



In the land of the black swan, where unicorns are born

i. Introduction

After three intense months, nothing is more natural than the first quarterly letter from **Fuse Capital** to address a subject that is hotly debated today: the black swan theory.

Developed by Lebanese-American Nassim Taleb as the premise of his 2007 best seller *The Black Swan*, this theory addresses a rare event with a huge and unprecedented social impact. According to the book, it is inexplicable in a concrete way and impossible to predict by only analyzing the past.

To understand this logic a little further, we must remember the discovery of Australia in 1770. Before this accomplishment, it was believed that all swans were white, after all, no one had seen a different one. However, as proven by the literature, after encountering black swans, the biology and way of thinking of the time changed completely.

Back to Taleb's theory, rare events like the first black swan occur more frequently each year, even though our minds are not programmed to deal only with what we have seen before. Naturally, when such an event happens, we invent explanations to rationalize them. This is because it is "much more enjoyable to create something than feeling stupid and ignorant when something unforeseen happens".

The reason we decided to start with this brief summary is very simple: COVID-19 is a clear example of a black swan that has been shaking all markets around the planet. But rest assured, our intention is not to alarm you or make any value judgment. We seek to learn from these disruptive events, and understand how the Venture Capital industry has behaved in other similar events.

Winston Churchill: "Never let a good crisis go to waste."

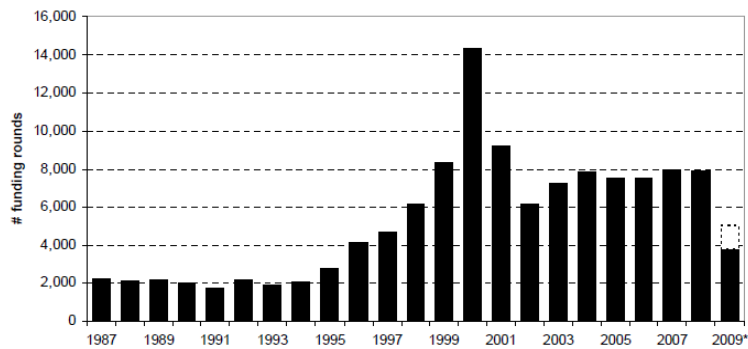
ii. The United States Venture Capital market in recent decades as a global proxy

Before starting our analysis, it is essential to inform that we will use the United States Venture Capital industry as a global proxy because it is more mature and contains a greater number of studies and data, so that we can support our theories. It is worth mentioning that, decades ago, the moment the American industry went through was embryonic and similar to what Brazil lives today.

During the second half of the 1990s, this industry began consistently expanding, as shown in **Chart 1**. Favorable conditions such as the internet boom, the hot IPO (Initial Public Offering) market and the *exits* of little-known institutions have made the allocation of resources in funds of this type to grow consistently.

This positive dynamics was only interrupted by the bursting of the dot-com bubble in 2000, and caused the number of funding rounds by the Venture Capital industry to begin to fall, returning to the level of 1999.

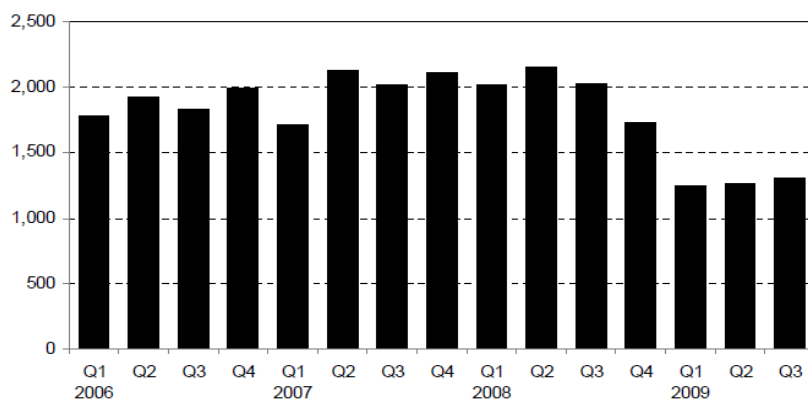
After another year of reduction in the number of rounds, in 2002, the curve rose again, remaining at the average level of 7,800 rounds per year, the same as before the bubble burst.



