Executive forum: we know the saviour ... and it is them: the future face(s) of venture capital

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Executive forum: we know the saviour … and it is them: the future face(s) of venture capital

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ABSTRACT

Venture capital has rebounded thanks to a handful of select venture capitalists. The venture capitalists leading this renaissance are returning to the venture capital model in its most traditional form as a real partner to start-ups, as a risk-taker and most importantly as an innovator and disruptor at the fund level. Less than stellar venture capitalists can only hope to replicate these innovative ways in a rapidly changing landscape where they will be forced to adapt or risk being exposed and shepherded out of the ecosystem. The age of easy fundraising has come and gone and with it goes the ability for poor venture capital funds to lurk in the background and ride the coattails of their more innovative counterparts to easy payouts. When taken in conjunction, visibility, disruptive leanings and hyperactivity are game changers, especially for the fittest venture capitalists. These innovators are doing something about the industry’s tarnished reputation. Investors, entrepreneurs and the “other venture capitalists” should take notice. This executive Forum paper introduces them and develops an understanding of what they do and how they do it.

Introduction

We deal with start-ups on a daily basis. Whether it’s with founders, venture capitalists or municipalities looking to breed innovation in their own backyard, one thing is clear: things are changing in the start-up world and with it the role of a venture capitalist. Despite a recent renaissance of sorts, qualms pertaining to venture capital have been inundating from all corners of the start-up ecosystem for over most of the past decade, ramping up concern that the venture capital model is broken, which indeed it largely was. However, the tide is turning thanks to those who we see as the great venture capitalists out there. But before we get into the specifics of who they are and more importantly what they do to differentiate themselves, it’s important to note how we got to such dire straits that necessitated such a dramatic overhaul in what is expected of a venture capitalist to thrive nowadays.

The Kauffman report\textsuperscript{1} most notably aired the dirty laundry of venture capital and its abysmal returns for the decade preceding its publication in 2012. An astounding 62% of funds...
failed to exceed market returns after factoring in the risks, the variety of fees and carried interest paid out to general partners. Moreover, only 20% of venture capital funds produced returns that beat the capital markets by more than 3% on an annual basis according to the report.²

Many of the venture capitalists we interacted with during this period were quick to recognise that the industry has seen better days as an investment class as well. In the wake of the financial crisis, a handful of notable venture capitalists started painting a gloomier picture, proclaiming that it is simply not a profitable asset class, given the declining availability of profitable exits (particularly by way of IPOs).³ Competition has been especially fierce in the light of Matt McCall’s research that indicates that of the $30 billion invested into the venture capital space on an annual basis during the economic downturn, only $10 billion were capable of positive returns.⁴ Vinod Khosla has gone as far as to say that 70–80% of venture capitalists add negative value to their portfolio companies.⁵ It does not end there.

A recent survey done by VentureBeat shows that entrepreneurs are not impressed with their experience with their investors as well. Results of the survey indicate that the average investors are uninvolved, difficult to work with and fall prey to standardisation by employing antiquated “business as usual” tactics. The latter is especially worrisome, as “business as usual” has traditionally paved the way to chronically misaligned incentives. Our experience with the types of terms founders is receiving from some investors show that too many entrepreneurs get off on the wrong foot with venture capitalists. Some promising start-ups even go so far as to ruin their cap table thereby killing any opportunity to secure follow-on investment thanks to dealing with a short-sighted investor. We’re not surprised that many are left disappointed after being duped by some VCs. In short, the message was clear: venture capitalists could do much more to support start-up companies, let alone how they engage with one another.⁶

However, these statements of discontent coming from all over the ecosystem are more of an effect as opposed to the cause of the problem. The reality is that venture capital largely became en vogue during the 90s. As is the case with any industry that is booming, non-specialists wanted to get a piece of the growing pie and started investing in start-ups while masquerading as venture capitalists without doing their proper homework. The number of firms dedicated to investing in start-ups grew tremendously during this period. naturally, the market was flooded with some less than stellar firms staffed by inexperienced executives.

