The transatlantic divide: Investigating the differences in investment practices between European and US venture capital firms

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Objectives / Summary research question

- *To investigate whether differences in investment practices of European and US VC funds might go some way to explaining historical difference in performance between European and US VC funds.*

➢ Background:

European VC returns have been worse than US (but appear to be improving):

1985 -2010 VC returns (overall):
- Europe: 2.5%
- US: 14.5%

(Thomson Reuters data for KA 2011)

10 year VC returns to 2013:
- Europe: 0.84%
- US: 5.03%

(EVCA / Invest Europe)

10 year VC returns to 2018:
- UK: 8.4% *(BVCA)*
- US: 12.8% *(Cambridge Associates)*

➢ Why important?

- Institutional investors avoiding European VC funds
- Small size of UK/European funds > lack of patient capital for scale up
- Need US VC's greater resources of funds
- By adopting US investment practices European VC performance could potentially be improved > increased investment in asset class.

➢ Prior research

- Many variables known to affect performance of VC funds.
- Only small no of studies seek to explain relative underperformance of European versus US funds. Differences in fund choices / characteristics between US and Europe do not explain performance gap (Lerner et al 2011)
- Studies mainly quantitative – only very few studies have used qualitative interview techniques to investigate investment practices.

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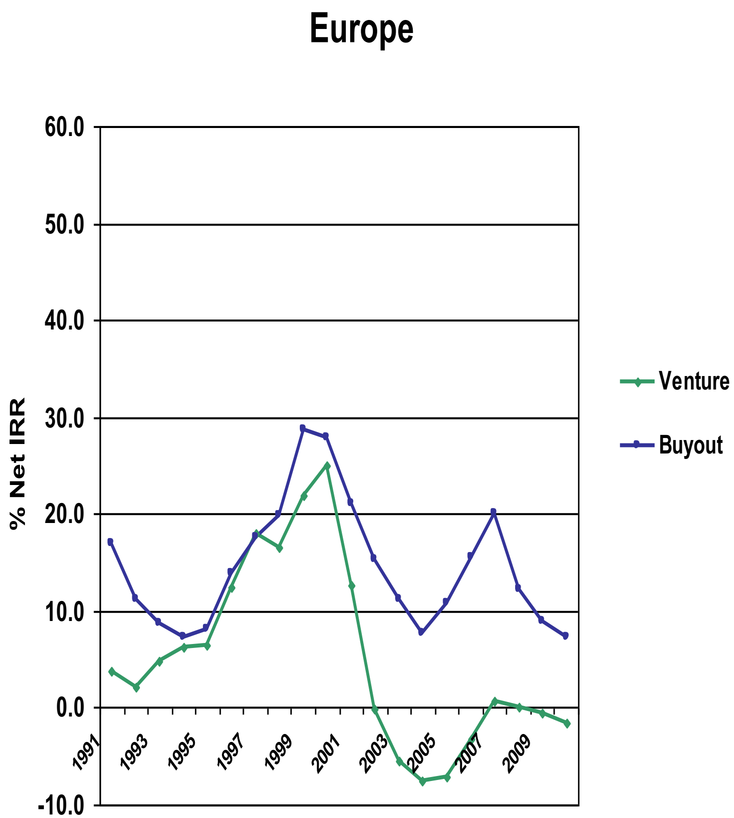
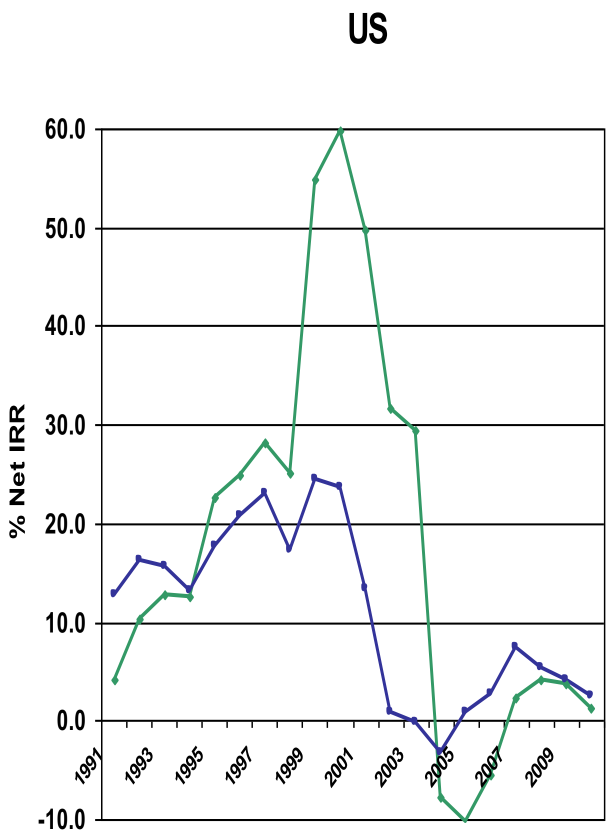
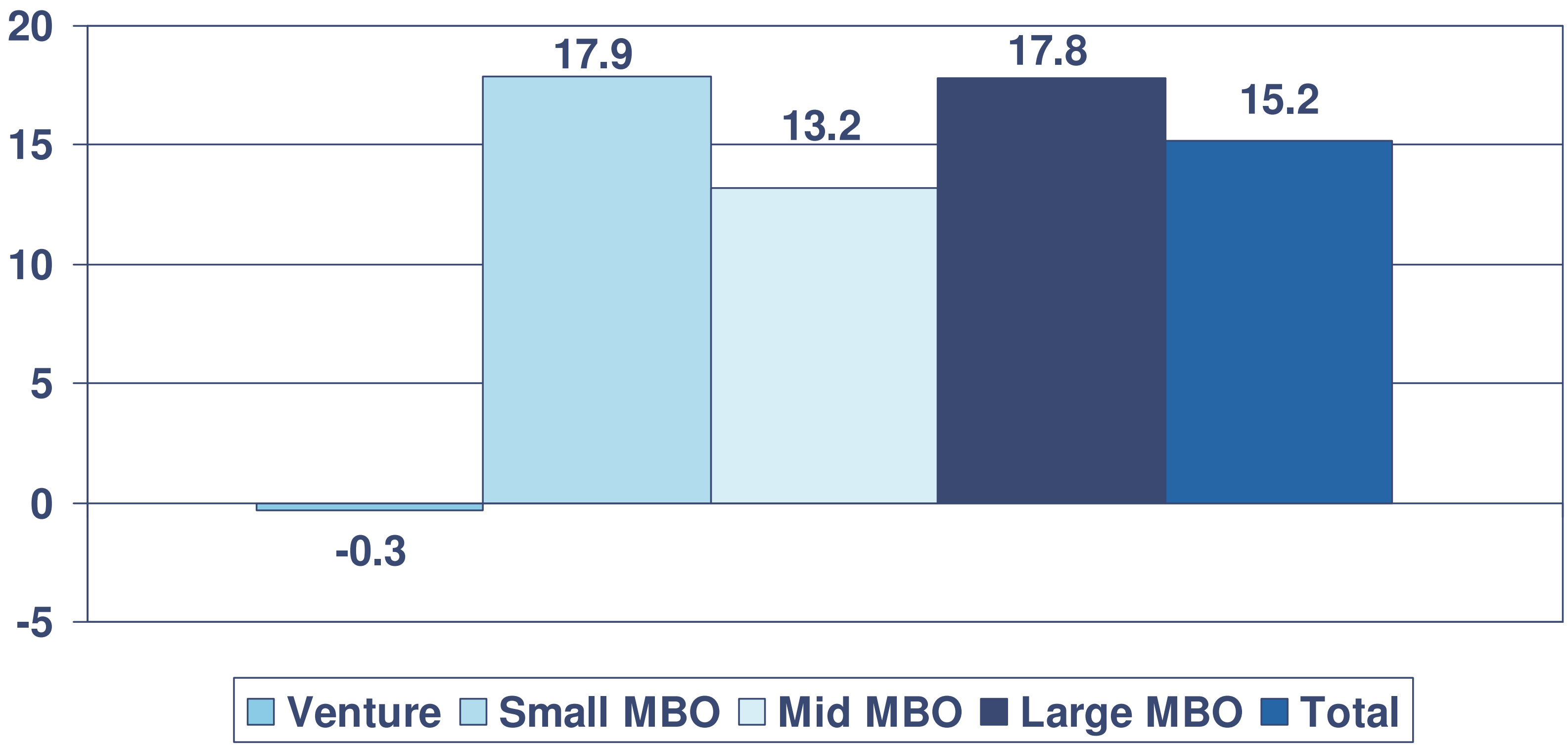
Starting point: Returns for Europe and US – five-year rolling IRRs