Source: VentureXpert (accessed November 11th, 2009); all industries and countries are included.
 Note: *) The year 2009 only includes the months from January to September. The dotted line indicates the number of funding rounds proportionally scaled to the whole year ($3,817 / 3 * 4 = 5,090$)

Chart 1: Numbers of funding rounds (January/1987 - September/2009)

When we look more closely at the effects of the 2008 economic crisis, it is worth taking **Chart 2** as a basis, which provides a quarterly analysis of the effect on the rounds. We noticed, for example, an acceleration of the fall in the third quarter, when the numbers of rounds went from 2,157 to 1,246 in the first quarter of 2009, representing a drop of 42%.

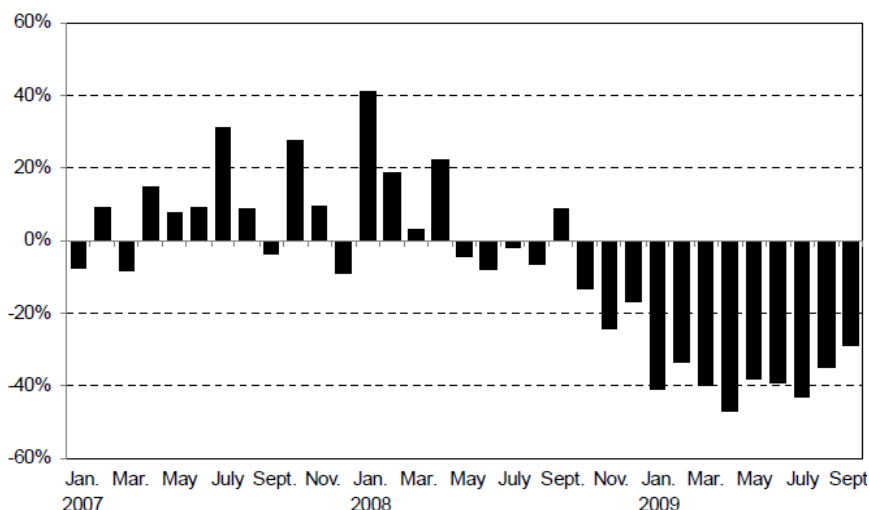


Source: VentureXpert (accessed November 11th, 2009); all industries and countries are included.

Chart 2: Changes in the number of funding rounds (compared to the previous year)

However, as it is a volatile and highly seasonal industry, in terms of funding, it is essential to compare the numbers of rounds year by year, excluding the calendar effects. From this perspective, we will have consistent evidence that the 2008 crisis began to affect the Venture Capital industry in May of the same year (see **Chart 3**).

In other words, these negative effects occurred between the collapse of Bear Stearns on March 16, 2008 and Lehman Brothers' bankruptcy filing on September 15, 2008. This shows that the effect of this crisis reached the Venture Capital industry almost instantly. On the other hand, the positive note is that, with the same speed, many business opportunities were generated. A breath of fresh air for the present days.



Source: VentureXpert (accessed November 11th, 2009); all industries and countries are included.

Chart 3: Changes in the number of funding rounds (compared to the previous year)

iii. Goodbye, good times or Thanks, hard times

The debris also presents a certain level of opportunity for those who are ready to take advantage. And a constant economic recovery is fertile ground for those who have prepared themselves in adversity. As stated by Nassim Taleb, "uncertainty is something present, desirable and necessary for evolution".

Nassim Taleb: "Uncertainty is something present, desirable and necessary for evolution"

A whole generation of startups that gained prominence after the financial crisis was founded between 2008 and 2010. Because they were quick to recognize the imminent changes, they created revolutionary products that completely changed our daily lives. As Clayton Christensen defines in *The Innovator's Dilemma*, startups "have meant huge disruptive innovations".

Some companies, such as Uber, Airbnb, Palantir, Lyft and Pinterest, have been valued at more than ten billion dollars in their last rounds of funding with Venture Capital, some of them, even, already are publicly traded. Today, their total market value is 123 billion dollars.

In the wake of this process, one of industry's most successful fund is Andreessen Horowitz, created at that time in Menlo Park, California, United States. In an interview with an American Magazine, when asked about the reasons for opening the company in the midst of the crisis, Marc Andreessen, co-founder, replied: "I am looking for a new generation of megalomaniacal, ambitious, assertive and focused inventors. In the mold of Steve Jobs."

The examples are diverse and prove to us that it is in crises that we are most creative and that we learn to work with less. This is in fact a driving force for startups, and some people knew very well how to take advantage of the situation. The optimist can always see the opportunity in difficulty.

