# The Lower-Risk Startup: *How Venture Capitalists Increase the Odds of Startup Success*

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Our goal is to understand how venture capitalists (VCs) can systematically help startups increase their odds of success, beyond simply providing more capital. The primary levers of a VC to do this are team building, operational improvement, perspective and strategic guidance, skill building, customer development, analytics, and the VC firm network. We will discuss the range of philosophies we found among major VCs in their approaches. We find that certain operationally oriented VCs are hiring unusually large teams of operators and that the firms with this strategy typically have top-quartile returns (above 20% IRR in the relevant time periods). We then define a blueprint for how investors can assess their strengths in order to meaningfully help portfolio companies succeed.

We believe that developing and institutionalizing management techniques that enable better startup success rates will increase the availability of disruptive technology, while also increasing investor returns and entrepreneur success rates. Given the mediocre median returns of the VC industry (4.41% end-to-end pooled for the 10 years ended March 31, 2012, according to the Cambridge Associates U.S. Venture Capital Index) and the high failure rate of the typical entrepreneur, techniques to improve the odds of success are highly needed.

## METHODOLOGY

Our study draws on a wide range of research: in-depth interviews with more than 50 venture capital investors, entrepreneurs, startup incubators, and advisory service providers; a proprietary database and survey of VCs' portfolio value creation practices; a wide scan of academic and practitioner publications focused on the topics of entrepreneurship and venture investing; and the authors' personal experience working in venture capital, early-stage technology companies, and strategy consulting.[1]

We should emphasize a key caveat. For our study, we wanted to analyze whether the *Portfolio Operator strategy* led to higher returns. Sadly, this is virtually impossible to do rigorously, for several reasons:

- This strategy is relatively new, so insufficient data are available for the small number of funds pursuing this strategy.
- Returns data for VCs are difficult to obtain and difficult to compare with one another across inconsistent fund sizes, check sizes, and strategies.
- VCs with higher returns naturally have more cash, feel more self-confident, and therefore are more likely to invest the money needed for the expensive *Portfolio Operator strategy.*

We can only say with reasonable confidence that most of the funds with well-developed portfolio operator strategies have returns in the top quartile (above 20% IRR) for the time periods during which they have used that strategy. We obtained data on returns from Preqin, Fortune, and sources at funds of funds. Our thesis that greater participation correlates with higher returns is consistent with two other formal studies: "Returns of Angel Investors in Groups" (2007), by Robert Wiltbank and Warren Boeker, with funding and support from the Ewing Marion Kauffman Foundation, and "Prediction and Control Under Uncertainty: Outcomes in Angel Investing" (2009), by Robert Wiltbank, Stuart Read, Nicholas Dew, and Saras D. Sarasvathy. The studies were based on entirely distinct datasets. Both found that higher levels of angel participation in investments, as measured by number of hours per week interacting with a portfolio company, correlates with higher returns.

## WHO SHOULD BE INTERESTED IN THIS RESEARCH

*Venture capitalists.* With the increasing competition in the startup funding space, providing distinctive support to portfolio companies can be a strong competitive advantage for VCs in deal sourcing as well as for improving returns.

*Entrepreneurs.* Our findings help startups assess who the most value-added investors are. Furthermore, this study allows entrepreneurs to understand how they can extract more value from their current investors.

*Large corporations.* Almost every large company is or it should be thinking about new, disruptive businesses it can incubate and/or buy. Our findings provide insight on how to successfully gestate new businesses.

## WHY AND HOW VCs SHOULD BE ACTIVELY INVOLVED IN PORTFOLIO COMPANIES

The conventional school of thought is that investors generally should create value by selecting the "right" companies, business plans, and teams in which to invest. This article argues that in addition to that *selection function*, venture investors have a wider role to play—*the value-creation function*.

VCs can add more value to their portfolios through the following seven elements, the "TOPSCAN" framework:

- *Team building*: designing and recruiting for a startup's most important asset, its human capital base.
- *Operations*: enhancing administrative, accounting, legal, and technological capabilities.
- *Perspective*: strategy, competitive positioning, defining the target market, and scoping the product.
- *Skill building*: building the right skills, especially for senior management.
- *Customer development*: identifying and gaining access to the right customers.
- *Analysis*: how entrepreneurs measure, understand, and report the performance of their early-stage companies.
- *Network*: the cheapest and sometimes most value-added service that an investor can provide is access to his/her network, particularly to potential investors and acquirers.

A company's need for the TOPSCAN services is greatest in its earlier life. However, even among private equity funds that invest in late-stage, stable, established companies, we see some such funds building portfolio operations groups. These firms clearly believe that their portfolio companies benefit from a similar resource.

Venture capitalists are financiers of a special nature. They fund highly uncertain projects that usually operate within a very fast moving environment with constantly shifting technological paradigms. The teams they work with are entrepreneurs trying to engage in extensive product and customer development efforts for a product they don't typically have a full vision of, for a customer whose needs are opaque, and for a use case that is ambiguous. This is a very different world from traditional corporate lending or investing.