Source: EVCA 2010 pan-European private equity performance benchmarks study (Thomson Reuters)





1996-2006 Funds – Since Inception to December 2010 (% p.a.)



bvca The voice of long-term investment

CapitalDynamics

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Global venture capital trends

Funds raised:

Venture funds raised in North America and Europe were $66bn in 2018 (up 52% from 2017) (PitchBook).

2018 was best year ever for European VC funds raised at €11bn (Invest Europe)

Fewer but larger VC funds - median fund size now $76m (PitchBook)

Sequoia raised $8bn VC fund in 2018; Index Ventures raised $1bn fund

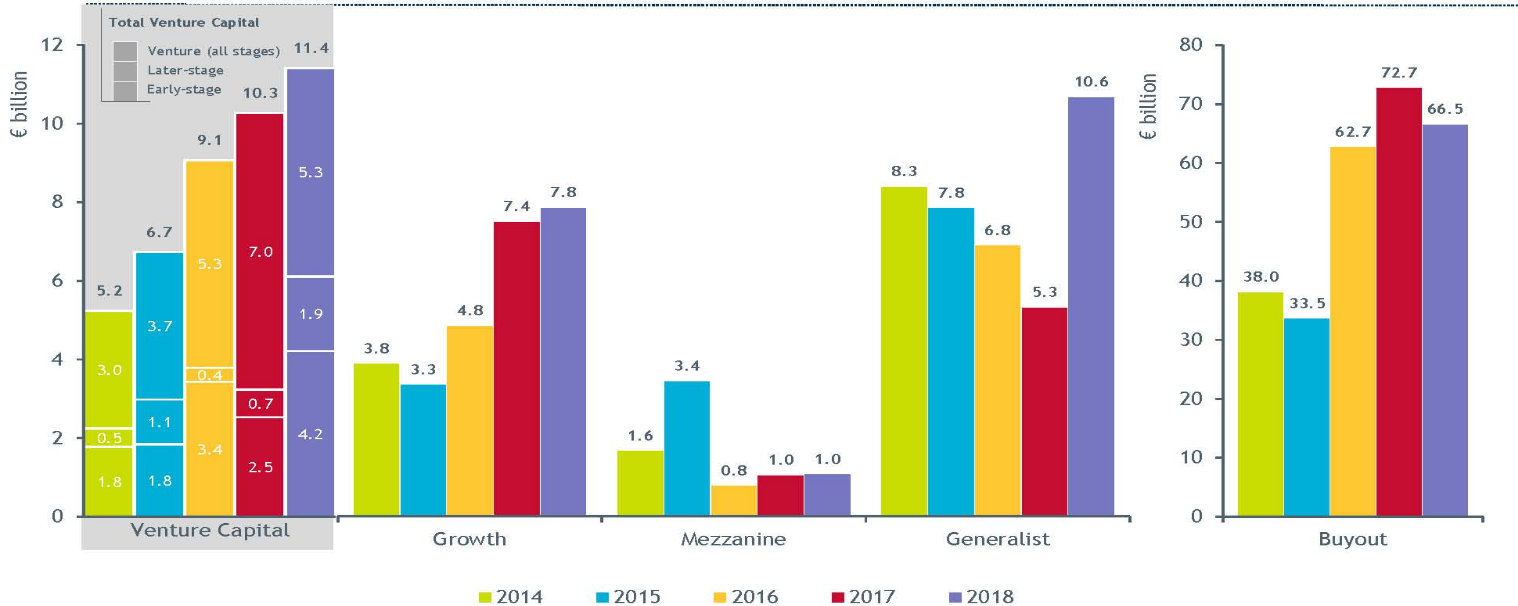
Previously, Rocket Internet raised the then largest European VC fund ever at $1bn & Atomico raises $765m European VC fund in 2017

Softbank raised $100bn tech fund in 2017! And is now raising next $100bn fund.