Anyone with sufficient capital can technically raise funds with an investment focus geared towards early stage companies, but it’s another thing to understand how to be a real value adding investor especially to a first-time founder looking to navigate the business world. At the end of the day, the best venture capitalists are precisely the types of investors that are real partners to their portfolio’s founders. That means being available 24/7 and certainly not worrying about putting together overly complex terms in a term sheet by focusing on the minutiae thereby driving up legal fees for which the start-up founders will ultimately have to pocket. Instead, they understand that the bulk of their returns come from the best outcomes. Most importantly, they understand that when the founders win, they win.

The Kauffman report proclaimed that they had met the enemy of the industry by holding up a mirror to its own role in facilitating the downfall in venture capital as a limited partner by pumping capital into a system wrought with underperformers. We, however, know the saviours of this asset class and they are none other than the venture capitalists themselves. These select venture capitalists are innovating at the fund level, essentially returning to the drawing board to identify mechanisms in hopes of rebranding venture capital while
securing a greater proportion of the profitable exits that venture capital experiences in a given year. The notion of innovation at the fund level has perhaps yet to catch the eye of the mainstream, but the ripples of creativity are already making a substantial impact and paying large dividends to those involved.

So how can entrepreneurs and prospective investors in venture capital funds identify the innovative firms that are more attuned to their interests? Or which VCs can a VC looking to rebrand itself model itself after? The opacity of the venture capital industry makes this selection of firms awfully troublesome for outsiders and nearly impossible, even with the proliferation of better hand-collected global databases on the market such as Dow Jones VentureSource, PitchBook, PWC MoneyTree, Global Corporate Venturing and CrunchBase. Aggregators and predictive algorithms such as CB Insights’ Investor Mosaic and Mattermark’s Benchmarking Report have contributed to improving the selection process for investors a great deal as well.

However, whether it is the lack of data, the even greater scarcity of quality data, or rampant levels of selective disclosure employed by firms, the ability to compile information at a sufficient volume to be representative continues to be an arduous task. If we were to take venture capitalists at their word, for example, 67% of funds would post returns above average. It doesn’t help that confidentiality requirements in limited partnership agreements force funds to secrecy with only the occasional convenient leakage of PR on successful exits, effectively leading to a skew in the venture capitalists’ favour in the public perception and the eventual publication of Kauffman-esque reports.

As is the case with anyone else with a vested interest in the start-up ecosystem, finding the right piece of information can be difficult. Although information out there may be spread across a variety of resources, an aggregate view of what these resources provide is quite impressive. Piecing together what’s missing from one source with what’s available in another can really open up a comprehensive view of the industry. After having done so ourselves, we like to pay attention to indicators that are forward looking and somewhat indicative of future performance. More than anything and aside from the obvious, we like to focus on the intangibles as venture capital is undoubtedly a people business at the end of the day. It’s no secret that the key for a fund to perform is less to do with finding great opportunities, but more so to do with getting access to these opportunities. Andrew Parker of Spark Capital summed things up perfectly: “knowing that this handful of companies would become interesting in 2010 is not what makes a great VC. It’s convincing the entrepreneurs in all these companies to partner with you on their journey; that’s the battle.” A similar logic follows when it comes to finding the right hires for your portfolio, finding the right syndicates and so on across the business – in short, intangibles matter.

We far too often witness venture capitalists asking for the moon, entrepreneurs getting into bed with the wrong investors and municipalities looking to attract the wrong venture capitalists to spark innovation in their community. We want to share some mechanisms we like to use to differentiate the innovative venture capital firms from the rest to help entrepreneurs, investors, government agencies, venture capitalists and researchers. What we see is that more than anything, innovation can no longer be something that only occurs within a portfolio of start-ups. Innovation at the fund level is crucial for the success of all parties in the ecosystem.

This type of innovation can rear its head in a variety of ways, but we have loosely grouped it into three key indicators, each of which are common amongst these innovative venture
capital firms – visibility, hyperactivity (in angel investments) and disruptive leanings. To the casual bystander, blogging, tweeting, angel investments and forgoing some investor-favourable terms may seem rather trivial and even perhaps unpractical for an investor to do. But in reality, these types of intangibles are much to do with how these venture capitalists are precisely differentiating themselves. These types of indicators, which are more qualitative in nature get too easily discounted because they are hard to measure. However, data pooling and number crunching can go a long way in showing how these sorts of intangibles can continue to transform the ecosystem for the better.

