The Rise of Fat Venture Capital

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10/9/2013

http://andrewchen.co/2013/10/09/the-rise-of-fat-venture-capital/#

Reinventing the VC industry
In 2007, before YCombinator and AngelList had changed the industry, I worked in a nondescript office park in the heart of the venture capital industry off Sand Hill Road. Amid the leafy sprawl of buildings next to 280 and Stanford University, billions of dollars were and are invested out of the fancy offices of VC/PE firms you've never heard of. The whole industry has been shrouded in opaqueness since it was created decades ago, built on relationships from business schools, professional networks, and investor referrals. In 2007, I worked at a big firm as an Entrepreneur-in-Residence, and did my best to make sense of this world.

The first thing I noticed was that the venture capital industry seemed so opaque as to be self-defeating. Entrepreneurs didn't know who to talk to, and most can't name more than 2 or 3 firms. While venture capitalists would pontificate about the importance of differentiation, all of their websites consisted of a bunch of blue-shirted dudes that all invested in the same stuff. This always confused me.

I remember at one point I had lunch with a General Partner of a Sand Hill firm and we talked about PR:

Me: So why don't VCs do more PR?

General Partner: Great entrepreneurs know to come to us. We don't have to go to them. And in fact, having great investment returns and being out there in the public don't really correlate, so we don't do it.

It sorta made sense to me then. This approach had been true for the first few decades of the venture capital industry. Getting ahold of a GP through an entrepreneur's network seemed like a basic test of competence.

Thus, other than raising the money, you didn't need much overhead to run a VC. You just needed a couple guys in a nice office, 1 admin per partner, and a website. If you wanted to get fancy, you could have a venture partner or associate or two. Maybe 6 professionals plus their admin staff.

But just a few years later, in 2013, we now see VC firms with over 80 professionals. Not just one, but multiple firms are doing this. And even small funds are experimenting with events, content marketing, software infrastructure, etc.

This is the new era of "Fat Venture Capital."

How did this happen?

Lots of trends driving differentiation of capital
There's a lot of trends driving VCs to differentiate. The obvious stuff: It's cheaper to start a company. There's more seed money, in the form of both accelerators writing $20k checks and seed funds writing $500k checks.

There's a lot more information out there, for both what firms to pitch and what terms to expect. There's been a lot of great material covering the trends affecting startups so I won't elaborate more here.

What's less frequently discussed has been the recent trends on the venture capital side. A lot of firms decided that the high market risk, low tech risk nature of digital bets meant that they needed to employ a "barbell" strategy. Lots of seed stage investments, plus lots of late-stage investments, and not much in-between. Many early firms that traditionally would lead Series As and then hand off the larger "late stage venture capital firms" now see themselves playing at every stage. But if you wait to do later stage bets, then the traction is more obvious, and there's more head-to-head competition between firms as they chase obvious deals. More head-to-head competition means that differentiation matters.

Similarly, the lower capital requirements of startups means that there's been a lot of new firms started recently. It's a lot easier for some successful startup execs to start a new VC fund by raising $20M or $50M, rather than a traditional VC that raises $200M or more. This has brought a lot of entrepreneurial energy to a sector that often behaves like a sleepy money management industry, rather than the dynamic startups in which they invest.

This entrepreneurial energy is especially important in an industry where the guys who invented the industry are now long retired. When you read books or watch documentaries about the early VC industry, you can see that the early guys who knocked on the doors of insurance companies in the midwest were truly entrepreneurs. Years later, many firms are led by professional investors who are two generations removed from these early innovators. While the successful-entrepreneur-turned-VC is still widely admired, plenty of firms are stocked with MBAs-turned-associates-turned-VCs, who are prone to view VC as a career rather than an competitive and entrepreneurial endeavour in itself.

And of course, many large firms are simply reacting to the competitive pressure from Andreessen Horowitz. They popularized this services-based approach and this WSJ interview is worth reading about their approach. The CAA analogy is particularly insightful.

The unbundling of the General Partner

The impact for entrepreneurs is straightforward. It used to be that an investment from a General Partner of a VC was a bunch of things bundled together:

- Money
- Expertise
- Oversight
- Professional network

These days, we're moving to a model where this all gets unbundled. Money comes from the VC, but also from a long list of investors sourced from crowd funding platforms. The professional network for a firm is supported by a large services team. Advice can come from a long list of advisors and operational folks that are easy to track down on LinkedIn. Functions like executive recruiting, technical recruiting, PR, etc. don't come from the particular GP who wrote the check, but rather, the services team that works for them. Instead of the GP sending you random links they've read, instead there's dashboards and link-sharing services that are private amongst the other portfolio companies of the investor.

Furthermore, we'll see the internal functions of a VC firm, like marketing, evolve to be pointed towards entrepreneurs rather than investor management. Instead of press releases on PEHub, we'll see firms act more like SaaS marketers: Content marketing, professional events, even paid advertising. Why shouldn't a VC firm be buying Facebook ads targeted at the next crop of Stanford CS graduates?

Ultimately great VCs will continue to do well. Many won’t embrace the Fat Venture Capital model, but will do fine, because their judgement, expertise or network is just that good. But for the rest of the industry, moving to differentiate will be the norm.

Entrepreneurs will benefit. More transparency and competition will mean that the “the good ones will come to us” attitude will be a thing of the past. Instead, great VCs will chase the great entrepreneurs, because in a world where the supply of great entrepreneurs is smaller than the supply of plain ol’ money, that’s the way it should be.