European Private Equity Funds Raised – by fund stage focus

Funds raised by fund stage focus

2014-2018 - Incremental amount raised during the year



Source: Invest Europe / EDC

Global venture capital trends (cont'd)

Investments:

Global venture investments were $255bn in 2018 – an all time high! ($175bn in 2017) (KPMG)

41% of 2018 deals by amount in North America, 39% China, 8% Europe (Preqin)

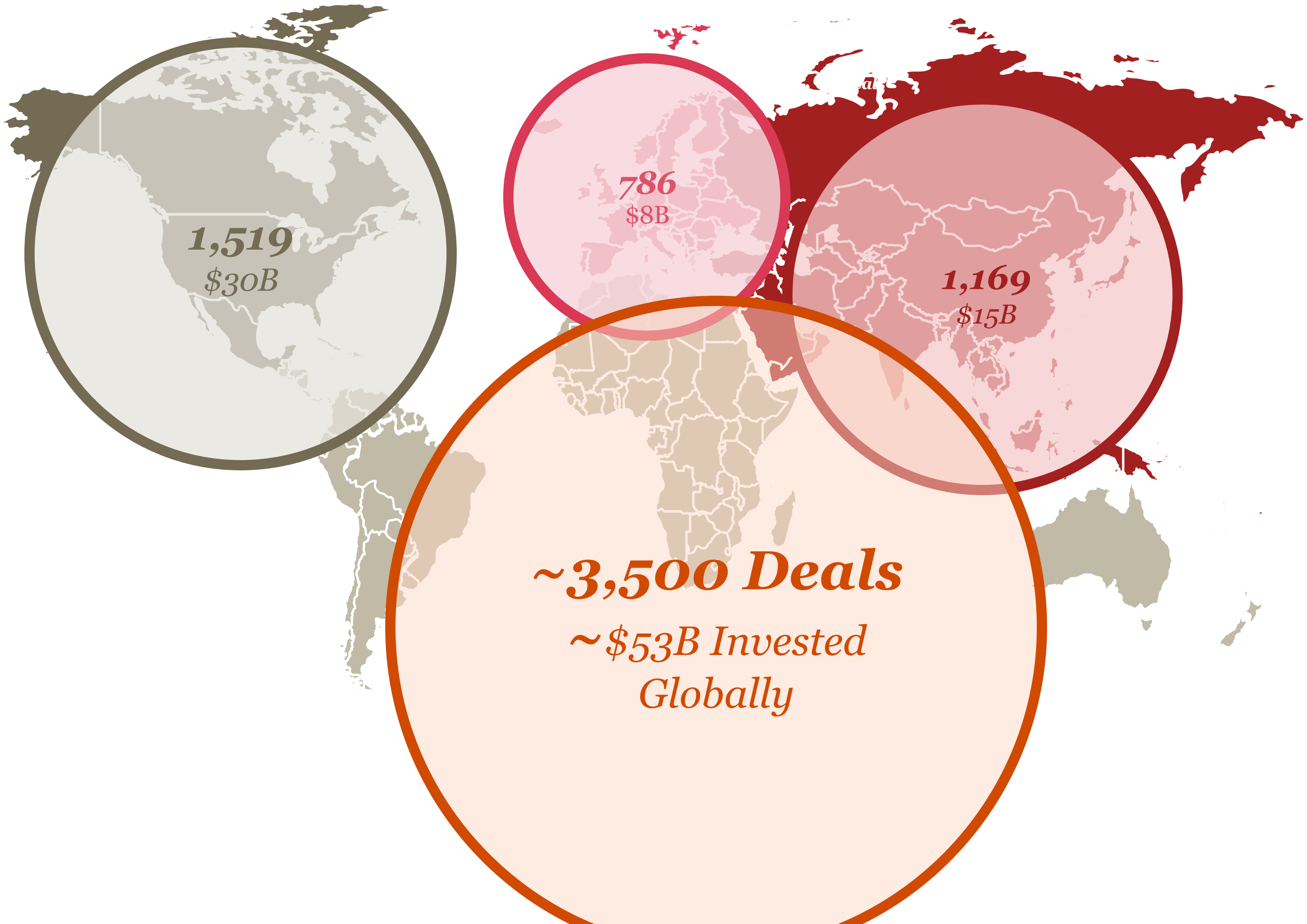
Global buyout deals totalled $456bn in 2018 up 18% from $388bn in 2017 (record was $460bn in 2015) (Preqin)
(US: $175bn, Europe: $98bn, Asia: $63bn (2017))

2018 was best year ever for European VC investments (€8.2bn); growth capital was €11.9bn (Invest Europe)

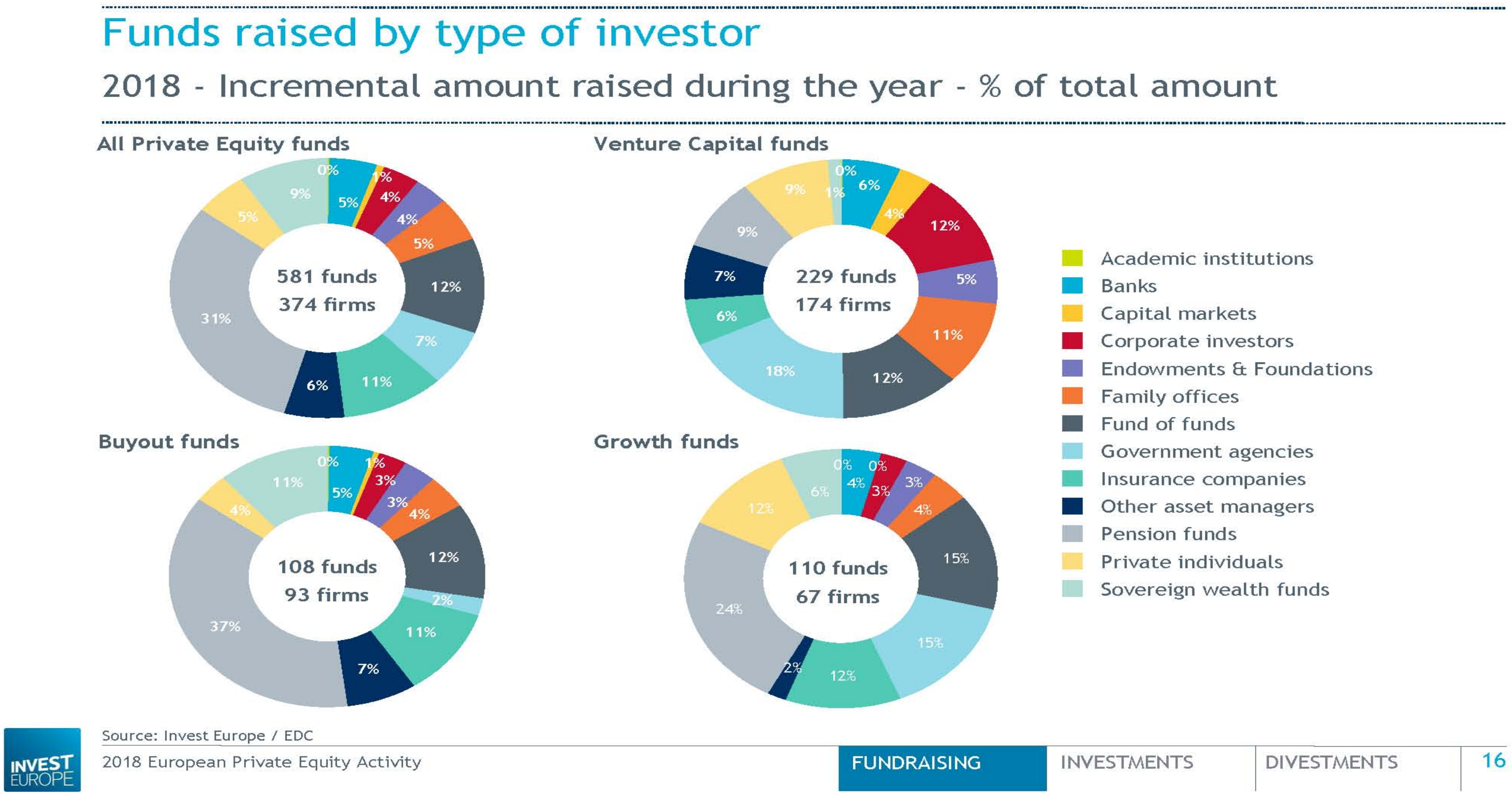
Mega-rounds raised by 23 European start-ups in 2018 (Crunchbase) including Moonbug: €132m, Benevolent AI: €100m, Atom Bank: €164m