**Setting the table: not discounting those hard to measure intangibles**

Not having the luxury of access to internal rates of return or entry and exit multiples for all the venture capital firms out there, we like to use a number of proxies as indicators of performance. As we all know, past performance is not always indicative of future success.\(^{11}\) We like to use a form of analysis that is forward looking and complements some of the more historical measures we look at. For example, Chris Farmer’s InvestorRank, introduced in 2011, essentially focuses on the connections between venture capital firms. Connectivity is undoubtedly an important component in any venture capitalist’s work, from syndication, deal sourcing, fundraising, and connecting entrepreneurs to the right people for hires, partnerships, exits. Instead of recreating the wheel here, we put together some proxies that would complement Farmer’s work. Our proxies for future fund performance hinge around three additional characteristics that we find to be important from our experience, which are a venture capitalist’s risk appetite, ability to source as well as lead deals (“leadership”) and finally its exit performance (see Table 1).

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**Table 1. Indicators of performance of venture capitalists.**

<table>
<thead>
<tr>
<th>Risk appetite</th>
<th>Leadership</th>
<th>Exit performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>We are alluding to a particular venture capitalist’s emphasis on investing in seed and early stages. Recall that the heftiest payouts associated with unicorn exits are generally allotted to those funds willing to enter an investment early. The rate at which these funds have exhibited an appetite for investments in these stages are somewhat indicative of the probability for which they can get in early for the next batch of Uber’s and Airbnb’s relative to funds focusing on later stages</td>
<td>Leadership acknowledges those venture capital firms where their investment professionals are actively sourcing deals and being lead investors as opposed to employing a “follower” type investment focus of solely tagging along bigger deals</td>
<td>This is an indication of past performance, but it also reflects experience, which is clearly indicative of future performance. We reward those that post an impressive exit ratio, measured by way of exits (trade sales and IPOs) divided by total investments, and those that managed to exit a large number of investments in absolute terms. We cannot say for certain that IPO or M&amp;A exits are “successful,” but we screened out exits that are clear duds by excluding Chapters 7 and 11 bankruptcies or any other manifestation of being out of business</td>
</tr>
</tbody>
</table>

Formula: the number of seed and early stage investments over the last 5 years divided by the number of total investments during the same timeframe

Formula: divide the total number of a venture capitalist’s investments over the last 12 months by the total number of its investment professionals, defined as an employee that has influence over investment decisions (i.e. principals, partners, directors, and associates)

Formula: multiply the exit ratio with absolute number of exits. By doing so, we don’t unfairly disadvantage new funds (that naturally have fewer exit totals) and not the VCs with a more established track record (that tend to have lower exit ratios)
What we consistently see is that the visible, hyperactive and disruptive venture capital firms outperform the industry average across the board in risk appetite, leadership and exit performance. To assess the landscape on a more macro level and to put things into context by pitting these VCs with the industry norm, we compiled a list of 276 American venture capital firms, representing 1580 funds that made 15,012 deals in 10,979 companies in the period of 5 years leading up to 31 July 2014 using PitchBook. We weeded out “zombie funds” via an initial screening by excluding funds that did not close a new fund in the past 5 years or that have not made a single investment over the past 6 months in order to ensure a certain level of quality throughout the sample. Lastly, we made sure to break things down into three separate time frames for when a venture capital firm was founded in order to ensure a level of comparability between firms (pre-internet bubble, post-internet bubble in the lead up to the 2007 financial crisis, and post-financial crisis up through to the present).

