers affordable head-to-toe looks daily that raised \$2.5 million earlier this year. “There is some technology involved [at DailyLook,] but it is not the world’s most leading-edge technology. You don’t need the best engineers in the world that can only work at Google and Facebook.”

As fashion and entertainment industries intertwine, the benefits of L.A. loom larger. On the start-up scene, online video companies have been a force (a few of them are Maker Studios, Zefr, StyleHaul and AwesomenessTV, which revealed last month it was being acquired by DreamWorks) and fashion start-ups have welcomed the expertise in that space that L.A. companies provide. “We’ve been doing a lot with video, and we have really found great design and video talent — video editing and actresses that are in videos — and that’s something that is particular to L.A.,” said Dan Murillo, cofounder and ceo of Little Black Bag, a social commerce

site that has raised more than \$10 million in funding. “If you look at where the majority of interesting YouTube video content is being created and the YouTube content studios, those are all headquartered in L.A., and we are taking advantage of that.”

Los Angeles has its share of disadvantages, mostly having to do with the fact that it’s simply not as established as Silicon Valley on the tech and venture capital fronts. For L.A. firms, it’s hard to compete for engineers with the mass of tech companies up north. “There are so many times we have lost engineering talent to the Googles and Twitters of the world,” said Michael Dubin, ceo and cofounder of Dollar Shave Club. “Ironically, it is harder to sell engineering talent [on L.A.] than VCs.”

Dustin Rosen, founder and ceo of style photo-sharing app Pose, believes “really great companies will attract engineers,” pointing out that L.A. mobile entertainment network Scopely has been able to lure people from the Bay Area. “L.A. is a great place to live, if there are these great companies, they will come to L.A.,” he said.

Another common complaint is that there isn’t as much funding available in L.A. Seed-stage financing — typically the first \$1 million or below — doesn’t appear to be the primary issue, but it’s the advanced stages of funding, most obviously the rounds when checks of \$10 million to \$25 million or more are written, that are especially problematic. “There is a huge opportunity for later-stage funds to focus specifically on Los Angeles,” said Adam Goldenberg, co-ceo of Intelligent Beauty Inc., owner of JustFab and DermStore, and a partner in seed-stage venture capital firm CrossCut Ventures. “When you need that \$10 [million] to \$50 million check for growth capital, you can’t find that in Los Angeles, so you are going to have to go to VCs that are out of Silicon Valley. Compared to New York and Chicago, L.A. is behind in having later-stage growth funds. The reason that is the case is because Los Angeles is so well covered by Silicon Valley.”

Goldenberg thinks larger, late-stage funds will pop up here, but Bettinelli isn’t quite as confident. “It would be nice to have one \$1 billion fund, but I don’t think L.A. could support that yet,” he said.

Tracy DiNunzio, founder and ceo of clothing resale concept Tradesy, contended that L.A.’s comparable lack of capital has serious implications for its start-ups. Because valuations and fund-raising can be connected, she explained L.A. companies sticking to smaller sums of L.A. venture capital may get valuations 30 to 50 percent below companies in Northern California. “The valuation of the company, especially at the seed stage, doesn’t have that much to do with what the company is at that stage. It has to do with how much money you can raise, making that number between 25 to 30 percent of your valuation,” said DiNunzio. “What is happening here in L.A., the reason we are getting the lower valuations, is that we are backing into our valuation.”

Having a lower valuation and less money means less time to prove a company can succeed. “We just work harder,” said DiNunzio of how Tradesy and companies like it deal with the valuation conundrum. “We really focus on creating a sustainable business that has a very strong core value proposition, that is zero hype and all substance.”

The bottom line is that wealth and talent breeds more wealth and more talent, and the proliferation of start-up accelerators in L.A. has contributed mightily to the propagation of local start-ups. Among the L.A. accelerators are Idealab, Science, Launchpad LA, StartEngine, K5 Launch, MuckerLab and Amplify. DiNunzio, who worked with Launchpad LA to hone Tradesy, outlined, “What they provided is office space, mentorship and some cash. At the time, it was \$50,000. Now it is between \$100,000 and \$200,000 for each company. They took 6 percent. They basically sit you in a room, introduce you to every investor that rolls through Los Angeles, and give you feedback about your pitch and your fund-raising strategy. My Launchpad class ended just about a year ago and, at the time that it ended, we were 2.5 employees, including me. Now, we are at 18 people and have grown

significantly and taken a bunch of capital. It was tremendous for us.”