VC "dry powder" in North America and Europe totalled $128.5bn in 2018 (PitchBook).

Q2'19 Global regional comparison of VC investments
(Source: PwC/CB Insights MoneyTree Report)



European Private Equity Funds Raised - by type of investor



European venture capital funding

(Source: Invest Europe)

	Venture 2018	Venture 2017	Venture 2007	Buyout 2018
Total funds raised	**€11.4bn**	**€10.3bn**	**€7.9bn**	**€66.5**
Banks	6.0%	6.5%	14.7%	4.6%
Insurance companies	5.8%	4.6%	7.3%	10.9%
Pension funds	9.0%	3.1%	11.7%	37.1%
Government agencies	18.1%	27.3%	13.5%	2.1%

Research methodology

- Critical realist philosophical framework
- Mixed methods approach (Creswell 2009)
- Quantitative review of secondary data
- Qualitative semi-structured interviews with VCs

  - "engaged scholarship" (Van de Ven 2007)

  - purposive sampling

  64 separate VC firms interviewed (UK – 24, US – 25 (Baltimore 1, Boston 4, Cincinnati 1, New Jersey 1, New York 1, Pittsburgh 4, Silicon Valley 13), cont Europe – 15 (France 3, Germany 3, Ireland 3, Netherlands 1, Scandinavia 2, Spain 1, Switzerland 2)) *(Sanders, Lewis and Thornhill (2009) suggest undertaking between 25 and 30 interviews)*
- Workshop of VCs / academics confirmed relevance and approach
- Thematic analysis to identify emergent themes (Boyatzis 1998)
- Themes summarised onto Excel; analysed for % of recurring themes
- Areas investigated: Size and vintage year of fund, Strategic focus of VC fund (industry sector, stage of investment, geographic focus), Performance of VC fund, Professional backgrounds of investment executives, Deal generation, Approach to due diligence, Investment approval process, Terms of investment, Use of syndicates, Monitoring and portfolio review, Adding value, Exit process.
- Principal limitation: Findings only apply to sample; cannot be extrapolated to all VCs.

VC firms in sample (64 firms: US 25, UK 24, E 15)

	US	UK	cont Europe
Size *			
Small (<$84m)	3	9	8
Medium ($84m-$365m)	12	13	6
Large (>$365m)	10	2	1
Sector			
IT	10	8	2
Lifesciences	3	2	1
Mixed	11	8	10
Focused	1	6	2
Stage			
Seed/early	11	11	9
Venture (incl early)	12	13	6
Growth	2	-	-
* per Lerner et al (2011)			

Research methodology (cont'd)

- Exploration of difference in performance, in addition to investigating investment practices of VC firms, also includes:
  - structural factors (size of funds, strategic focus, backgrounds of investment executives)
  - wider environmental factors (culture, attitude to risk, wider ecosystem)
- Qualitative semi-structured interviews with other stakeholders (LPs, entrepreneurs, advisers, VC professional bodies, CVCs)
  - very few studies have ascertained views of non-practitioner experts (Marston et al 2013 interviewed 13 other stakeholders for Nesta)
  - 40 other stakeholders interviewed (Europe 19, US -21), incl: 7 LPs, 6 entrepreneurs, 7 VC-related, 7 advisors, 6 CVCs, 7 others.

  VC and other interviews took place in 2013 and 2014
- Thematic analysis to identify emergent themes; frequency analysis of recurring themes
- Questionnaire of factors important to investment success:
  -52 VCs completed questionnaires (UK 24, USA 18, cont Europe 10)
- Development of framework for best practice – theory building (Eisenhardt 1989, Van de Ven 2007).

Conceptual framework

VC firm / fund

- Structural factors
- Operational factors

Wider environment

- Culture, Markets, Ecosystem, Scaling, Tech clusters, CEOs/entrepreneurs, Luck!

UK / Europe / USA

- Review of differences between UK / Europe / USA
- Engaged scholarship
- Theoretical frameworks

Fund performance

Key findings (VCs) – Europe / US differences

- **Fund performance**

- Confirmation of returns gap - US firms in sample had greater no of funds with top-quartile performance and certainly outlier performance than UK / European firms. For VC firms where independent performance on funds was available (26 VC firms) 15 firms had top-quartile performance for their most recent fund (US 7, UK 5, E 3), 19 firms had at least one fund where performance was top quartile (US 11, UK 5, E 3) and 12 firms had two or more funds with top-quartile performance (US 7, UK 2, E 3). In addition 6 US firms, but no UK or E firms, had funds where performance showed IRR >50%.

Key findings (VCs) – Europe / US differences

- **Structural differences**

- Fund size: US VC funds (average size $282m) are considerably larger than UK ($168m) and continental European ($128m) funds. The largest US fund ($1,515m) is ~3 times the size of the largest UK ($557m) and continental European fund ($557m).

  "There's not enough top tier, early stage, series A-focused funds around (in Europe)" : US VC

  "There's a massive inefficiency in the UK because you haven't got scale of funds. It's just hugely inefficient, a huge drain on management time" : UK LP

Key findings (VCs) – Europe / US differences

- Number and background of partners:

  US firms have around one more partner in total than UK and continental European firms (US 6.4 per firm, UK 4.9, E 5.3), and proportionately more partners with operational (US 2.7, UK 1.5, E 2.0) and, to a lesser extent, entrepreneurial backgrounds (US 1.0, UK 0.7, E 0.9).

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  "US VCs are operational VCs, ex-entrepreneurs and have run companies whereas here in Europe they are more interested in all these financial details, financial alliances, maybe their background is as bankers or consultants. Which is not the case in the US; they are more hands on, they understand, they are closer to the entrepreneur": UK Entrepreneur

Key findings (VCs) – Europe / US differences (cont'd)

- **Operational differences**

- Investment strategy: More US VCs pursue a "1 in 10" (home run) investment strategy (81%) than UK (57%) and E VCs (57%).