Here is our league table based on our forward-looking metrics of performance (risk appetite, ability to source deals, and exit performance) (See Figure 1):

![Figure 1. Venture capital league table.](image)

Just as a small explanatory note, we didn’t take into account the size of the respective exits due primarily to the lack of sufficient data. Though the exits of unicorns are readily available, information on some of the lower tier trade sales remains scattered thereby compromising any reasonable attempt to create a meaningful benchmark to compare exit size. This is why you don’t see the big names like Andreessen Horowitz, Union Square Ventures, or Upfront Ventures, who we’ve mentioned throughout this piece, populating the league table. This certainly does not reflect how we believe these household names are extraordinary. They
absolutely are extraordinary and are in most instances driving innovation at the VC level. But if you’re involved in the start-up ecosystem, that simply goes without saying.

For illustrative purposes, we interposed the most visible and hyperactive venture capital firms in the league table conveniently with a Twitter logo and a caricature of a hyperactive individual. What we see is that these firms are well represented throughout the list. It’s also indicative of how intangibles like visibility, hyperactivity (in angel investments) and disruptive leanings are somewhat correlated to performance. Interestingly enough, the league table also consists of a healthy mix of firms founded pre-internet bubble, post-internet bubble and post-financial crisis, downplaying the notion that only historically reputable funds are equipped to survive and differentiate themselves from the rest. We also see VCs that focus on different investment stages represented as well.

**Why visibility matters**

Privacy is considered a real commodity nowadays with the integration of social media into our daily lives. However, in an industry that has historically been fraught with a lack of transparency, social media has been a welcomed change, associated with an inevitable degree of transparency, and a number of venture capitalists have run with it, most of the time for the betterment of the start-up ecosystem.¹²

With transparency, superlatives like respect and trust are not so far behind for those exhibiting a degree of openness. Looking at the dismal venture capital performance as shared by the Kauffman report and the sense of mistrust built between limited partners, venture capitalists and founders as a consequence, this bond is especially paramount. Despite the fact that visibility can tremendously help the brand of a venture capital firm, social media activity has less to do with marketing and branding and more to do with sharing, educating and vocalising the ins-and-outs of the start-up world. And that is the beauty of things and the crucial idea of paying it forward that is evident amongst the best we see.¹³

Fred Wilson, co-founder of Union Square Ventures and notable blogger, ventures so far as to say that blogging is one of the key responsibilities of a good venture capitalist. He claims to have found his stride through blogging.¹⁴ Blogging can be extremely powerful for venture capitalists. It forces them to think, articulate and question. The content of blogs can often go a long way in demystifying convoluted concepts for entrepreneurs, bridging the knowledge gap between investor and investee, calling for the downsizing of overly stringent protective provisions, and ultimately aligning incentives between limited partners, venture capitalists, and entrepreneurs. Consider that an Upfront Ventures survey shows that 52% of the questioned entrepreneurs indicated that providing transparency through blogging is essential, 44% of them thought that blogging was more a “nice-to-have” feature and only 4% of the entrepreneurs had a negative connotation with blogging.

As an illustrative example, consider a number of venture capital bloggers like Mark Suster and Brad Feld who took to their respective sites to explain the downside risks for start-ups when issuing convertible notes upon hearing a number of start-ups falling prey to the deceptive aspect of this particular security.¹⁵ As opposed to allowing more entrepreneurs to learn the hard way, these bloggers took it upon themselves to explain the thorny side of convertible notes and how they can lead to the dreadful full-ratchet effect (with a discount!) if follow-on investors value the start-up at a lower price per share.¹⁶
Venture capital bloggers are not only educating, but they are becoming thought leaders in the space as well by speaking up, thereby influencing others to adapt as well in an industry that has historically placed a tremendous premium on a lack of disclosure. For example, the gradual removal of “heavy pref” laden term sheets in favour of less investor-protectionist terms partially originated out of blogs. We’ll cover this a bit more when we talk disruptive leanings.

A level of entrepreneur friendliness and trust that can emerge from being visible on social media is an irreplaceable advantage for venture capitalists when it comes to securing the hottest start-ups for their portfolio. That very point may be a bit of a moot point for some, but the numbers indicate that the visible venture capitalists outperform their non-visible counterparts by a decent margin. Just take a look at Table 2 where the socially active venture capitalists outperform their non-visible counterparts from risk appetite to leading deals.

