From value-added VCs to Equity Crowdfunding Syndicates: the new Platforms of the Venture Capital Industry

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Abstract

"If you look at the venture business, for an industry that funds innovation – it really doesn’t have that much”, declared Josh Kopelman, founding partner at First Round Capital, in 2013. Notwithstanding, observing the industry in the last decade, one can identify at least two evolutions. First, a new generation of VC firms, to which First Round Capital belongs, has emerged and is reinventing VC firms’ traditional organization to offer additional services beyond investment capital and their partners’ time. Second, equity crowdfunding, spearheaded by equity crowdfunding syndicates, now allows entrepreneurs to raise funds entirely online and has become an interesting alternative to traditional venture capital.

This paper’s first objective is to describe and evaluate the strategies embraced by these new types of value-added VC firms. The second objective is to review online syndicates’ characteristics and their evolution since their inception 3 years ago. I first consider whether they can become credible competitors of VC firms and end with a few predictions regarding the space equity crowdfunding syndicates are likely to occupy.

I show that the new emphasis placed on VC firms’ value added services has empowered new entrants in the VC market, enabling them to break into the concentrated circle of the very few VC firms actually earning significant returns. Beyond the objective of improving their portfolio companies’ operating performance, I show that VC firms embrace this strategy in order to 1) increase the size of their inbound deal flow, 2) improve the firm’s brand and 3) provide General Partners with additional arguments to close competitive deals.

In a second part, I argue that online syndicates could increasingly embrace the key success factors shared among successful venture capital firms. However, their lack of reputation may undermine their performance in the next venture capital cycle. I conclude that equity crowdfunding syndicates are primarily an interesting addition to the traditional early-stage industry, rather than a substitute for traditional VC firms. Lastly, I show how VC investors can take advantage of online syndicates to increase their firms’ competitiveness.

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1. Introduction

1.1. Motivation and research questions
In the last five years, the Venture Capital industry has grown significantly both in Europe and the US and has reached unprecedented levels since the explosion of the dot-com bubble. Even though investments slowed down in the last two quarters, $58.8 billion dollars were invested by VC firms in the United States in 2015, turning 2015 into the second-highest full year since 1995 (NVCA, 2016). Furthermore, research offers evidence that Venture Capital positively impacts the economy, providing funds to companies responsible for 5.3-7.3% of employment in the US. Notably, VC-backed companies have been at the origin of 35% of all US IPOs between 1980 and 2015 – although only 0.22% of companies created within this time period were VC-funded (Puri & Zarutskie, 2012).

Most Venture Capital firms now claim to be “entrepreneur friendly” (NVCA, 2013). They also strive to differentiate between themselves by highlighting their value-added beyond their capital investment: the advisory skills of their partners, their past experiences as entrepreneurs or their large network of business partners. Nonetheless, this value-added has up until recently mainly been provided by only one investor, who supervises 10 portfolio companies and thus cannot spend more than 2 hours per week with each of his/her portfolio start-ups: “The popular image of venture capitalists as sage advisors is at odds with the reality of their schedules” writes Zider (1998).

A new generation of VC firms, spearheaded by Andreessen Horowitz, recently started to integrate functional teams, which do not focus on the analysis of investment opportunities but dedicate their time to supporting portfolio companies’ daily operations. These teams allow VC firms to offer additional services to help entrepreneurs meet their strategic challenges regarding recruitment, finance, design or marketing. These also work on organizing collaboration between portfolio start-ups and build connections between entrepreneurs and third-party business partners or potential customers. The success of Andreessen Horowitz, which raised $300m when it was created in 2009 and manages around $3bn 6 years after motivates me to conduct a deeper analysis of this new strategy in venture capital.
- What are the reasons driving VC firms to reshape their organization to integrate operating professionals?
- How do these VCs provide additional value to their portfolio companies?
- How does this strategy impact VC firms' competitiveness?