  "So you have to be absolutely willing and ready to lose companies and to push them really hard on going big. The battle is being won by people who produce big exits": US VC

VC's dilemma (from Kenney and Florida, 2000)

- Errors of omission: not investing when one should
- Errors of commission: investing when one should not

Rule of thumb - for every 10 investments:

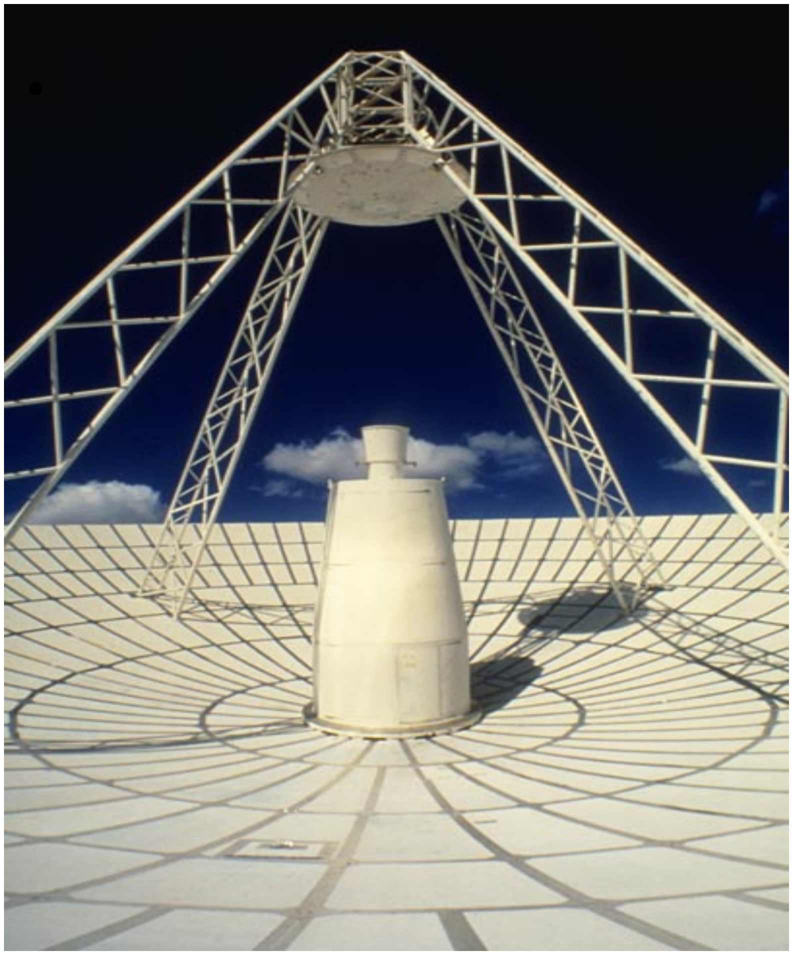
- 3 are complete losses
- 3 or 4 neither succeed nor fail; difficult to extract original investment
- 2 or 3 return >1x to ~2x or 3x
- 1 or 2 return > 10x

Key findings (VCs) – Europe / US differences (cont'd)

- **Operational differences**

- Investment theme: Focus on investment thesis / theme was cited as important by more US VCs (US 11, UK 5, E 3).

Technology sector: "Hot" areas for investment focus



- Deeptech: AI / Machine learning
- Cyber security
- Virtual reality / AR
- Autonomous vehicles
- Drones
- Robotics
- Fin tech
- Bitcoin / blockchain
- Big data
- Cloud computing
- Mobile applications
- Internet of Things
- Medical instruments / devices / diagnostics
- Biotechnology / biometrics
- Nanotechnology
- Clean Tech
- Ed Tech / Agri Tech

Key findings (VCs) – Europe / US differences (cont'd)

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  "We do those 'prepared mind' initiatives, so you try to develop a thesis around what you think is going to be a future area of investing. That's why venture investing is so hard because you don't really know what you're investing in": US VC

  "About 10 times per year partners decide where to put resource to try and identify an investment thesis, whatever it takes, and present to everyone in the group a thesis with respect to: is there an investable idea behind that?": US VC

Key findings (VCs) – Europe / US differences (cont'd)

- **Operational differences**

  "The majority of the quality venture firms actually know how to spot a trend, spot it early, and then find who are the companies worth backing; or who are the entrepreneurs in their stable worth backing into that trend": UK VC

  This UK VC went on to say that Europe does not have "enough of that" and either the European VCs think that venture is about finding something "buried in a lab" or they look at trends that happened a year or two ago and try to continue the previous trend.

Key findings (VCs) – Europe / US differences (cont'd)

- **Operational differences**

- Deal sourcing: Personal networks and proprietary contacts were more important to UK and continental European VC firms than to US firms.

  US firms cited their brand name, profile in the marketplace and track record as the principal means whereby deals are sourced.

  VC firms with high profile can negotiate deals with lower valuations which can lead to higher returns.

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  “The big brand VCs say “I don’t do anything outside of the Valley; I don’t do anything that involves catching a plane” but you know when you look at what they’ve got there, they are dead right. They don’t need to”: UK VC

Deal funnel: Silicon Valley VC *(from New Yorker article on Marc Andreessen of Andreessen Horowitz, 18.5.15)*

- 3,000 “warm” introductions per year of start-up opportunities
- AH invests in 15 per year
- 10 of those will fail
- 3 or 4 will survive / prosper
- 1 might join the “unicorn” club (worth > $1bn)
- Unicorn may become a Facebook or Google once a decade.

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“Over 20 years our returns are going to come down to 2 or 3 or 4 investments, and the rest of this (the no of staff and trappings of the VC’s offices) *is the cost of getting the chance at those investments. There’s a sense in which all of this is math – you just don’t know which Tuesday Mark Zuckerberg is going to walk in” Marc Andreessen.*

Key findings (VCs) – Europe / US differences (cont'd)

- Due diligence: More US VCs do most of their due diligence in house (US 75%, UK 52%, E 60%). UK, and particularly continental European, VCs more likely to use external experts for tech, financial, IP and legal due diligence.

  "We only invest in areas where we have the expertise in house. If we can't diligence it because it's not an area we know and understand we are not going to be helpful to the company": US medtech VC

  "We always bring in know-how from our board of advisors….or the networks of those guys": German VC

Key findings (VCs) – Europe / US differences (cont'd)

- Investment approval: All US firms with investment committees involved either all of the investment partners or just the senior partners in the decision, with no other internal or external people involved in the decision process.