Though it may be a far cry to extrapolate a causal relationship between social media activity and a firm’s future performance, the numbers indicate that there is some sort of correlation between a firm’s visibility and performance. It may come as no surprise then that fund investors and start-ups more often than not tend to elect to partner with the more transparent and entrepreneur-friendly venture capitalists.

To measure visibility on blogs, we include those firms that were most active within the blogger space as represented by their venture capitalists. The most active and popular bloggers were measured by the total average monthly unique visits that a blog accumulated. Larry Cheng put together a great overview of this through 2011 and we checked the activity levels of each of the top bloggers since then to ensure that the list was still indicative and representative.

Visibility can of course be achieved beyond the blogger space as well. A look at the most active VC tweeters yields similar results in that these funds typically are more active, show a higher risk-appetite and post impressive exit ratios in their own right. To find the most active and connected venture capitalists on Twitter, we used a list of the 1000 most commonly followed Twitter accounts by the 507 members of Robert Scoble’s Tech Investors list as per 8 March 2014, which was compiled by Tyler Pearson at tylerp.me. The most active and popular VC tweeters were determined by weighing the number of tweets a particular

Table 2. A comparison between the performance of “Visible” and “Invisible” venture capitalists.

<table>
<thead>
<tr>
<th>Proxies</th>
<th>Risk appetite (5 yr)</th>
<th>Performance (5 yr)</th>
<th>Leadership (LTM)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formulas</td>
<td>Seed + early/total</td>
<td>Exit ratio × exits</td>
<td>Deals/# investors</td>
</tr>
<tr>
<td>Descriptives</td>
<td>Average (%)</td>
<td>Median (%)</td>
<td>Average</td>
</tr>
<tr>
<td>Founded pre-2000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-social</td>
<td>48</td>
<td>47</td>
<td>7.98</td>
</tr>
<tr>
<td>Bloggers</td>
<td>67</td>
<td>67</td>
<td>16.07</td>
</tr>
<tr>
<td>Tweeters</td>
<td>64</td>
<td>61</td>
<td>18.18</td>
</tr>
<tr>
<td>Founded 2000–2006</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-social</td>
<td>60</td>
<td>66</td>
<td>4.30</td>
</tr>
<tr>
<td>Bloggers</td>
<td>85</td>
<td>85</td>
<td>7.25</td>
</tr>
<tr>
<td>Tweeters</td>
<td>75</td>
<td>81</td>
<td>7.38</td>
</tr>
<tr>
<td>Founded post-2007</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-social</td>
<td>77</td>
<td>89</td>
<td>1.21</td>
</tr>
<tr>
<td>Bloggers</td>
<td>92</td>
<td>93</td>
<td>2.66</td>
</tr>
<tr>
<td>Tweeters</td>
<td>91</td>
<td>92</td>
<td>3.53</td>
</tr>
</tbody>
</table>
venture capitalist or venture capital firm had at the time of writing relative to how long they have had an account on Twitter. We disregarded the number of followers because it’s not so indicative of the level of engagement with followers.

**Why angel investments matter**

As is the case with almost any type of arrangement, misaligned incentives typically lay at the crux of any tension amongst partners whether it’s the founder–venture capitalist or limited partner–general partner relationship. Just by the very nature of these relationships, venture capitalists are in positions of influence. VCs can hypothetically be dis-incentivized to give their all if their management fees are large enough. This sounds unthinkable and unethical, which it absolutely is. But human nature is an interesting thing and a 2% management fee that is pocketed on a $1+ billion fund can have negative spillover effects on a VC’s output level when seeking potential leads compared to a VC that is solely relying on carry to make a similar return. We believe that angel investments are a partial solution. We find that incentives of funds that are headed by VCs that are doubling as active angel investors are more aligned between all relevant stakeholders (GPs, LPs, founders).