We believe that partially due to this unique context—quite distinct from that of other asset managers like private equity investors, hedge funds, and commercial banks—VCs can and should add tremendous value by supporting their portfolio companies more actively beyond writing them checks. Almost all VCs say that they respond to portfolio CEO requests and make introductions to people in their network when asked. We view that as the minimum level of appropriate support.

Our research shows that many leading VCs have invested significant resources in building out portfolio operational support, based on a fundamental belief that their companies are typically incomplete in multiple ways and will benefit by systematic support. It is relatively easy for most VCs to do this, as VCs typically enjoy a strong network and many have significant operational experience in their focus industries.

The Portfolio Operator strategy has potential to boost returns, as discussed previously. In addition, VCs (particularly those focused on internet investments) live in a social-media-enabled world where almost every investor has a very visible public resume on LinkedIn; many have a public blog; and blogs and rating sites such as TheFunded.com closely track their behavior. Social media footprints make it exceptionally easy for entrepreneurs to assess precisely how much value a potential investor can add, and reach out to those investors specifically.

## ANALYSIS OF CURRENT PRACTICES

We have identified three common categories of VCs in terms of attitude and practices towards investing and portfolio company support: Financiers, Mentors, and Portfolio Operators—ranked in order of increasing level of operational involvement.

Where each VC lands on the spectrum is the result of both the general partners' philosophy and the specific assets that the fund can leverage. For all VCs, the money they manage for their limited partners (LPs) is of course their most important asset. But on top of that, VCs leverage a wide array of assets to support their portfolio companies:

### VC Resources to Increase Portfolio Company Value

- *Cash*: A significant operational toolkit is expensive. Given the mediocre average returns of the VC industry, and the modest assets under management of VCs relative to the AUM of a typical private equity fund, many VCs simply cannot afford to invest meaningful dollars in a large portfolio acceleration infrastructure. Those who can have a significant advantage. See VC Profile 5 (Andreessen Horowitz).
- *Brand*: The fact that a company has been funded by a well-respected fund/partner alone can increase a company's odds of success, because that brand makes it easier for the company to attract talented employees and follow-on investors. By definition, startups have no brand at launch. See VC Profile 7 (First Round Capital).
- *Industry network*: One entrepreneur observed about one of the most prominent VCs in America, "[X]'s default response to all problems is to e-mail introduce you to 3–10 people in his network who can help." See VC Profiles 1 (NextView Ventures) and 3 for examples.
- *Funding network*: Later-stage VCs pay careful attention to who the earlier funders in a company are, using the reputations of the funders as a proxy for their own diligence. The next-best asset to a large pool of capital in-house is the ability to easily help raise more capital in later rounds from past syndicate partners. See VC Profiles 7 (First Round Capital) and 9 (ff Venture Capital).
- *In-house expertise*: VCs can provide consulting, accounting, or operational resources, both directly from their own staff and from preferred service providers. See VC Profile 9 (ff Venture Capital).

All of the resources listed here are synergistic, that is, more success creates more cash, which strengthens the brand, which increases the industry and VC network, which strengthens the in-house expertise. This is one of the key reasons that venture capital is one of the few asset classes in which past performance is consistently predictive of future results.

Finally, we have found that Financiers, Mentors, and Portfolio Operators also differ in their investment decision process. Because Financiers will have modest influence on the company after their investment, they are very dependent on the operational competence and industry insight of the management team they initially back. Portfolio Operators, on the other hand, can better accommodate weaknesses in the initial management team, for example, the absence of a strong lead in certain functional areas. Portfolio Operators know that they can train, modify, and/or expand the team as the company develops.

The following sections describe the three types of venture capitalists, their beliefs, characteristics, and examples of how they operate.

### Financiers—*"I'm a banker, not an operator."*

The Financiers are the most traditional group of VC investors; they view venture capitalists as "glorified commercial bankers." They see their LPs' financial capital as their most important asset and their activities focus on leveraging that asset in the most effective way. Financiers believe that the most value added by a VC comes from carefully scrutinizing early-stage companies, generating leads, conducting a thorough due-diligence process, and eventually investing the right amount of capital at the right valuation and structure. The relationship to their portfolio after making the investments primarily consists of monitoring.

Financiers take a more active role when the portfolio company is looking for a follow-on round of investment or when the company plans an exit. Financiers believe that optimizing the number of good deals per general partner is the key to success and that deep involvement after investing would not only potentially destroy value for the VC and its LPs but could even put value at risk for their portfolio companies. Ezra Roizen, investment banking partner at Ackrell Capital, has worked with a wide range of venture-backed companies and observes:

> Finding good teams and strategies in which to invest should be a VC's top priority—capital is their main asset and their two main skills should be finding and selecting good companies, and forming capital. I believe that is the essence of the VC value proposition. Once you deduct the time it takes to identify great companies, and the time it takes to raise funds, you really have very little time remaining to actually spend with specific investments. So I believe it's appropriate for their focus to be on deal flow and capital, with a sprinkle of sage advice on macro strategy decisions, follow-on financing, and M&A.