  "When you get back to the successful firms it's been our experience that the more concentrated the authority or responsibility in the firm then your odds of success go way up": US LP

  Whilst most VCs reach investment decisions unanimously or by consensus, a senior partner could force a decision at 4 of the US VCs

  "What we found was that consensus would kill the outliers. Anybody who feels strongly about something can make it happen": US VC

Key findings (VCs) – Europe / US differences (cont'd)

- Investment terms: More US VCs have "entrepreneurially friendly" terms in their term sheets (US 57%,UK 23%, E 14%) with (eg) liquidation preferences used more by E/UK VCs than US VCs (E 71%, UK 36%, US 29%).

  Protecting the downside versus aiming for the upside approach.

  "*Europeans are saying How do I not lose? - and Americans look at the question How do I win?" : US VC*

  "The history and the track record of the industry in Europe is things go wrong most of the time and when it goes right it doesn't go very far. It's actually quite rational to think maybe I should be a bit careful here" : UK advisor

Key findings (VCs) – Europe / US differences (cont'd)

- Dividends: Only UK and continental European VCs referred to the requirement for dividend streams. European VCs might seek to enhance their returns by insisting on a dividend stream much to the criticism of US Silicon Valley VCs.

  "*No American CEO wants a European VC. I worked for a European VC and they do things exactly as you describe. What are our dividends that we're going to get? Questions that American VCs just vomit all over*"*: US Silicon Valley VC*

Key findings (VCs) – Europe / US differences (cont'd)

- Syndication: No indication of less syndication in UK/Europe than US (cf Schwienbacher 2005). Syndicate for monetary or, sometimes, value add reasons.

  "*We syndicate not because we need to but because we want to": US VC*

  Syndication de-risks investment, especially if investment is early stage: "*Sharing risk in early stages is the sensible thing to do": UK VC*

Key findings (VCs) – Europe / US differences (cont'd)

- Some (UK) VCs preferred not to syndicate:
  "We concluded a lot of the syndicate stuff is very complicated. We've had lots of bad experiences (with syndication)": UK VC

  Issues can arise with syndicate members:
  - investing through funds of different vintages with different time horizons to exiting investments,
  - not being as commercial or risk orientated as others
  - having conflicts on pricing and terms of a deal
  - disagreeing on what should be done with poorer performing investments

- US VCs tend to syndicate with people they like, respect and trust:
  "We tend to invest with the same half dozen friends consistently over time": US VC
  "You have to kind of play nice if you want to get invited to other deals": US Corporate VC

Key findings (VCs) – Europe / US differences (cont'd)

- US VCs syndicate less with European VCs than vice versa.

  "There's a cultural mismatch that's very strong": US Silicon Valley VC

  "Europeans with US syndicates will get a lift and the US with European syndicates will get a drag": UK LP

- Only 19% of US VCs invested with UK / European VCs:
  "*It's not easy* (to get US VCs to want to invest in UK companies)*. There may be a special relationship* (between US and UK) *but there ain't no special relationship when it comes to venture capital. VC is interested in returns - and that's it!": US Advisor*

Key findings (VCs) – Europe / US differences (cont'd)

- Evidence of US VCs clubbing together with relatively small investments in very early, seed stage investments in order to "test the water" and not miss out on potential outlier investments:

  "*It's driven by everybody wanting to be in. Nobody wants to miss the deal that becomes successful. At the super competitive level you have to be in all the right deals": UK VC commenting on Silicon Valley VCs*

  A Silicon Valley VC has a $20m seed fund which it uses to make *"experimental investments with far out things"* which are not yet ready for full VC investment. This VC slims down the investment decision making process so that just one partner can decide on an investment of up to $250k in just one meeting with a company.

“*I always love the perception which is somehow we’re perceived as gamblers in Silicon Valley. The reality is, I’m a pretty conservative guy who just takes enough risk to generate the high returns we want.”*

US Silicon Valley VC keen to avoid the perception that US VCs are just throwing money at deals and effectively placing “bets”.

Key findings (VCs) – Europe / US differences (cont'd)

- Portfolio reviews: Tendency in Europe to keep investments going for longer whereas US VCs cut their losses (4 interviewees: 3LPs, 1 advisor).

  "(US VCs) can afford to walk away from them without impacting the total fund performance. In the UK, with smaller funds, the proportion of the fund of each investment is going to be larger and, therefore, there's going to be greater reluctance to walk away and admit you got it wrong": UK LP

  A UK VC carries out formal triaging of its portfolio four times per year in order to determine which investments they are going to continue to support:

  "They (partners) tend to fall in love with their investments and they become a little too emotionally attached to them and it is very hard to then stop": UK VC

Key findings (VCs) – Europe / US differences (cont’d)

- Focus on metrics

  Quantifiable measures used to gauge performance or progress based on VC’s experience with previous investments.

  “The US VCs know exactly what metrics they’re willing to fund. The reason they’re willing to put another X in is because they’ve seen that happen before. And I think the Euro guys really don’t, they’re just imputing it from what they read rather than having (the experience)”: UK Corporate VC

Key findings (VCs) – Europe / US differences (cont’d)

- Adding value: There is less evidence of adding value activities by US VCs (other than networks with other VCs and with corporate VCs).

  “The best companies are the ones where you add the least value”: US VC

  A US mid-stage Silicon Valley VC commented that it is a myth that value add is important:

  “Most successful companies are built by good CEOs not by VCs. My best deals are where I do the least work, because the company is run by a good CEO”: US VC

  Acting as a sounding board for CEOs and assisting with international expansion was more prevalent with UK and continental European VCs than with US VCs.

Key findings (VCs) – Europe / US differences (cont'd)

- Exits: More US VCs wait for the best exit (US 23%, UK 14%, E 0%) and are proactive in achieving an exit than European VCs (US 36%, UK 18%, E 23%).

  European tendency to exit earlier:
  - tension among different investors based on age of investment
  - pressure from limited partner investors to show returns
  - need to demonstrate realised returns in connection with fundraising for subsequent funds
  - pressure from management teams to realise all or part of their investments.

  "*It's not exit at all costs. It's exit at the right price and under the right circumstances*": US Boston VC

  Easier exit process in US (via big tech cos / IPOs) (23%) cited by 32% UK VCs, 16% US VCs, 21% E VCs, as noted by Schwienbacher (2008).

Other areas of difference between Europe and US (VCs)

- **Wider environment differences:**

- Cultural issues: (attitude to risk, lack of confidence, not thinking big enough) (33% of firms commenting) cited by 47% US VCs, 23% UK VCs, 29% E VCs. “How do I win?” (US) versus “How do I not lose?” (Europe).