In June 2013, AngelList introduced a new type of investment vehicle: online syndicates. These allow any investor to create their own “pop-up VC fund”, by pooling investments from other accredited investors online in order to invest in high-growth-potential companies. In 2015, $160M was invested through online syndicates, 53% more than in 2014 (AngelList, 2016). Altogether, online syndicates invested more in 2016 than any other traditional seed fund. Moreover, some of the largest online syndicates now have sufficient backing to invest several millions of dollars per deal, and hence to start competing with traditional venture capital firms. In 2013, the advent of these syndicates gave rise to different reactions from traditional venture capital investors, but a large majority of them acknowledged the potential disruption that these syndicates could bring to the industry.

The second objective of this paper is to assess online syndicates’ impact on the early-stage financing industry, as of today and in the coming years.
- Under what conditions could online syndicates be competing with traditional VC firms, and how will this evolve in the future?
- How do traditional VC investors view the rise of online syndicates?
- What space are equity crowdfunding syndicates likely to occupy in the future early-stage financing landscape?
1.2. Structure of the paper

In order to answer these research questions, in Chapter 2, I explain the role of Venture Capital, describe its economics and outline several relevant market characteristics. In Chapter 3, after reviewing the evolution of the industry in the last decade, I examine in detail how Andreessen Horowitz designed a new model of venture capital firm. I then consider how smaller VC firms can also improve their value proposition despite having more limited resources to invest in portfolio companies’ support. The chapter ends by assessing of the pros and cons of this model.

In Chapter 4, I put AngelList in the context of crowdfunding, and explain how online syndicates work. I analyze their design, and its related strengths and weaknesses, in order to assess if they are likely to become true competitors of traditional VC firms.

In a last chapter, I describe the views of Venture Capital investors on these syndicates, and show that online syndicates, as an investment vehicle, can present interesting complementarities with VC funds. In conclusion, I make a few predictions on the space online syndicates are likely to occupy in the early-stage financing landscape.

This paper draws from the entrepreneurial finance literature, and from the analysis of articles published by industry professionals such as venture capital investors, limited partners, entrepreneurs and online syndicates’ lead investors. This analysis is also informed by 8 in-depth interviews, 7 with VC investors working in a traditional VC firm and 1 with a lead investor managing an online syndicate on AngelList.
2. An introduction to Venture Capital

2.1. The role(s) of Venture Capital

Start-ups are typically small and young companies facing a high level of uncertainty that often prevents them from accessing traditional sources of capital like banks or funding from capital markets. They have scarce revenues that do not allow them to cover their development expenses, and often no tangible assets to pledge as collateral to raise debt financing from banks. Venture capital has emerged as an important financial intermediary to provide capital to these companies, filling the gap between the provision of limited funds to entrepreneurs from family and friends, and the provision of secured, low-risk funds from financial institutions (Ortgiese, 2007). The National Venture Capital Association provides us with a definition of Venture Capital as: “money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors” (NVCA, 2001).

Early-stage investors need to manage three risks: uncertainty, asymmetric information and agency problems (Josh Lerner, Leamon, & Hardymon, 2012). Early-stage deals are uncertain because companies are young, have no track records, and often use cutting-edge technologies. Investors also need to deal with situations of asymmetric information insofar as entrepreneurs know more about their companies than they do. Finally, investors bear important agency costs, considering that entrepreneurs might not manage the company according to their investors' interests subsequent to an investment. VCs cope with these risks by staging their investment in different phases, by using investment contracts to protect and align their interests with entrepreneurs' interests (Kaplan & Stromberg, 2000), or by taking board seats in their portfolio companies (Josh Lerner, 1995). They also specialize in specific industries to reduce the asymmetry of information (Dotzler, 2001).