As a result, Financiers are more hesitant to invest in a team with clear weaknesses, as they do not have the infrastructure to address those weaknesses.

Of course, the Financiers are not completely detached from what is going on in their portfolio companies, but they tend to focus more on formal interaction. Examples include: VCs taking board seats, suggesting structures for board meetings, and providing monthly reporting templates.

The most perfect example of a Financier is Correlation Ventures, which some have called the "Moneyball" of venture capital. Even though the firm's two managing partners are both former startup entrepreneurs, Correlation Ventures never takes board seats and has only modest operational involvement. They gain access to investment opportunities by offering a very rapid investment decision (two weeks or less), with a very low hassle process, leveraging their large investment in predictive analytics. They have $165 million in assets under management.

**Case 1: How VCs can destroy value for their portfolio companies.** As stated previously, Financiers believe that the risks of destroying value in their portfolio companies through being closely involved outweigh the potential benefits. Throughout our research we have come across many examples in which VC involvement did not have a positive effect. Two, in particular, illustrate this point:

> "One of my portfolio companies had an exit opportunity, but one of the VC board members wanted a higher valuation. As a result the negotiations did not succeed and eventually the company was never sold. In his next venture, the same entrepreneur decided to sell too quickly, even though in hindsight he could have made a bigger return by waiting a bit longer. Apparently, his earlier experience had given him that bias."
>
> "Worst advice I ever gave: I was working with an open-source software company and had a pretty strong view on the industry at that time. As a seed investor, I loved their growth but after a few years my partners and I wanted to see revenue. The entrepreneur clearly opposed this view and wanted to grow further first before monetizing. I am glad he did not follow our advice, because in hindsight he was clearly right to approach it in this way." The company is now the overwhelming leader in its space.

## Mentors—*"I try to be the CEO's consigliere."*

By far the largest group of VCs can be classed as Mentors. Mentors believe their fund and personal assets can improve the performance of the ventures they invest in. The most important asset they bring to the table is their personal and professional network, which they leverage to strengthen portfolio companies. Throughout our research, we observed many examples of this: introductions to potential customers, suppliers, partners, and executive-level employees.

What distinguishes the Mentors from the Portfolio Operators, however, is that they deliberately choose not to institutionalize the support they give to their portfolio companies. Support is almost always initiated by the entrepreneur and does not involve preset systems or processes. As one Mentor said, "My entrepreneurs have my cell and email address—and I always answer them." As a result, Mentors assessing a new investment need to be comfortable that their input will be heard by the companies—that the CEO is coachable.

In the past few years, there has been a surge of small, solo-GP funds, typically with under $40 million in assets (e.g., Baseline Ventures, Coastano VC, Cowboy Ventures, Harrison Metal, K9 Ventures, and PivotNorth). Although in many cases these solo GPs have strong operational track records, they typically have only very limited resources to engage substantively with their portfolio, and so would normally be classified as Financiers or Mentors.

**Case 2: Convincing a top recruit.** A promising investment had been making great progress after raising its seed round and was almost ready to launch its product. It needed an experienced digital marketing executive on its board prior to launch, and after interviewing several people, it had found the ideal candidate. Unfortunately, the candidate himself was reluctant to make the switch from a secure job at a media company to a startup. However, a meeting with one of the VC's partners—a successful and well-respected entrepreneur in the digital marketing space—helped to convince him to join the company.

**Case 3: Founder mentoring.** Iker Marcaide is the founder and CEO of peerTransfer, a service that makes it easier and cheaper for international students to make their educational payments in the U.S. He founded the company in 2009, and has raised a $1.1 million seed round and a $7.5 million series A. His leading VC investor is Spark Capital, which led both rounds and brought Accel Partners and Mevron on board for the series A. Iker described his relationship with Spark as,

> ... basically a mentoring relationship with one of their general partners. We talk often and I go to him whenever I have questions. What is most important for me is that I trust him. I am a first-time founder and I profit from the experience and expertise they bring to the table. They help me finding the right service providers (accountants, lawyers, etc.) and leverage their network when I am recruiting people for sales or business development positions, which is their field of expertise.

**Case 4: Leveraging a network.** In this case, the VC's network saved the company:

> Almost two years ago we had a portfolio company that was creating Facebook applications. It was doing great—showing fast growth and on its way to further financing—but also highly dependent on Facebook. One day I got a panic call from them: Facebook had turned them off and they were not able to reach anyone at the Facebook Policy Team. They estimated that they had a week before customer turnover would become so big that they would be done. Luckily, I had worked successfully [in the past] with one of the leaders of the Facebook team, called his house, and managed to get them back on within two days.

**VC Profile 1: NextView Ventures, Rob Go.** NextView Ventures is a seed-stage VC firm focused on internet-enabled businesses, both consumer facing and B2B, based in Boston, Massachusetts. NextView has three Partners with $21 million in assets under management.

> An example of what we believe is a valuable support to our portfolio companies is around the next rounds of funding. We are intensely involved in this process and actively maintain a database of individual partners in many VC firms and relevant information about them, like personal life, character, usual negotiation tactics, deals they are involved in, and so on. As a seed investor we believe that we should not overload our startups with lots of reporting formats, and so on.