Start-up success, however, is most critical to more success. In L.A., there are companies that have been akin to start-up prep schools for executives who move on to help build other companies. Brian Lee cofounded LegalZoom before launching ShoeDazzle and Honest Company, and has gone on to invest in several start-ups he didn't found, such as StyleSaint and Scopely. ShoeDazzle has served as well as a training ground for executives who dot the e-commerce landscape in L.A. Deborah Benton, president and chief operating officer at Nasty Gal, was chief operating officer of ShoeDazzle. Jeff Biesman, senior vice president of marketing at Little Black Bag, was formerly vice president of customer marketing and client services at ShoeDazzle. An “emerging e-commerce competence is something that is definitely present in L.A.,” said Murillo.

MySpace, today not considered a giant success, although it was one in its heyday, has been the source of many current start-up leaders. Intelligent Beauty co-ceo's Adam Goldenberg and Don Ressler, and BeachMint ceo and cofounder Josh Berman, all came from MySpace. Kyla Brennan's stint as an assistant at MySpace influenced her future leadership at Pinterest marketing service HelloSociety, where she is founder and ceo. “I was at MySpace during a pivotal time right before News Corp. sold them, and I learned a lot being there even in my role as an assistant. I remember certain times thinking if I had a company I wouldn't do things this way,” said Brennan.

Achievement in fashion or entertainment in L.A. has led some to invest in the tech segment. Stylist Rachel Zoe has been involved with Pose and DailyLook, and celebrities including Justin Timberlake, Ashton Kutcher and Will Smith have all entered the tech game.

Exactly which companies will acquire L.A. start-ups when they get the bulk to attract major buyers remains a mystery. Urban Outfitters Inc. has been rumored to be circling Nasty Gal and, similarly, retailers on and offline could arise as acquirers. Gap Inc.'s purchase of catalogue and online specialist Athleta, and Nordstrom Inc.'s commitment to online innovation put them on the list of companies that could be scouring for digital concepts in L.A. and beyond. Fung Capital, a venture firm affiliated with Li & Fung Ltd., took a minority position in Onestop Internet Inc., an e-commerce service provider to apparel and retail brands, in 2011, and Li & Fung could emerge as a potential player. Media companies have dabbled in L.A. Hearst Ventures, a unit of Hearst Corp., has a minority equity investment in Science, and Bertelsmann Digital Media Investments, a subsidiary of Bertelsmann AG, has been active in L.A. with investments in StyleHaul and YieldMetrics. DreamWorks is shelling out \$33 million for AwesomenessTV, but the studios haven't been aggressively snapping up local digital firms so far.

“If you look at the big acquirers, they are mostly in the Bay Area. In terms of big companies that could acquire tech start-ups in L.A., it is media companies. They haven't been too acquisitive lately,” said Murillo. “It is harder to sell your company being based in L.A. to a company that's based in the Bay Area.”

L.A. start-ups have experienced success — HauteLook sold to Nordstrom in 2011 for \$270 million, for instance — but more big exits and a track record of building large-scale, profitable companies would solidify the L.A. start-up scene. To get there, L.A. companies should avoid the pitfalls of their predecessors. “The rap on L.A. is people always sell too soon,” said Settle, who advised L.A. start-ups to look to companies up north that have withstood pressure to exit quickly and remained independent longer. Goldenberg is optimistic that L.A. start-ups are on the right path.

“In the next two or three years, you are going to see substantial exits,” he declared. “Will they be the next Facebook and create tens of billions of dollars in shareholder value in L.A.? I don't know.”

Jones doesn't expect a massive transfer of tech power away from Silicon Valley, but that doesn't mean L.A. is

irrelevant. “Supplemental markets like New York and L.A. can do great things. We can build billion-dollar brands,” he said.

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