Angel investors, who are in general not professional investors, use less formal methods (Kerr, Lerner, & Schoar, 2014), but also prefer to invest in their field of expertise or in their geographical area to reduce ex-ante risks. They also tend to repeatedly visit the company they invest in to limit agency costs ex-post (Goldfarb, Triantis, Hoberg, & Kirsch, 2013).
2.2. How Venture Capital works

Interactions among players in the VC market are shown in the figure above from Da Rin (2010). Most venture capital firms are organized as Independent Partnerships of around a dozen professional investors, called general partners ("GPs"). Gompers & Lerner (2001) define Venture Capital as a cycle, which starts when a VC firm raises money from institutional investors such as university endowments, public or private pension funds, insurance companies or wealthy individuals (altogether called limited partners or "LPs") through vehicles called "funds". These funds’ lifetime spans over 8 to 10 years, divided in two equal parts. A first period lasts for 4 to 5 years during which general partners invest, monitor and add-value to portfolio companies ("the investment period"). In a second 4-to 5-year long period, GPs sell their equity in order to reimburse their LPs ("the exit period"). The performance of their previous fund then enables GPs to raise another fund. The most common exits happen through the acquisition by later-stage funds ("Leveraged Buyout"), by other larger companies in M&A operations or when companies go through an IPO (Gompers & Lerner, 2001). Most of the time, VC firms try to raise another fund once the investment period of the preceding fund has ended, and hence manage several funds at the same time. A particularity of the Venture Capital model, compared to capital markets or other types of asset class, is that investors need to commit their funds during an 8- to 10-year period. While it allows VCs to keep investing during busts or financial downturns, it also provides...
limited flexibility to investors who could face liquidity constraints, such as individual investors. Online syndicates tries to overcome this limitation by letting individual investors withdraw their funds at any time, as we’ll see in Chapter 4.

2.3. The economics of Venture Capital

VC investors’ compensation is two-fold. A fixed compensation comes from annual management fees of around 1.5% to 2.5% of the size of the funds or of the total amount invested in start-ups (Josh Lerner et al., 2012). A performance-based compensation called “carried interest” or “carry” is distributed to GPs when they reimburse the funds. If the VC firm has been successful investing the fund, they reimburse the total amount committed by their LPs and a certain interest fee previously agreed upon called hurdle (around 7-8%). The remaining amount is then shared according to a specific rule (80%/20% is the most common repartition) between LPs and GPs. The carried interest mechanism notably allows LPs to align GPs’ interests with theirs (Kaplan & Schoar, 2005).

Furthermore, most of VC funds’ gains come from a very small number of their investments. Sahlman, 2010 finds that 85% of VC returns stem from the proceeds generated by only 10% of their portfolio companies. According to the NVCA, on average, 50% of VC-backed companies fail, 40% return moderate amounts (1-2x) and less than 10% produce returns (10x or more) (NVCA, 2015). These statistics are important insofar as they underline the importance for investors to experiment and to diversify their portfolio of investments to achieve significant returns (Ewens, Nanda, & Rhodes-Kropf, 2015). These suggestions are also valid for online syndicates’ backers, who get to choose each deal they want to invest in.

2.4. Market characteristics

The Venture Capital market is a cyclical market, and evolves in reaction to the public market variability (Gompers, Kovner, Lerner, & Scharfstein, 2008). Venture Capital returns have evolved below and above the returns of the S&P500. Analyzing data on US VC firms from 1980 to 1997, Kaplan & Schoar (2005) show that, net of fees, VC returns outperformed the S&P500 during this period. However, the Kauffman Report shows that 78% of the VC funds, in which the Kauffman Foundation had invested, failed to hit returns 3% above the Russell 2000. The Russell 2000 is an index measuring the performance of the bottom 2,000 stocks that are part of the 3,000 biggest US stocks, and is often used as a benchmark to compare
the performance of “small-cap” mutual funds. LPs expect their investment to outperform the Russell 2000 by 3% considering the illiquidity and the risk of the venture capital asset class compared to public markets (Mulcahy, Weeks, & Bradley, 2012). Looking at VC firms separately, the performances are also highly skewed, with very few firms—often the most established, experienced (Kaplan and Schoar, 2005) and reputable (Hsu, 2004)—actually performing well and a large number of others providing low or negative returns to their investors.