**VC Profile 2: Resolute.vc, Mike Hirshland.** Resolute.vc is a seed-stage venture capital firm managed by founder Mike Hirshland. It operates in the San Francisco, New York, and Boston markets.

> First of all: do no harm and let the entrepreneur run the company. There are a lot of VCs out there that feel a need to demonstrate value and get involved in the day-to-day business of their portfolio companies. I have the blessing of never having been an operator, so I'm not trying to grab the wheel and drive. I once invested in a company where every VC brought its own advisors and experts (in recruiting, marketing, technology,

and so on) to the table. A great idea in theory, but when all give different advice it becomes a very confusing situation for the founder.

**VC Profile 3: West Coast early-stage fund.** This early-stage venture capital firm manages funds of $70 million and is an example of a Mentor. The firm supports its 60+ portfolio companies on an ad-hoc basis. In monthly mentoring conversations with the companies' founders, the managing partner and associate (who have operational/entrepreneurial backgrounds) discuss opportunities and potential ways for them to leverage their networks. Whenever requested by the entrepreneur, the partners leverage their network of advisors to support portfolio companies with specific challenges, which mainly revolve around marketing and go-to-market strategies.

### Portfolio Operators—*"We have a structured, standard process for adding value."*

Portfolio Operators agree with Mentors that their unique personal and fund assets can be used to develop their portfolio companies, but unlike the Mentors, they do this in an institutionalized and structured way. Whereas Mentors tend to be reactive in their support, Portfolio Operators proactively look for ways to improve the performance of their investments through systems and processes. We know of numerous instances in which companies took lower valuations to win Portfolio Operator VCs as investors versus other categories of VCs, because the entrepreneurs so valued the resources a Portfolio Operator could bring to bear. In other cases, entrepreneurs have offered board options or other sweeteners to highly attractive Portfolio Operator VCs.

The most common service Portfolio Operators offer their portfolio companies is recruiting assistance. Most of the VCs in this category not only provide personal references to interesting candidates, but also use their own websites as job boards for portfolio companies. First Round Capital takes this a step further by running a program in which it recruits MBAs for internships and full-time positions with its portfolio companies. This illustrates a common approach to the Portfolio Operators category: assessing the VC's most valuable assets and designing a structure to leverage those assets. First Round can leverage its brand and 155+ company network to provide MBA students with an attractive double offer: work at a vetted startup and gain exposure to a prominent VC.

We find that Portfolio Operator VCs are building teams of employees that are unusually large for the VC industry and include many people with strong operational backgrounds. These larger teams tend to be accompanied by a transition toward pyramidal organization, which is increasingly becoming the norm in Portfolio Operator funds. As Harvard Business School professor Noam Wasserman discusses,[2] VCs have long been structured as "upside-down pyramids" in which GPs outnumber more junior employees. This phenomenon is attributable to the fact that VCs are "knowledge-intensive firms in which esoteric expertise predominates over standard knowledge." The need to exchange rich information in the course of pre-investment activities (e.g., due diligence) serves as a disincentive to expand the firm beyond a certain size or adopt formal, pyramidal structures (which are, to a certain extent, an emergent property of large and/or complex organizations, in which workers become specialized and need to structure their interactions more). Although late-stage VCs have the luxury of concrete quantitative data, early-stage VCs rely on more tentative information for which analysis cannot be easily delegated.

Post-investment activities, such as operational support for portfolio companies, however, can be delegated and benefit from economies of scale. Pyramidal structures are the most efficient means of systematizing and delivering this support due to the benefits of leverage, delegation, and specialization.

We think that three trends are accelerating the transition to pyramidal models and operational focus. First, the cost of starting a company has come down dramatically and, as a result, young entrepreneurs with modest capital and only angel/Series-A investors can find themselves leading significant businesses beyond their management capacity. Second, the rate at which startups can scale has increased dramatically, so the judicious application of VC resources can have an exponential impact. Third and finally, we have moved to a more transparent world in which both VCs and entrepreneurs are easier to examine with due diligence. This puts pressure on VCs to differentiate themselves substantively. The pyramidal model ultimately won out in other, more mature knowledge-intensive industries, such as law and investment banking, and the same may occur in venture capital.

**VC Profile 4: General Catalyst Partners, Chris Farmer.** General Catalyst Partners is a venture capital firm based in Cambridge, Massachusetts, that focuses on early-stage and growth equity investments. General Catalyst has 11 partners with approximately $2.2 billion in assets under management. It currently has 33 full-time employees (including partners, EIRs, and venture partners) and invests out of its sixth fund of $500 million. Chris Farmer is a venture partner at General Catalyst and co-founder of Ignition Talent, a talent acquisition and advisory firm. His views underline many of the beliefs Portfolio Operators hold: "We have systematically built 'ecosystems' for our portfolio companies to add value to them, e.g., our Corporate Partner Days, CIO Forums, related non-profits and service support, e.g., recruiting, events, real estate, analytics, and so on."

