Essays on Venture Capital

ABSTRACT

The main focus of this doctoral dissertation is on networking and syndication activities of Venture Capital (VC) firms. VCs are highly interconnected to each other, and they tend to establish dense networks through syndication of risky investments in high growth entrepreneurial ventures. While networking with other VCs facilitate sharing of contacts, resources, deal flow and technical know-how, syndicating investments lead mainly to diversification of financial risk.

Through this dissertation, we study when and under what conditions cooperation efforts among entities lead to superior results. By studying young VC firms based in the US, we find that a young VC firm networking with reputed VC firms can have up to 70% higher economic impact on exit rates as compared to plain vanilla networking. We find that young VC firm benefits by networking with reputed VCs when it is leading a syndicate for investing in an entrepreneurial venture perceived as less attractive by the VC firms. Our result also suggests that those young VC firms which adopt a relationship approach and network more with other VC firms in the initial five years of their operations not only perform better in the short-run but also have a higher chance of surviving in the long-run. Besides, such firms are more successful. However, this long-term advantage of cooperation can only be achieved when the focus is on the sharing of knowledge and resources among VC firms and not just on diversifying financial risk. We establish this as our results suggest that syndication impacts a young VC firm's performance positively in the short-run only. In the long-run, however, such firms have a lower chance of surviving and are less successful.

Even though the advantage of syndication is limited to the short-term only, this approach does help VC firms when they are trying to capture new markets. Our results suggest that while investing in India-based portfolio companies, foreign VC firms, syndicating with other foreign VC firms are more likely to exit successfully. However, foreign VC firms syndicating with Indian VC firms and Indian VC firms syndicating with other Indian VC firms do not explain the rate of successful exit. Moreover, we find syndication to have no role in explaining the exit rate for Indian VC firms. We attribute this failure of the Indian VC firms to take advantage of syndication to lack of cooperation among VC firms from different cultures and also to the thinness of the Indian VC market.

A VC firm can invest in an entrepreneurial venture in seed stage, early stage, expansion stage or late stage. An investment in seed stage and early stage is riskier compared to an investment in expansion stage and late stage. The recent gap created due to a shift in focus of VC firms to entrepreneurial ventures in expansion stage and late-stage has been filled by Angels. We find entrepreneurial ventures funded by Angel syndicates have a better chance of raising a subsequent round of funding as compared to ventures funded by solo Angels. This advantage of cooperation among Angels is not limited to the investor, but also extends to investee firms. We find that ventures established by a group of founders (2 or more) have a higher chance of getting a subsequent round of funding as compared to ventures established by a solo founder.

In this dissertation, we try to establish that while connecting with other entities helps in diversifying financial risk, it is sharing and cooperating that makes one achieve success, both in the short-term as well as in the long-term. This success is particularly amplified when you make an extra effort to connect with reputed people with value-adding motive in mind rather than just sharing of financial risk.