Therefore, LPs rather invest more money in already existing and well-performing Venture Capital firms than invest in new Venture Capital firms raising funds for the first time. This creates a feedback loop, which enhances the position of leading and pre-existing venture capital firms and creates significant barriers to entry for newcomers, be they emerging VC firms or online syndicates. As stated in a 2013 Ernst & Young report: “LP investors are showing a preference for the most successful brand name funds, which suggests consolidation will continue” (EY, 2013). Despite these results, in the last decade, the concentration cycle in VC markets has been challenged by several newcomers, as I describe in the next chapter (Sorrentino Hajer, Wiggins, & Cicero, 2015).
3. Innovations in the Venture Capital industry

3.1. 2009: Is Venture Capital broken?
Several industry experts have raised serious criticisms about Venture Capital in the last decade, some of them even concluding that the Venture Capital model was broken (Austin, 2009). On the LP side, the Kauffman Reports, published in 2012, showed that 62% of VC funds did not exceed market returns after accounting for fees. More than GPs failing to make the right investment decision, the low performance of the asset class could also be explained by the market’s incapacity to support the large amount of money invested by LPs while returning significant performance (Wilson, 2009). The report also raised serious concerns about GP’s compensation model, which would fail to reduce agency costs between LPs and GPs, providing that the main part of GPs’ compensation stems from their 2% management fees rather than their carried interests. A survey also showed that 53 out of the 100 Venture Capitalist executives believed that the Venture Capital market was broken in 2009 (Austin, 2009).

Moreover, entrepreneurs raised their voice around their negative experiences with VC investors, denouncing the excessive control rights or downside protection demanded by VCs, or the time many of them would take to make investment decisions in companies facing crucial needs of capital (Chapman, 2013). It notably led to the creation of VentureHacks, a blog created by Naval Ravikant, whose goal was to increase the transparency in the VC industry. VentureHacks eventually became AngelList. VCs themselves voiced criticism about their peers, Vinod Khosla even declaring that “70-80% of VCs added negative value to start-ups” (Cutler, 2013).

3.2. Emerging funds and innovations in Venture Capital
In parallel, the market evolved. First, start-ups evolved. Influenced by new entrepreneurship methodologies such as “The Lean Start-up”, benefiting from the plunging costs to start a company due in part to the advent of cloud computing, the ubiquity of open source technologies and fewer upfront expenses (Kupor, 2014), a new generation of younger and less experienced entrepreneurs has emerged. In particular, 2007 and the advent of Amazon Web Services EC2 signaled a clear break between two generations of entrepreneurs (Ewens et al., 2015).
3. Innovations in the Venture Capital industry

Facing a larger demand for smaller amounts of capital, new sources of funding have appeared such as accelerators, Micro VCs, super angels, and crowdfunding platforms. In particular, micro VCs and super angels using easy terms, entrepreneur friendly practices and not any requiring board seats (D. Lerner, 2014) came out contrasting with VC firms’ market practice. VCs reacted by adopting a strategy called “spray and pray”, according to which they invest a smaller amount of capital and give less guidance to a larger number of earlier stage start-ups. The goal is to provide start-ups with enough funds to let them reveal their potential in order to de-risk VCs’ larger investments at later stages. (Ewens et al., 2015).

In parallel, a new generation of VC funds, called emerging funds, defined as the first four funds of a given GP (Clarkson, 2016), broke into the small circle of well-performing VC firms and consistently accounted for the largest part of the industry total gains (Sorrentino Hajer et al., 2015).

Their performance can be linked with their innovative strategies, which can be broken down into 5 success factors (Park & Vermeulen, 2015): 1) their increased visibility, particularly online, 2) the new emphasis they have placed on branding their firm (NVCA 2013), 3) their commitment to bringing more transparency to the market, 4) the adoption of more entrepreneur-friendly investment terms, and 5) the increasing importance they have attached to added value beyond their financial investment (Sorrentino Hajer et al., 2015).