Most—if not all—of General Catalyst's investment partners come from strong operating backgrounds. For example, one partner took four companies public before joining General Catalyst. Furthermore, it has a very active entrepreneur-in-residence program. Over 35 companies have started in its offices, for example, Kayak, Demandware, and Brightcove.

Farmer adds, "The entrepreneurs seek us out (or we convince them to join us) because of our deep experience building businesses and because of the leverage that the platform offers them. But the entrepreneurs deserve the credit, and we simply hope to systematically multiply their energy and break down walls for them."

**VC Profile 5: Andreessen Horowitz.** Perhaps the most prominent example of a Portfolio Operator VC is Andreessen Horowitz ("A16Z"), a Menlo Park–based fund that has raised $2.7 billion since it was founded in 2009 and has made investments in Airbnb, Facebook, Skype, Twitter, Instagram, and many other highly successful startups. It gives its portfolio companies structured support through one of its four operational support teams, focused on executive recruiting, marketing/PR, technology, and business development. The fund has six Partners and employs more than 40 operational staff, helping portfolio companies with preparing negotiations, making client introductions, and providing preferred suppliers.

A16Z partners have been very public about their strategy to model the firm after Hollywood's Creative Artist Agency (CAA). A16Z tracks the elite engineers in Silicon Valley (and to a lesser extent elsewhere), identifying who is looking to build a company and who is looking for a new role. Just as CAA offered a full suite of services to its actors, A16Z wants to make it as easy as possible for its entrepreneurs to focus on their core job of building great companies.

**VC Profile 6: Extreme Venture Partners, Ray Sharma.** Extreme Venture Partners (EVP) is a Toronto-based early-stage VC comprising five partners. From its website:

- We recognize that sometimes all that is needed to propel a good idea into greatness is a small amount of funding and support from a seasoned team of technology and business alumnus.
- Whether you are pre-revenue or expanding, we want to be involved as early as we can so we can provide the most support and impact possible.

The general partners of EVP are also the cofounders of Xtreme Labs, one of the leading mobile platform developers in Canada, employing almost 150 full-time mobile and tablet application developers. EVP portfolio companies get preferred access to Xtreme Labs at a discounted rate. These related companies now employ more than 1,000 people, mostly focused on mobile app development. Ray Sharma (chairman Xtreme Labs, founding partner EVP, CEO of XMG Studio Inc.) takes pride in the amount of jobs the group has created even more than in the successful exits.

**VC Profile 7: First Round Capital, Howard Morgan.** First Round Capital is a VC based in New York, San Francisco, and Philadelphia, investing from its fourth fund of $135 million. Current high-profile investments include Square, Mint.com, and Fab.com. FRC has seven partners with more than $400 million in assets under management and 22 full-time employees. FRC has a wide range of initiatives to support portfolio companies. For example, it organizes yearly CEO, CFO, and CTO summits in which executives of all portfolio companies in certain roles come together, as well as a related online community. Because of the internal, closed nature of the platform, it has become a trusted source for advice (e.g., "Our finances are out of control and we need a CFO yesterday; what should we do?"). It offers the portfolio free access to a "venture concierge," a lightweight consulting and research service that helps its entrepreneurs save time on research-related tasks.

**VC Profile 8: Google Ventures.** Google Ventures has over 115 portfolio companies, makes 60–80 investments a year, and is investing north of $100 million per year. It leverages both Google's vast resources and a dedicated 54-person team, including 10 partners. One partner, Joe

Kraus, observed, "We believe helping companies plays more of a role than most people give it credit for."[3]

**VC Profile 9: ff Venture Capital, John Frankel.** ff Venture Capital (ff VC) is a New York–based seed-stage VC. Founded in 1999, ff VC has made more than 160 investments in over 60 companies, including 500px, Cornerstone OnDemand, Klout, Quigo, and Voxy. As of October 2011, the firm had $38 million in assets under management and 12 employees (including three partners), which is probably the highest ratio of employees to assets under management of any asset management firm in the U.S.

In an interview, John Frankel, Partner, highlighted the firm's institutionalized services and processes:

> We are strong believers in continuous process improvement. We have invested extensive effort in identifying best practices for the disciplines necessary to grow a startup, e.g., product development, sales, marketing, and fundraising. For each function, we share as needed template plans, sample spreadsheets, and sanitized best practices across the portfolio. We have also partnered with over 50 (and growing) service providers specializing in the startup community, who provide discounted services to our portfolio.
>
> ff VC has a dedicated finance and accounting team which provides outsourced CFO, accounting, and related services to over a dozen portfolio companies at cost. We particularly focus on helping our portfolio companies in raising later rounds, preferably from Portfolio Operator VCs like us, whom we know will add value.
>
> We work hard to build a vibrant entrepreneur community through regular events and an online community. This includes close relationships with leading universities, which the companies can tap for future employees and research. We also help the companies tap our proprietary database of talent in transition: high quality people who have told us they're looking for great opportunities with pre-vetted startups.