  “This is a cultural thing, in California we ask the question, well if everything this guy says is true, how big can the outcome be? In Europe they ask the question, what are all the ways this guy could be lying to me?”: US Silicon Valley VC

Other areas of difference between Europe and US (VCs)

- **Wider environment differences:**

  The relative wealth of US VCs, particularly those in Silicon Valley, compared to European VCs may partially explain the higher level of risk taking on the part of US VCs:

  "Because all the partners have made hundreds of millions so far (in US). It's a totally different ball game": European VC

  "There are wealthy partners in the Valley: well, they started wealthy. They were very successful entrepreneurs. They can take more risk and they can write a big cheque to start the fund": US VC related

Other areas of difference between Europe and US (VCs)

- Fragmented markets: different cultures, laws, regulations, stock markets, tax systems, languages, politics in Europe.

  "*Because they (German companies) don't know the language (of other European countries), they don't know the legal environment and so on, and they don't know the people, actually, they prefer to go to the States and that is very capital intensive. That's one reason why we can't create big companies in Europe*": *German VC*

Other areas of difference between Europe and US (VCs)

- More open ecosystem in US: sharing of contacts, talents and information, versus proprietary networks in Europe (52% UK and 33% E VCs referred to proprietary networks for deals cf 26% US VCs).

  "This country (US) is a lot more philanthropic. People feel they want to give back and that runs through the whole Valley. People are much more protective in Europe."I've got here and I'm not necessarily going to help you": US based UK entrepreneur / adviser

- Sheer size and scale of tech sector in US. Difficulty of scaling in Europe (Coutu 2014).

Other areas of difference between Europe and US (VCs)

- Silicon Valley: The "uniqueness" of the Silicon Valley VCs and the environment in which these firms operate was a common theme arising from the interviews. All Silicon Valley VC firms in the sample for which fund performance data were available were in the top performing category.

Top 20 Start-up Ecosystems (Start-up Genome 2019)

1. Silicon Valley
2. New York City
3/4. London
3/4. Beijing
5. Boston
6/7. Tel Aviv
6/7. Los Angeles
8. Shanghai
9. Paris
10. Berlin
11. Stockholm
12. Seattle
13. Toronto
14. Singapore
15. Amsterdam
16. Austin
17. Chicago
18. Bangalore
19. Washington DC
20. San Diego

(from Global Startup Ecosystem Index by Startup Genome)

Other areas of difference between Europe and US (VCs)

"The investments, the CEOs and their teams are just surrounded by a phenomenal ecosystem (in Silicon Valley). The connections are just phenomenal: connected advisers, connected partners. The Valley is just unique": UK VC

"US (West Coast) VCs use overwhelming force in supporting a project. And I don't just mean dollars of overwhelming force, but connectivity and networks and relationships with big corporates. Europe is not able to efficiently filter the ones that will gain traction from those that won't. The vast majority fail to gain traction": UK LP

Other areas of difference between Europe and US (VCs)

- Lack of good CEOs, serial entrepreneurs, sales & marketing skills in Europe (31% of firms commenting) cited by 41% UK VCs, 26% US VCs, 21% E VCs, as noted by Axelson and Martinovic (2013).

Other areas of difference between Europe and US (VCs)

- Lack of good CEOs, serial entrepreneurs, sales & marketing skills in Europe (31% of firms commenting) cited by 41% UK VCs, 26% US VCs, 21% E VCs, as noted by Axelson and Martinovic (2013).

- Luck: Several interviewees (5 UK VCs, 1 E VC, 2 US VCs, 3 LPs, 1 entrepreneur, 1 advisor, 2 others, 1 CVC) commented on the part luck plays in investment, and therefore, fund performance success.

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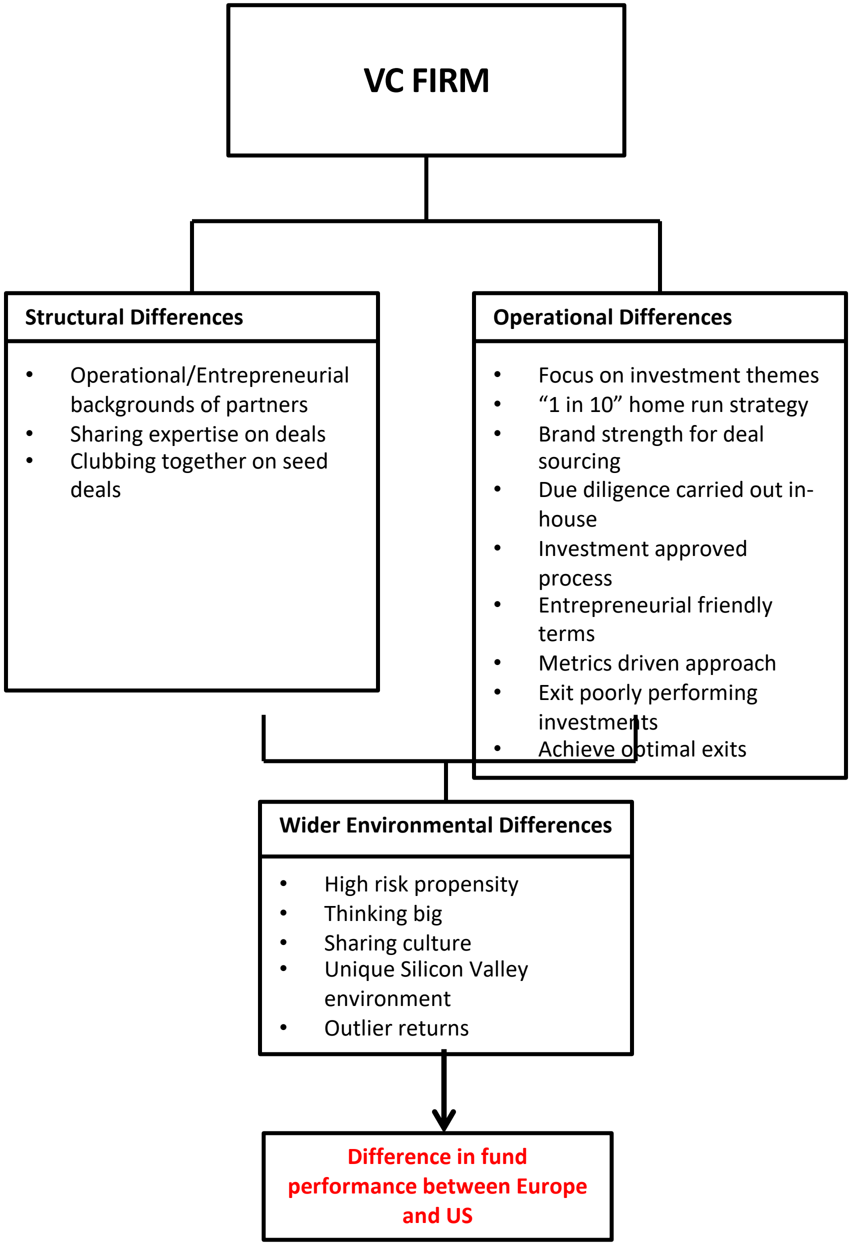
  "If there were UK managers who had serially successful funds, I'd say it wasn't luck, it was the skill of the managers, but there have been too few serially successful funds": UK LP

