

Inside the Mind of a VC

Why Syndicates Matter

Periodically, our partnership takes a few days off by ourselves to contemplate what we are doing well and, more importantly, what we need to improve. We recently returned from such a gathering with profound new respect for some rather ancient wisdom:



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syndicates matter. Looking back over 20 years of successes and failures of our venture-capital-backed startups, we noticed a recurring pattern. While a strong syndicate of like-minded, like-sized venture investors did not ensure success, the absence of such a group was a leading indicator of failure. We were hard-pressed to remember more than one occasion when going it alone,

or pressing ahead with a syndicate of weaker players, yielded positive results.

Sadly, this pattern is not news. When I joined the venture business in the early 1990s, it was already conventional wisdom. My partners, with over a decade in harness by then, had learned those lessons through the boom and bust of the mid-1980s. But with the Internet bubble, the VC funding boom, and the rush to get into increasingly hot deals, that wisdom was lost—not just by OVP, but by the industry as a whole. Many deals were done

based on how much cash a single venture firm wanted to put to work, rather than how much the startup needed or what kind of help other than money would have benefited the new company.

So ours is a cautionary tale, not only for those of us acting as fiduciaries for other people's money, but also for those who would take that money and build a company. As an entrepreneur, you and only you get to decide whose money you take. Raising venture capital is hard. It can be tempting, after running the gauntlet and emerging at the other end with a term sheet, to try to negotiate the terms but simply accept the set of players as a given. If you have done your homework on the VCs, as they will have on you, you will already know who you want on your board when things go bump in the

night. (Trust me, they will!) Instead of taking the first term sheet you get, with a pre-programmed syndicate, you might consider the Chinese menu approach. If you have a number of

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quality venture firms at your door, consider taking one from column A and one from column B. Chemistry matters, so those firms may or may not agree to team up, but it does not hurt to ask.

Of course, an alternative approach is the standard ploy of trying to play one firm or

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syndicate against another to get the best terms. This overlooks an important point: the best terms are not merely found in valuation and preferences; rather they are offered by the investing group that gives you the best chance of success. An old saying goes, “If you make the pie big enough, you can afford to leave a little on the knife.” Many successful ventures survived near-death experiences because of great syndicates. The investors offered their company real added value, and had the courage and the capital to hang in there through a period of difficulty. An OVP example was a wireless firm in Seattle called @mobile, which we backed along with a top VC from the Valley. It came within weeks of going under, but with a little more cash and a lot of hard work, it recovered to deliver 20 times our investment. In contrast, many failed ventures never got the chance to find out if another few weeks or months might have enabled them to survive and ultimately prosper. Their investors ran out of good advice and dry powder at an inconvenient time, or got a sudden case of “deep pockets but short arms disease.”

As venture capitalists, we’ve seen this movie from the other side of the screen. We’ve been left holding far too many bags after others have hit their investing limit or have simply cut and run. So, there are VC firms we trust and others that we shy away from. There are partners at fine firms who we know well and whose behavior we can forecast, and there are those we know to avoid. And we’ve discovered that even among firms we like and partners we greatly respect, an added risk arises if there is any significant difference in the amount of money

that two VC partners want to invest. It doesn’t hurt to be slightly smaller than your syndicate partner, but it can get very lonely if your investment is much larger.

Whether you are an entrepreneur, a service provider to such a firm, or a venture investor yourself, syndicates matter. In good times, strong syndicates offer respect, trust, and a positive collaboration of styles and resources. In tough times, you know how they will react and you know that your objectives are aligned. Don’t settle for less than a strong syndicate. Otherwise you’ll be selling your company, and your chances for success, short.



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