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The truth about venture capitalists, Part 2

8-11 minutes

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As promised:

Comparing venture firms, and comparing partners within firms:

When raising venture capital, remember that venture firms vary wildly in style and quality.

For example, some venture firms are very entrepreneur-friendly. Others are notoriously brutal.

Interestingly, financial success in the venture capital profession does not seem to be correlated to entrepreneur-friendliness.

Individuals (partners) within each venture firm vary wildly in style, personality, knowledge, experience, ability to be helpful, drive, and ethics.

Personally I'd recommend being more focused on picking the right partner than picking the right firm.

This is slightly counterintuitive advice -- and firm quality does matter -- but the partner is the person you're going to be working with. The other people at the firm you will see probably twice in the whole lifespan of your company.

Best of both worlds is to pick a strong partner at a strong firm, but be aware going in that even strong firms have weak partners.

Venture capital professionals arguably used to be a more homogeneous group: the founders and pioneers of the business, and their hand-picked proteges who had grown up as venture capitalists under close supervision and with rigorous training.

The explosion of venture capital in the late 90's has led to a much broader range of people becoming partners in venture capital firms.

Many partners today have little venture capital experience but come out of an operating background (an executive role at a big company, or experience as an entrepreneur with their own startup), or come out of some other background (corporate attorney or executive recruiter), or come straight out of business school with no meaningful experience whatsoever.

There are pros and cons to working with any of these kinds of partners.

For example, VCs with operating experience are great when it comes to sitting down and talking about how to run a business, but sometimes they have less perspective (because their career was probably focused on one or two companies, whereas a professional VC has probably invested in 30+ companies), and they may have trouble keeping their hands off the steering wheel.

A VC with an executive recruiting background can be incredibly helpful at recruiting -- one of the main areas in which a VC can add value (see below).

And a VC who used to be an attorney can be very helpful when you need to get a parking ticket fixed.

But there's probably still no substitute for the VC who has been a VC for 20 years and has seen more strange startup situations up close and personal than you can imagine.

A venture capitalist's ideal investment:

A venture capitalist's ideal investment is the one that would be a huge success without her.

How much help, and what kinds of help, you can expect from your VC:

Assuming your startup does not fall in the category of a VC's ideal investment, what kinds of help can you hope for from your VC?

First, it's important to really internalize that the founders of a startup are the ones who have to make a startup succeed.

Odds are, nothing your VC does, no matter how helpful or well-intentioned, is going to tip the balance between success and failure.

In addition, VCs are -- usually -- incredibly busy people. Sitting on as many as a dozen boards, sourcing new investments, tracking the fast-moving technology industry, raising money and managing their LPs, and pitching in on their partners' companies and their problems takes up a lot of time.

(Although every once in a while you will run into a VC who is lazy as sin -- but that's a topic for another post, when I've had more to drink.)

The best assumption to make is that your VC's primary value add is the cash they are investing.

Then you'll always be surprised on the upside.

Additional areas in which a VC can help include: recruiting, strategy, partner introductions, customer introductions, additional fundraising, and generally being a good sounding board and source of advice and industry knowledge.

Some firms run incredibly helpful programs such as forums in which new consumer Internet startups can interact with major advertisers, for example.

The only real way to find out how much help you can really expect from your new VC is to ask the founders of other companies funded by that same partner.

Finally, never expect the help to just happen unsolicited. If you want it, ask for it proactively.

You actually don't want a VC who provides too much help without being asked. I leave the why as an exercise for the reader.

How VCs spend an awful lot of their time, and why you should feel sorry for them:

My friends who are VCs seem to spend a surprising amount of their time working with their failing companies.

The reason goes right back to the definition of a VC's ideal investment: their winners are succeeding -- they don't need very much help.

Some of the best VCs in the industry spend most of their time on their successes, helping to boost them to higher and higher levels of success.

But generally, life in the VC trenches seems to consist of trying to jumpstart or otherwise fix fatally flawed startups.

Can you imagine how un-fun that would be?

Venture capitalists: soulless and rapacious capitalists, or surprisingly generous philanthropists? Or both?

Here's something surprising about venture capitalists: their primary job is often helping very worthwhile nonprofits build larger and larger endowments to be able to continually make the world a better place.

The largest investors in many top-tier venture capital firms are nonprofits -- particularly universities and large philanthropic foundations.

This is partially because such institutions are very patient investors and have very long time horizons. But this is also partially because many of the top venture capitalists feel a real sense of obligation and mission to help such vital organizations grow and flourish.

Traditionally this has been hard to see because venture capital firms have wrapped the identities of their investors (limited partners, in the lingo) in confidentiality agreements. But more recently, via certain SEC filings and disclosures by public universities, it has become possible to get a glimpse into the investor bases of some of the world's best venture capital firms.

For example, it has been previously well publicized that you can see who Sequoia's investors are by reading the SEC disclosure on the Google/Youtube acquisition.

You can see in that filing that Sequoia's major investors include such universities as Amherst, Brown, Colby, Columbia, and Dartmouth -- and that's just into the D's. Similarly, philanthropic foundations invested in Sequoia include the Ford Foundation, the Moore Foundation, the Irvine Foundation, the Rockefeller Foundation, and the Hewlett Foundation.

This is not unusual.

The best VCs get to improve society in two ways: by helping new companies take shape and contribute new technologies and medical cures into the world, and by helping universities and foundations execute their missions to educate and improve people's lives.

Why we should be thankful that we live in a world in which VCs exist, even if they yell at us during board meetings, assuming they'll fund our companies at all:

Imagine living in a world in which professional venture capital didn't exist.

There's no question that fewer new high-potential companies would be funded, fewer new technologies would be brought to market, and fewer medical cures would be invented.

We should not only be thankful that we live in a world in which VCs exist, we should hope that VCs succeed and flourish for decades and centuries to come, because the companies they fund can do so much good in the world -- and as we have seen, a lot of the financial gains that result flow into the coffers of nonprofit institutions that themselves do huge good in the world.

Remember, professional venture capital has only existed in its modern form for about the last 40 years. In that time the world has seen its most amazing flowering of technological and medical progress, ever. That is not a coincidence.

How to make a VC's head explode, in one easy step:

Point out to her that her compensation from carried interest should be taxed as ordinary income, not capital gains, since she's receiving a fee for service and it's not her capital at risk.