Angel investments by fund managers can go a long way in indicating that a particular fund may not be susceptible to misalignments for a variety of reasons. For one, many VCs invest their own capital in the very start-ups that their funds are investing in. As a VC fund, what better way is there to prove your confidence in your portfolio companies than to invest your own money as an angel investor into these companies as well? These investors are putting their money where their mouth is. As is the case with visibility, venture capitalists that invest alongside their funds can do wonders in establishing trust with their LPs and portfolio companies. One of the many issues that the Kauffman report cited was how GPs typically invest only 1% of a new fund’s capital whereas an LP invests 99%, thereby creating the opportunity for VCs to sit back and reap profits through management fees while LPs bear the majority of risks. Angel investments partially blunt these sorts of concerns.

A VC’s angel investments in ventures beyond its own portfolio can be indicative of a fund’s good intentions as well. A fund manager’s angel investments are a great window of insight into what sorts of technologies and investments a VC are trusting her own money with, which is certainly an interesting point to consider for prospective limited partners and entrepreneurs looking to engage with a particular fund manager. After you factor out any potential conflicts of interests, does your VC’s angel investments align with their views on the investment landscape? A lot can be understood by reading in between the lines here. Angel investments can also be largely indicative of how connected a VC is to the industry, much as Chris Farmer’s InvestorRank proxies for. Is your VC getting into great deals as an angel? These sorts of connections can largely indicate the quality of the investor you are working with and the level of value they’ll be able to offer in support.

It may come as no surprise for many of us that the venture capitalists that are hyperactive in the angel investing world perform better than their counterparts across the board in our measures of performance (risk appetite, leadership, exit performance). With the emergence of invaluable sources such as AngelList and Mattermark, information on fund manager activity is easily accessible nowadays. These fund managers are building a reputation as a trustworthy counterpart by way of added transparency on their individual engagements (see Figure 2).
A venture capitalist’s angel investments may not be as riveting as the groundbreaking technologies that are being churned out by their portfolio companies, but their role as angels alongside their capacity as fund managers is innovative in their own right. As is the case with visibility, angel activity is merely another example of how creativity not only occurs at the portfolio level, but it can permeate at the fund level as well (see Table 3).

### Why disruptive leanings are crucial

The last of the three indicators is a bit of an umbrella term. Disruptive leanings simply imply that these venture capitalists are not afraid to mix it up. Just some notable examples include Upside Partnership redefining how they set up their fund by sharing a portion of their carry with their portfolio companies, Andreessen Horowitz full service agency with dedicated functional experts that helps its start-ups with everything from business development, hiring, to marketing, Union Square Ventures’ Opportunity Fund that works in tandem with their core funds by only deploying capital in existing portfolio companies, allowing the fund to capture more of the upside upon the exit event without taking on additional management fees from its limited partners, Rubicon Ventures that has optimised its set-up to cater to the interests

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**Table 3.** A comparison between the performance of “Active” and “Passive” venture capitalists.

<table>
<thead>
<tr>
<th>Proxies</th>
<th>Risk appetite (5 yr)</th>
<th>Performance (5 yr)</th>
<th>Activity (LTM)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formulas</strong></td>
<td></td>
<td>Exit ratio × exits</td>
<td>Deals/# investors</td>
</tr>
<tr>
<td>Descriptives</td>
<td>Average (%)</td>
<td>Median (%)</td>
<td>Average (%)</td>
</tr>
<tr>
<td><strong>Founded pre-2000</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not-hyperactive</td>
<td>52</td>
<td>52</td>
<td>10.29</td>
</tr>
<tr>
<td>Hyperactive</td>
<td>65</td>
<td>61</td>
<td>22.26</td>
</tr>
<tr>
<td><strong>Founded 2000–2006</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not-hyperactive</td>
<td>63</td>
<td>68</td>
<td>4.45</td>
</tr>
<tr>
<td>Hyperactive</td>
<td>81</td>
<td>83</td>
<td>13.62</td>
</tr>
<tr>
<td><strong>Founded post-2007</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not-hyperactive</td>
<td>79</td>
<td>90</td>
<td>1.43</td>
</tr>
<tr>
<td>Hyperactive</td>
<td>89</td>
<td>89</td>
<td>4.20</td>
</tr>
</tbody>
</table>

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**Figure 2.** VC’s top 20 hyperactive.
of the many corporations that they have relationships with. The list goes on amongst the notable and upcoming VCs out there.