**International startups.** Startups in places where the entrepreneurship ecosystem is not as developed as the U.S. require more attention from investors. Fabrice Grinda is the founder and CEO of Olx.com and a serial angel investor. Grinda has founded several companies prior to Olx, and his investments span the U.S., Europe Brazil, Russia, and Turkey. He has backed more than 100 startups so far (predominantly early-stage investments). Grinda emphasized that outside the U.S., he typically looks for CEOs who are already seasoned managers, more so than in the average U.S. startup: "We invest in more experienced teams in emerging markets because these are markets that require a lot of workarounds and where the ecosystem is not as developed. We often back former consultants and B-school grads."

Omar Koudsi is the founder of Jeeran.com, a Jordanian VC–backed startup. Koudsi highlights the need for more-involved VCs in regions like the one his company operates in. He firmly believes that seasoned VCs can add a lot not just in building the ecosystem, but also in developing the entrepreneurs themselves and guiding them on strategic matters: "Most investors in the region are in the high net worth individual mode and not yet in professional VC mode. The market is slowly changing, and I believe professional VCs will add tremendous value to an up and coming region in the tech world like ours."

## GUIDE TO CHOOSING YOUR VC STRATEGY

How can VCs decide which role of the three (Financier, Mentor, or Portfolio Operator) they should choose? A company should determine its strategy based on both the assets it has and those it can acquire. Some VCs have a culture and team that only fits one of the models we have discussed. However, when evaluating intangible aspects of one's competitive strengths, it is easy to overestimate one's abilities. Therefore, VCs would benefit from a methodology to assess and evaluate rigorously the assets they can leverage, as well as the most efficient way for them to build on those assets.

We start by defining a method of objective measurement for a VC's assets and evaluating the VC's various resources:

- Evaluating cash resources
- Evaluating brand resources
- Evaluating network resources
- Evaluating in-house resources

These are detailed in Exhibits 1–4.

# Exhibit 1
**Evaluating Cash Resources**

| How to evaluate | |
|---|---|
| Cash is relatively easy to objectively evaluate: the absolute amount of funds available for overhead. Alex Katz, CFO and Partner, ff Venture Capital, observed that ff VC's management fee on $38 million of capital under management doesn't cover its infrastructure of a dozen staff; only the past strong performance of the firm and a commitment by the Partners to reinvest in such costs makes its extensive infrastructure possible. | |
| **Focus if cash resources are strong** | **Focus if cash resources are not strong** |
| • Select the support services (HR, legal, administrative, and so on) that could create the most value for companies through time saving and flexibility, out of the "TOPSCAN" menu. | • Focus on making targeted introductions, which is typically the cheapest way to meaningfully assist portfolio companies. |

## FURTHER AREAS FOR POTENTIAL INVESTIGATION

A logical follow-up to our research would be a rigorous, quantitative, statistical analysis about the connection between the assets a VC firm possesses, the role the GPs assume, and the performance of the fund the firm manages. Our initial findings, based on a limited set of survey responses, seem to indicate that there is a measurable positive relationship among the three factors. While

# Exhibit 2
**Evaluating Brand Resources**

| How to evaluate | |
|---|---|
| Media footprint assessment:<br>1. Count the number of articles, TV interviews, events, etc., that mention the fund.<br>2. Split these mentions into two groups: mentions that were initiated by a third party (not the VC or the portfolio company) and those that are the result of self-marketing.<br>3. Weigh the mentions that are initiated externally at least three times as high as the internally initiated ones.<br>4. Compare mention totals, weighted by recency, to market leaders (funds with the greatest exposure and respect, e.g., Union Square Ventures, Andreessen Horowitz).<br>5. If score is 25% or less than leaders, you likely have room to improve.<br><br>There are also other ways to assess brand strength—for example, analyzing how often potential investments come to the VC based on strength of reputation. More crudely, you could look at your firm's Klout score, or ranking in the various media that cover the VC industry. | |
| **Focus if brand is strong** | **Focus if brand is not strong** |
| • "Don't be evil"; don't damage the firm's reputation.<br>• Leverage brand equity in marketing and access to talent. Make sure that all portfolio companies leverage the firm's brand equity, e.g., mention you on their website. | • Constantly and consciously build own brand image by investing in great companies and ensuring they spread a positive reputation about you. Keep in mind the Yiddish proverb, "The charity cup with the fewest coins rattles the loudest." Be wary of overinvesting in media before you have the accomplishments to support that visibility.<br>• Introduce your companies to your existing press relationships. |

