EQUITIES

Who You Know Matters: Venture Capital Networks and Investment Performance

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Many financial markets are characterized by strong relationships and networks, rather than arm's-length, spot-market transactions. We examine the performance consequences of this organizational choice in the context of relationships established when venture capitalists (VCs) syndicate portfolio company investments in a comprehensive sample of U.S.-based VCs over the period 1980–2003.

Controlling for known determinants of VC investment performance, we find that VC funds whose parent firms enjoy more influential network positions realize significantly better performance, as measured by the proportion of portfolio investments that are successfully exited through an IPO or a sale to another company. Similarly, we find the portfolio companies of better-networked VC firms are significantly more likely to survive to subsequent rounds of financing and to eventual exit. The magnitude of these effects is economically large, and is robust to a wide range of specifications.

If more highly networked VCs enjoy better investment performance, our findings have clear ramifications for institutional investors choosing which VC fund to invest in. In addition, our analysis provides a deeper understanding of the possible drivers of the cross-sectional performance of VC funds. Our findings also shed light on the industrial organization of the VC market. Given the large returns to being well networked that we document, enhancing one's network position should be an important strategic consideration for an incumbent VC, while presenting a potential barrier to entry for new VCs.

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