On an industry-wide level, we see that investor favourable terms are being exchanged out for more founder favourable clauses in term sheets as well. The very people that deal with this the most at Silicon Valley law firms Wilson Sonsini Goodrich and Rosati, Cooley, and Fenwick and West indicate in their quarterly reports on the industry how senior liquidation preferences, participating preferred shares and high liquidation preference multipliers continue to decline at a steady rate. This is certainly not a call to remove all protective provisions, but more to do with removing those that are unnecessary and uncalled for. As is the case with how entrepreneurs need to be protected, VCs and consequently limited partners need to be protected as well. For example, liquidation preferences are less important in the sense of downside protection, but it is crucial to ensure that the venture fund receives what it is
entitled to (see Figure 3). With respect to pro-rata rights, they can protect a VC’s investment as start-ups are staying private longer as well (see Figure 4).

It’s also worth mentioning that it is important not to consider these indicators as independent silos. Rather, they are interwoven components that make up the responsibilities of innovative VCs. Take, for example, Fred Wilson who we mentioned earlier. He shares the three “must-have” terms (board representation, liquidation preferences, and pro-rata rights) to cover in a term sheet on his blog back in 2009. These types of posts can positively impact the industry on a variety of matters including terms negotiated. We see the gradual decline in the use of exaggerated versions of these terms since then in practice.

Over the years, we are seeing venture firms learning from one another. On an industry level, these singular acts of disruption by each VC are most impactful when it is adopted at a larger scale. The progressive venture capitalists are learning from one another. As an example, the Foundry Group and Greycroft have since adopted similar funds (the Foundry Group Select Fund, Greycroft Growth) to that of Union Square Venture’s Opportunity Fund since it was first launched. We see more and more VCs blogging about terms and demystifying previously confusing concepts to entrepreneurs before they sign on the dotted line. It’s exciting to see that the focus on helping entrepreneurs and founders is starting to become the norm and deeply engrained in what is expected of a VC. Interestingly, we see similar dynamics playing out in corporate venture capital as well as in European landscape as well.

**Corporate venture capital**

Corporate VCs are in many ways different from their more conventional venture capital counterparts. Corporate fund managers have to often weigh the potential competing strategic considerations of their parent company with aspirations of financial returns. The dynamics of a CVC fund can largely deviate from one corporate to another depending on its relationship to the corporate itself as well as its aims, let alone with the prototypical venture capitalist. Despite these structural and philosophical differences, the three indicators of innovation at the fund level that we’ve mentioned are exhibited amongst the more celebrated corporate VCs within their subsection of venture capital as well. For example, Google Ventures as well as a handful of its general partners are quite active on social media demystifying concepts and educating entrepreneurs. Partners like Kevin Rose are especially busy as angel investors on the side. Bill Maris and his team are reinventing how to view the investment selection process by implementing a data-driven approach that is much more quantitative in nature than is standard in the industry. This sort of fresh thinking forces the industry to constantly refine its craft without relying on some outdated business as usual tactics.

**Europe**

Though we primarily tested our experience with data from the US, a quick scan of these indicators of innovation in the European context reveals that visibility, hyperactivity (in angel investments) and disruptive leanings are important across the Atlantic as well. From Earlybird Venture Capital in Berlin to Passion Capital in London, select firms are really distinguishing themselves as the crème of the crop when it comes to innovating at the firm level. You find VC bloggers like Ciarán O’Leary of Earlybird championing concepts such as being “long-term greedy” as an equitable way of sharing risk and advocating for increased competition in the
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European VC landscape\textsuperscript{23}, all of which help entrepreneurs profoundly as previously discussed in the US context. Passion Capital published a term sheet that ditches the legal jargon in favour of “plain English,” something more understandable for all parties involved. When it comes time to signing a stock purchase agreement with innovative VC firms like Earlybird and Passion Capital, entrepreneurs know exactly who they are dealing with and on what terms.