Winston Churchill, former Prime Minister of the United Kingdom: "A pessimist sees the difficulty in every opportunity. An optimist sees the opportunity in every difficulty."

What are the common patterns of all these successful initiatives? Find the answer in the next chapter.

iv. Levers that transform black swans into unicorns

In the examples shown above and in several others that we studied to put together this letter, some patterns are very clear and are repeated.

1. People

What defines the success or failure of a startup are entrepreneurs. In times of crisis, they need to be more creative. Do more with less. Their essence for the process is even more relevant at these times. Be certain of it.

Our team at Fuse is obsessed with understanding the entrepreneur before even understanding the project. We are not necessarily looking for the most intelligent, but for the most adaptable to changes, whether endogenous or exogenous.

In other words, we want not the entrepreneur with the best idea, but the one who knows how to listen, who is willing to exchange opinions and, above all, who is prepared for changes in his original path. The only certainty we have is that changes in the initial trajectories will happen.

Klauss Schwab, founder of the World Economic Forum: "In the new world, it is not the big fish which eats the small fish, it's the fast fish which eats the slow fish."

2. Competition.

When the market is hot, people are quick to copy models that are on the crest of the wave. It is not uncommon to see three or four companies compete in the same niche, as one of them offers some level of traction. Think of Groupon and the other collective purchasing companies, which, so successful, had to attract customers with their offers and ended up bankrupting countless establishments. Or even Instagram, which had several competitors and was still sold to Facebook for a billion dollars.

However, as this effect is not so widespread in a declining market, pioneer companies find ways to develop their ideas.

Note that, at first, this second point may be diverging from the first, because if we invest in the best entrepreneur, the effect of competition should be minimized. However, there are several cases in which the worst technology beat the best, or even where the less prepared entrepreneur performed better. All of these episodes have one thing in common: excess liquidity, in which companies look more at revenue growth, at the expense of profit.

ALBERT EINSTEIN “We don't want things to change, if we always do the same. The crisis is the best blessing that can happen to people and countries, because crisis brings progress. Creativity is born from anguish, just like the day is born from the dark night. It's in crisis that inventiveness is born, as well as discoveries made and big strategies. He who overcomes crisis, overcomes himself”

3. Purpose.

It is always easier to start a business in a blue ocean, almost a hobby for some. For us at Fuse, the purpose is the company's DNA, our backbone, the one that makes the entrepreneur overcome obstacles in search of something much bigger.

We believe that when times are tough, only true entrepreneurs have a specific purpose and continue to connect, creating value in pursuit of their dreams.

If we take Airbnb as an example, the purpose is quite clear in Leigh Gallagher's book *The Airbnb Story*. As much as we define the company as a hotel, a rental company or any other similar term, this is not how it is perceived by the founders. And this is very important in difficult times.

The purpose of Brian Chesky, Joe Gebbia and Nathan Blecharczyk, co-founders, is very clear. They define themselves as “home sharers”, and intend to be an engine of economic empowerment that helps hospitality entrepreneurs to monetize their spaces. In other words: the company was not created to compete with the hotel service, but to help the home sharing sector that already existed. We believe that without this clear idea, times would have been more bleak for the company.

Thomas Carlyle, writer: "A man without a purpose is like a ship without a rudder."

4. Resilience.

Failures are part of the entrepreneurial process. In fact, everyone from Walt Disney to Steve Jobs has failed at some point. But instead of being discouraged, they learned from the experiences and came back even stronger. Challenging experiences bring many learnings.

Let us take as a basis what Steve Jobs said in a speech to Stanford University graduates in 2005. Using his resignation from Apple, a company he founded, as a starting point, he said: “The heaviness of being successful was replaced by the lightness of being a beginner again. It freed me to enter one of the most creative periods of my life.” If the man in the black shirt, jeans and white sneakers were not resilient, this blow could have deprived us of innovations like iPod, iPhone and iPad.

Dean Karnazes, one of the greatest ultramarathoners in the world, when asked how he ran so many kilometers, replied: "Putting one foot in front of the other until you cross the finish line." Innovating, clearly, is much more for an ultramarathon than for a 100 meter dash.

The main point of this Karnazes reasoning is not only that the entrepreneur has to be resilient, but also that this be natural. The successful founder has to come with resilience in his DNA.