## EXHIBIT 3
### Evaluating Network Resources

| How to evaluate | |
|---|---|
| Quantitatively assess the impact of introductions that the GPs make between portfolio companies and members of their personal network. The dimension of the assessment can primarily be time-savings or cost-savings (marketing costs, search costs, and so on). You could do this by surveying the portfolio companies to understand the value they have received.<br><br>When evaluating the network of your firm's partners, segment the network and figure out what type of connections each partner contributes to the firm. Networks should be strong in terms of individual connections, but also diverse. For more on this topic see David Teten's *The Virtual Handshake: Opening Doors and Closing Deals Online* (TheVirtualHandshake.com).<br><br>Do not fall into the trap of evaluating network strength based on fame, friendship, or other personal, intangible factors. Try to stick to objective, quantitative evaluation. | |
| **Focus if network is strong** | **Focus if network is not strong** |
| • Survey portfolio companies to understand what sort of introductions they are seeking.<br>• Invest in a CRM system.<br>• Possibly formalize the relationship to ensure that best relationships remained engaged. For example, an attorney might have a standing offer of a one-hour meeting free of charge for each new portfolio company. | • Do not try to overstretch the personal networks of the GPs; rely on external partners and service providers and encourage them to make introductions on behalf of your portfolio.<br>• Consider offering regular "office hours." |

## EXHIBIT 4
### Evaluating In-House Resources

| How to evaluate | |
|---|---|
| This is the trickiest asset to evaluate. Most GPs have a respectable track record prior to joining the VC industry; otherwise they would not have been able to enter the industry. However, it is not always the most efficient use of time to utilize this expertise for portfolio companies. For example, if a partner has a strong investment banking background, it does not necessarily mean that she should be deeply involved with all the M&A deals of the portfolio companies.<br><br>Usually the best way to leverage in-house expertise is through informal sessions with portfolio company teams, where questions can be discussed, and GPs can give guidance and help track performance in the given field. A number of interviewees commented that other CEOs are always a better source of insight than the GPs, and that online CEO communities and networking with other CEOs were highly valuable. | |
| **Focus if in-house expertise is strong** | **Focus if in-house expertise is not strong** |
| • Monitor that you are using your resources judiciously; the amount you can spend on any one company is theoretically unlimited.<br>• Publicize your open-door policy to the portfolio. | • Establish relationships with outside consultants/service providers who can provide the expertise you lack in-house.<br>• Foster technology-enabled knowledge sharing (preferably in a structured way, i.e., internal events, knowledge database, and so on). |

these initial results confirm our findings quantitatively, a more extensive dataset would be needed to achieve statistical significance. We designed a questionnaire (see Appendices A and B) to measure the connections among the three factors.

## CONCLUSION

The venture capital industry fulfills a crucial role in our financial system. VCs could have even more impact if they could improve their success rate. The crucial factor in achieving higher efficiency is to understand your assets and choose a strategy that leverages your strengths and mitigates your weaknesses. Those VCs who are honest in their introspection and act accordingly are far more likely to be effective stewards of investor capital.

# APPENDIX A

## SURVEY OF VCs

1. In what year was your firm established?
2. In what year did you raise your last fund?
3. How much is your firm's total assets under management (AUM)—defined as the amount of capital invested, but not liquid, plus capital raised but not yet invested? (in million $)
4. How much money has your firm raised overall during its lifetime? (in million $)
5. How many general partners (GPs) are at your firm?
6. How many portfolio companies does your firm have currently?
7. What is your typical investment size? (please indicate your answer in $)

In the following questions we try to understand the performance of your firm. In our study, we will link this data to aspects about operational support and thus will try to draw insights about the relationship between the two factors.

For standardization purposes, we'd like to focus our analysis on one fund in your portfolio, the "Most Recent Fund Near Liquidity."We define this as the most recent fund that was raised prior to 2005.

8. What is the vintage year of your most recent fund raised prior to 2005?
9. What is the overall IRR of your firm for Most Recent Fund Near Liquidity? (in %)
10. What is the current money multiple of your Most Recent Fund Near Liquidity? (a number, not a range)
11. How many investments have you made from the Most Recent Fund Near Liquidity and what has happened to these investments?
    - Investments made from this fund
    - Exits with a money multiple of 3.0+
    - Exits with a money multiple between 1.0 and 3.0
    - Exits with a multiple below 1.0
12. For your Most Recent Fund Near Liquidity, on how many companies does one of your employees have a board seat?

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In this block we try to understand your and your firm's approach to supporting portfolio companies beyond simply providing capital.

13. What is your portfolio management philosophy?
14. On a scale of 1–6, an investor should...

1: Focus only on picking the best teams and should not interfere with any operational issue at all
6: Provide hands-on support to the portfolio companies in a very structured and institutionalized way

In this question, we would like to understand what you believe the order of importance is for various shared services an investor could provide to his or her portfolio companies.

15. Please indicate how important it is for a VC to provide the various types of support to the portfolio companies on a scale of 1–6:
    - Administrative help i.e., secretarial support (to portfolio companies)
    - Accounting support
    - Recruiting support
    - HR support (excluding recruiting)
    - Marketing/PR related support
    - Design support (graphic, UX, UI)
    - Management Coaching Services
    - Investment banking services (formally running a capital-raising and/or M&A process, not just ad-hoc introductions)
    - Referral to preferred services providers
    - Exclusive events for portfolio companies
    - Online community for portfolio company executives
    - Other ______________________
16. What do you believe are the capabilities/assets your fund possesses that your portfolio companies could most benefit from? (please rank)

1. ______________________________
2. ______________________________
3. ______________________________

Comments ______________________

In this question, we would like to understand the mix of services that your firm provides "beyond the money."