For those European-based VC firms that need some nudging to see the real value behind some of these intangibles that move beyond the traditional roles of a VC, Table 4 is quite indicative of how values like “paying it forward” that are already deeply engrained in the DNA of parts of Silicon Valley and making a return are not mutually exclusive. For example, looking at the visibility indicator in the EU and its relationship to performance, social VCs outscore their non-social counterparts from risk appetite, exit performance and overall activity by quite a margin. European VCs are in the same business of helping entrepreneurs and their respective start-ups succeed just like their US counterparts. Fund managers in Europe themselves are beginning to highlight how unimaginative funds that were resistant to change are now “running on empty” with an inability to raise new funds.\textsuperscript{24} Notable fund managers are moving from underperforming funds to more innovative ones that are fit to compete. We hope to see more and more European-based venture capitalists taking up the challenge of becoming more visible, hyperactive and disruptive. If not for the health of the industry and the entrepreneur, then for their exit multiples.

### Conclusion

The venture capital industry has changed. What’s expected of a venture capitalist to thrive has evolved as a consequence. It’s been acknowledged by limited partners, entrepreneurs and venture capitalists alike that the model was largely broken. Performance of the asset class was subpar for far too long for a greater part of the last decade and the industry desperately needed a facelift due to the growing glut of less than stellar VC funds. Since then a select group of innovative venture capitalists took it upon themselves to restore the art of venture capital financing. The venture capitalists leading this renaissance are returning to the venture capital model in its most traditional form as a \textit{real} partner to start-ups, as a risk-taker and most importantly as an innovator and disruptor at the fund level.

We see from personal experience that intangibles like visibility, hyperactivity (in angel investments) and disruptive leanings are too often discounted as irrelevant traits of a venture capitalist. In fact, we see that they are highly correlated with fund performance and are becoming more and more valuable for a number of reasons we discussed in this piece. We hope to see that more VCs will adopt these simple approaches to continue to facilitate a sense of trust within the ecosystem. We are also hopeful that some of these indicators that we have used in the past to much success will prove to be helpful for those entrepreneurs, institutional investors, government agencies and venture capitalists alike that are looking to continue to propel global innovation forward.

**Table 4.** A comparison between the performance of “Visible” and “Invisible” venture capitalists in Europe.

<table>
<thead>
<tr>
<th>Descriptives</th>
<th>Proxies</th>
<th>Risk appetite (5 yr)</th>
<th>Performance (5 yr)</th>
<th>Activity (LTM)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Formulas</td>
<td>Seed + early/total</td>
<td>Exit ratio × exits</td>
<td>Deals/# investors</td>
</tr>
<tr>
<td>Non-social</td>
<td>Average (%)</td>
<td>63</td>
<td>2.67</td>
<td>0.72</td>
</tr>
<tr>
<td>Social</td>
<td>Median (%)</td>
<td>64</td>
<td>0.83</td>
<td>0.56</td>
</tr>
<tr>
<td>Social</td>
<td>Average (%)</td>
<td>77</td>
<td>4.85</td>
<td>3.89</td>
</tr>
<tr>
<td>Social</td>
<td>Median (%)</td>
<td>83</td>
<td>3.57</td>
<td>1.75</td>
</tr>
</tbody>
</table>

For those European-based VC firms that need some nudging to see the real value behind some of these intangibles that move beyond the traditional roles of a VC, Table 4 is quite indicative of how values like “paying it forward” that are already deeply engrained in the DNA of parts of Silicon Valley and making a return are not mutually exclusive. For example, looking at the visibility indicator in the EU and its relationship to performance, social VCs outscore their non-social counterparts from risk appetite, exit performance and overall activity by quite a margin. European VCs are in the same business of helping entrepreneurs and their respective start-ups succeed just like their US counterparts. Fund managers in Europe themselves are beginning to highlight how unimaginative funds that were resistant to change are now “running on empty” with an inability to raise new funds. Notable fund managers are moving from underperforming funds to more innovative ones that are fit to compete. We hope to see more and more European-based venture capitalists taking up the challenge of becoming more visible, hyperactive and disruptive. If not for the health of the industry and the entrepreneur, then for their exit multiples.
Notes

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