Winston Churchill: "Success is going from failure to failure without losing enthusiasm."

v. Nice to meet you, my name is Fuse Capital

As we like to tell, the story of Fuse began ten years ago, when the founding partners, originally financiers, began to do business as entrepreneurs and invest in the technology industry. However, this migration is not easy. The culture and metrics of evaluation are quite different from those experienced by them, which were those of Wall Street. Perhaps because of this, the heart of the global financial market is in New York and the pulse of startups in Silicon Valley, the opposite end of the country.

As mentioned earlier, this transformation in culture is an ultramarathon and not a 100-meter dash. Between mistakes and successes, we find our DNA, and we use it with great rigidity in our company and in its investment policy. The learning curve is constant, but the mantras are and will always be the cornerstones of our company. Learn more about them below:

Mantra 1: From Entrepreneurs to Entrepreneurs

We invest, above all, in people. From this perspective, we seek options to help the entrepreneur, even if we do not make the investment. We believe that working together improves the ecosystem as a whole, which is good for both Fuse and our shareholders.

As our partners have already done business as entrepreneurs, we always try to put ourselves in the position of the founders. Thus, we constantly provoke ourselves within the company to find out if we are able to help them solve a possible problem.

Over these ten years, we followed the learning curve of the technology sector and made several partnerships with TOP 10 educational institutions in Brazil, with large companies that challenge us to solve problems through technology, with successful entrepreneurs who continue to manage their organizations and with several global Venture Capital funds. All this experience is used in favor of the entrepreneurs.

Perhaps because of this, thinking about the creators, our first fund will make available to their startups a hybrid model in which we can enter with equity in a seed and Series A stage and, in a more advanced stage, offer a debt instrument backed by receivables and/or diversified monthly recurring revenue.

Mantra 2: Capital preservation

If with mantra 1 we believe we will be able to leverage the startup's chances of success, with 2, we will show how some tools can bring more confidence in future investment.

We believe that with the support of our partners or even becoming a first consumer of a given initiative, we are preserving the capital of our shareholders. In the next letters, we will detail some of Fuse's investments, and exemplify this theme in more detail.

Like any industry, the Brazilian technology sector is also maturing, and we adhere to the thesis that this industry can no longer be seen as binary. The many examples of Brazilian unicorns and successful entrepreneurs in later initiatives already speak for themselves. However, be careful: asymmetry is very negative for those outside the sector and making investments in a non-professional way.

Mantra 3: Your purpose matches our purposes

There is a growing body of evidence showing that purpose-driven companies are more successful. In the image below we see a mix of aspects related to the theme.

In an increasingly competitive reality, people are not just looking for a product or service to buy, they want companies that they trust and believe in.

In today's world, the starting point must be why. We often jump without thinking about building the solution, and we forget to ask ourselves why we are doing this. What led us to this idea? What led us to think about this solution? Who do we want to impact?

David Hieatt, writer and co-founder of Hiut Denim and the DO Lectures: "Your purpose is the wind in your sail. And without a why there is no wind."



Sources:

1. The Energy Project, *What Is Your Quality of Life at Work*, 2013
2. Edelman, *The goodpurpose study*, 2013

3. Raj Sisodia, *Firms of Endearment*, 2007
4. Havas, *Meaningful Brands Index*, 2013

By taking the time to think and define your purpose, you will not only attract the right customers, you will have more clarity on what to work on. Again, always start with why.

In his famous lecture at TED in 2009, “How great leaders inspire action”, Simon Sinek pointed out that everyone needs to evoke an emotion with their first customers so that they feel something about you. Therefore, most purchasing decisions are based on emotion and not logic.

By communicating what you do and focusing on why, you create much deeper connections with your audience and give your business a greater chance of success. That way, you capture people by the heart and not just the mind.

The products you offer will undoubtedly evolve over time, but your purpose probably will not. It must always remain clear.

The naturalness of acting based on your why may take a while to be completely aligned with your attitudes, but it will become your compass, guiding you towards the best decisions.

We end this letter with a note of optimism, everything passes and always keep in mind that your principles connect your values to your actions, they are beacons that guide your actions and help you successfully deal with the laws of reality. It is to your principles that you turn when you face hard choices”

Ray Dalio, investor: “Principles connect your values to your actions; they are beacons that guide your actions and help you successfully deal with the laws of reality. It is to your principles that you turn when you face hard choices.”

Fuse Capital, Rio de Janeiro, 03/31/2020

“From entrepreneurs, to entrepreneurs”