Please indicate the level of service your firm provides to the portfolio companies in each category.

0: No help at all, entrepreneur should handle it
1–3: GPs leverage their network, but no structured processes exist
4–6: GPs use tools to measure the need for and the effect of their help and provide it accordingly
7–9: There is a team of free lancer professionals at the disposal of portfolio companies
10: There is a full-time in-house team at the disposal of the portfolio companies

- Administrative help i.e., secretarial support (to portfolio companies)
- Accounting support
- Recruiting support
- HR support (excluding recruiting)
- Marketing / PR support
- Design support (graphic, UI, UX)
- Management coaching services
- Investment banking services (formally running a capital-raising and/or M&A process, not just ad-hoc introductions)
- Referral to preferred service providers
- Exclusive events for portfolio companies
- Online community for portfolio company executives
- Other

In this question, we try to understand the magnitude of your firm's commitment in the various support types.

How many dedicated professionals does your firm employ in the various support functions, and in what year have you established the given support groups?

Please provide your response in FTE (full time employee) equivalent. If someone works part time, count him or her as a fraction of 1.

- Administrative help, i.e., secretarial support (to portfolio companies)
- Accounting support
- Recruiting support
- HR support (excluding recruiting)
- Marketing / PR support
- Design support (graphic, UI, UX)
- Management coaching services
- Investment banking services (formally running a capital-raising and/or M&A process, not just ad-hoc introductions)
- Referral to preferred service providers
- Exclusive events for portfolio companies
- Online community for portfolio company executives
- Other ______________________________

17. What question did we miss in this survey that we should have asked? ______________________
18. What advice do you have for other VCs who would like to increase the value of their portfolio companies? Please tell us if we can quote you by name for your response to this specific question. ______________

Thank you for dedicating the time and effort to filling out our survey! We strongly believe that the insights drawn from this study will benefit not only the venture community, but the U.S. economy as a whole.

We will handle your data with the highest degree of privacy. All results will be anonymized, and the majority of the analysis results will be based on aggregated measures.

What is the name of your fund? (Optional—results will be anonymized and aggregated) ______________________

## APPENDIX B

### SURVEY OF ENTREPRENEURS

1. In what year did your startup become live? What year did your CEO/Founders start working full time?
2. In what year did you receive your first round of non-founder capital i.e., the first round of capital raised from outside investors (could be VCs, Angels, F&F)?
3. What was the post-money total company valuation of this first round? (please indicate your answer in million $)
4. How many employees did you have upon raising this first round of funding?
5. How much of your (company leadership) is spent on non-customer and non-product activities? Includes legal, office admin, accounting, other vendor/supplier search, setting up office IT, and payroll/HR issues (ex. recruiting)

   - _ Very Little (<10%)
   - _ Significant time (10% – 30%)
   - _ A lot of time (30% – 50%)
   - _ It is killing me (>50%)

6. Please tell us how your investors (VCs or Angels) have given you support on the following dimensions—check all that apply of the following: 1) structured & consistent support through dedicated personnel, 2) list of preferred vendors who provided me with support, 3) ad-hoc advice (upon need), 4) none

   - Recruiting
   - Admin
   - Legal
   - Operations
   - Marketing / Customer Development
   - Procurement
   - Accounting
   - Other ___________________________________

7. Please tell us how helpful it would be to you to have advice and structured support from experienced VCs in the areas below—check one of the following:

   1) Extremely important (They have access to resources I could not readily access myself),
   2) Important (Their involvement will save me a lot of time),
   3) Neutral (I can do it but it's nice to have),
   4) Unimportant (Don't really need it)

   - Recruiting
   - Admin
   - Legal
   - Operations
   - Marketing/Customer Development
   - Procurement
   - Accounting
   - Other ___________________________________

8. What was the latest post-money valuation on your company? (please indicate your answer in million $)
9. What is your current number of employees?
10. What question did we miss in this survey that we should have asked?

Thank you for dedicating the time and effort to fill out our survey! We strongly believe that the insights drawn from this study will benefit not only the venture community but the US economy as a whole.

We will handle your data with the highest degree of privacy. All results will be anonymized and the majority of the analysis results will be based on aggregated measures.

What is the name of your company? (Optional - results will be anonymized and aggregated)

In case you wish you wish to receive the aggregated results from this survey, please leave your email address below

___________________________

## ENDNOTES

[1]Our research originated as an MBA student research study by Adham AbdelFattah, Koen Bremer, and Gyorgy Buslig, closely advised by David Teten, and sponsored and supported by Professor Morten Sorensen, Columbia Business School Daniel W. Stanton Associate Professor of Finance and Economics.

[2]N. Wasserman. "Upside-Down Venture Capitalists and the Transition toward Pyramidal Firms: Inevitable Progression, or Failed Experiment?" In *Entrepreneurship (Research in the Sociology of Work*, edited by L.A. Keister, Vol. 15. Emerald Group Publishing, 2005.

[3]See http://venturebeat.com/2012/08/13/google-ventures-startup-lab/view-all/.

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