  "I would say an awful lot of it is luck. That they happened to find Google, Yahoo, Pinterest, Facebook, right? Very, very early on, right? Once you're lucky, twice you're good. But I think a lot of that is just a matter of placing a lot of big, risky bets": US entrepreneur


VC FIRM
Structural Differences
Operational/Entrepreneurial backgrounds of partners
Sharing expertise on deals
Clubbing together on seed deals
Operational Differences
Focus on investment themes
“1 in 10” home run strategy
Brand strength for deal sourcing
Due diligence carried out in-house
Investment approved process
Entrepreneurial friendly terms
Metrics driven approach
Exit poorly performing investments
Achieve optimal exits
Wider Environmental Differences
High risk propensity
Thinking big
Sharing culture
Unique Silicon Valley environment
Outlier returns
Difference in fund performance between Europe and US

Consistent top performance

- Only two US firms (SF VC, NY VC), one continental European firm (Swiss VC) and no UK firms showed consistency of top-quartile performance across all funds.
  (Harris et al (2014) confirmed a persistence in the performance of US VC funds but did not investigate UK VC funds. Lerner et al (2011) noted a consistency in performance of US funds but not UK funds)
- Engaged the “1 in 10”, home run, high risk approach to investing
- Used theme approach for new investment areas
- Had partners with operational and / or entrepreneurial backgrounds
- Had more than one partner involved on deals, pre and post investment
- Benefited from high profile and track record for sourcing deals
- Used entrepreneurially friendly terms in term sheets.

“What I never managed to find was consistency of performance in European funds compared to the best US funds. I’d struggle to name anyone that had done it twice, to be honest”: UK LP

Outlier performance

- **Only 9 VC funds (of 6 US VCs only) exhibited outlier performance (returns > 50% IRR)**
- **Exhibited "1 in 10", home run approach to investing (4 VCs)**
- **Used a theme approach for new investment areas (3 VCs)**
- **Partners with operational and / or entrepreneurial backgrounds (all 6 VCs)**
- **High profile of firms aided sourcing of deals (3 VCs)**
- **Used entrepreneurially friendly terms (4 VCs)**
- **Due diligence on investments carried out largely in-house (all 6 VCs)**
- **Consensus approach to approving investments (4 VCs)**
- **Sponsoring partner approves investment (1 SV VC)**
- **Senior partner can "lay across tracks" to push deal through (SV VC)**

Outlier companies

“The big outliers were in the US, the maximum performance, I think we found, was 720% IRR as opposed to European 260%”: UK LP

Conclusions

- Confirmed performance difference between US and European VC funds
- US / Europe VC funds differ in several structural, operational, wider environmental areas
- New findings include: operational / entrepreneurial background of US VCs, doubling up on deals, theme approach, “1 in 10” approach, use of entrepreneurial friendly terms, brand name benefit, sharing vs proprietary, local sector knowledge and deep networks of US VCs, the “luck” factor
- “Uniqueness” of Silicon Valley VC environment
- VCs and other stakeholders largely agree on areas of difference
- Guidelines for best practice VC investing >>>>>>>>>

Guidelines for best practice VC investing: Structural

- Funds should be of adequate size to provide initial and follow-on finance in order to allow young, high-growth businesses to grow and scale.
- Sector expertise of investment partners permits better deal sourcing, in-house due diligence and value adding activities.
- Taking the risk and investing early at the seed stage, maybe in syndicate with other VCs, may result in investments with outlier performance.
- Investing in the local geographic area may help better overall fund performance because of tighter networks and in-depth knowledge of local opportunities.
- Partners with entrepreneurial / operational backgrounds help facilitate the investment process through knowledgeable deal sourcing and adding value to portfolio companies post investment.
- Partners working together on deals facilitates the sharing of information and expertise.
- Venture partners, additional to the main investment team can bring additional resource to deals with specialist skills and knowledge.

Guidelines for best practice VC investing: Operational

- Pursuit of a higher risk, “1 in 10” investment strategy can lead to outlier returns through “home runs” and contribute to superior performance.
- Use of milestone financing, or “drip-feeding” investments, can help minimise risk exposure on an investment.
- Following a theme-based approach to investment trends may contribute to superior performance as may a focus on disruption in terms of technology, market or business model.
- Brand name, profile and track record help to attract better quality deals which can lead to better fund performance.
- Due diligence carried out in-house by sector specialist investment executives may be more effective, and less costly, than due diligence carried out by external advisers.
- Investment decisions should be made by the investment team, not by people external to the process. Use of consensus in decision making can remove the outlier investments and depress returns; deals “railroaded” through by senior partners may enhance returns.

Guidelines for best practice VC investing: Operational (cont'd)

- Investment terms should be as entrepreneurially friendly as the local competitive environment permits.
- Syndicating with VCs who are known to the investor aids better alignment of interests and less conflict between syndicate members. Effective collaboration with other VCs in pooling of expertise and knowledge about a deal can lead to better outcomes with due diligence and improved value add.
- Use of a metrics based approach to monitoring portfolio companies and weeding out poorer performing investments soonest contributes to better investment outcomes and improved fund performance.
- The in-house resources that VCs can bring to bear on their investments through value adding activities should contribute to overall improved performance, although the best investments may be where VCs have to add the least value because the companies are well-performing.
- Exiting too early from an investment should be avoided if at all possible; waiting for the best exit can help achieve optimal gains.

Guidelines for best practice VC investing:
Wider environmental

- A “thinking big”, ambitious culture, combined with a higher propensity for risk, can lead to outstanding returns.
- Open networks encourage information sharing and hence better knowledge of new technology developments and markets in contrast with a more closed and proprietary approach. Regulatory and legal environments, including copyright laws, need to be conducive to innovation.
- Extensive networks between VCs, entrepreneurs, large technology companies and other stakeholders, and a non-proprietary willingness to share time and resource in a “giving back” culture, help achieve better overall performance.
- A good supply of experienced CEOs and repeat entrepreneurs are needed to run high growth potential venture backed businesses.
- Luck is an ingredient of success in VC investing; however a major component of VC success can be attributed to skill in recognising a serendipitous opportunity and capitalising on it.

Routledge International Studies in Money and Banking

VENTURE CAPITAL PERFORMANCE

A COMPARATIVE STUDY OF INVESTMENT PRACTICES IN EUROPE AND THE USA

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