In parallel, in a market where cash cannot be a differentiator and the best entrepreneurs can choose their VC investor, VC funds strived to craft a differentiated value proposition. Mixing this increasing need of branding and the necessity to differentiate, the last evolution of VC firm’s strategy consists currently in becoming a “VC platform” (Acunzo, 2015). Every VC I interviewed had a different view on the exact definition of a “platform strategy”. To cut a long story short, the strategy aims to bring the VC firm back to the center of the entrepreneurial ecosystem by offering additional services to entrepreneurs and organizing collaboration between entrepreneurs, third-party service providers, corporates, and follow-on investors.

One of the first and now probably the most emblematic firm to embrace this strategy is Andreessen Horowitz (henceforth a16z), VC firm created in 2009, but it also spreads to smaller VC firms that I describe in the next paragraphs.
3.3. The inspiration: a16z and the agency model

The following section links information from Harvard Business School's case: Andreessen Horowitz (Eisenmann & Kind, 2013), several interviews of a16z's GPs available online and an interview of Peter Levine, GP at a16z, conducted in person.

Marc Andreessen and Ben Horowitz founded Andreessen Horowitz in 2009. The founders knew that they had to bring something different to the market in order to be competitive. Their strategy can be described around three pillars: the marketing of their firm, their focus on founders' CEO, and the development of an extended value-added network around their firm.

First, they have placed a greater emphasis on marketing, hiring and being the first VC firm to promote a PR specialist as a partner of their firm. Marc Andreessen’s presence on social media increased dramatically and his thesis “Software is eating the world” (Andreessen, 2011) spread at lightning speed in newspapers around the world.

Second, they realized that the most promising companies in the history of technology had been founded by young “founder CEO”, who had kept their position as CEO as their company grew, but who had neither experience in management nor network. They addressed these two needs by partnering only with previous operators as GPs, and by building an extensive network of people, which would help entrepreneurs in their daily operations.

To build this network, they crafted a strategy inspired by a talent agency created in 1975 called Creative Artist Agency. The key success factor of Creative Artist Agency at the time was its focus on hiring functional experts, which would help Creative Artist Agency agents in providing their artists with a larger amount of cross-industry opportunities. Benefiting from the support of different in-house experts specialized on publishing, on the movie or the music industry, a CAA Agent could then offer a larger amount of opportunities to each artists. Marc Andreessen and Ben Horowitz decided to reproduce the same strategy applied in the Venture Capital space. The two cofounders hired a team of 43 functional experts, focusing only on entrepreneurs’ support and on building new opportunities for each of them to expand their business. Instead of formally playing the role of any external consultants, they identified the needs shared by every company and assigned each of their in-house team with the mission of building a network of business partners relative to these needs. For example, the team focused on recruiting built privileged relationship with
recruiting agencies, facilitating connections with entrepreneurs, instead of doing the recruiting agency's work themselves. As Marc Andreessen explained: "We're building a network and we're plugging founders into that network, which is not the same as servicing them" (500 Startups, 2013).

Within the top-tier VC firm, only Kleiner Perkins had a small team of design experts. No other firms had really thought of hiring functional experts. The histogram below illustrates the disruption brought by A16Z regarding VC firm's organization.

![Histogram](image)

**Figure 2: Number of employees per team in top-tier US VC firms**
(Source: Eisenmann, 2013)

The role of the "operating team" at a16z is based on three core principles (Eisenmann & Kind, 2013):

- Its scalability: a16z members shall not replace any employee in portfolio companies.
- The relationship with third party service providers such as recruiting or PR agencies has to be bilateral: a16z's team focused on recruiting could provide contacts to recruiting agencies and not only be requesting some. The idea is that third party partners could later reciprocate and refer interesting candidates or investments opportunities they would have worked with to a16z.
- Any business relationship built by a member of a16z's operating team should aim at improving the firm's deal flow.
a16z’s operating team is structured in 5 departments dedicated to help entrepreneurs in 5 key areas: the recruitment of tech talents, the recruitment of executives, marketing, business development, and the identification of potential acquirers or follow-on financers.

Executive Briefings, a service offered by the market development department, is an interesting example of the new role embraced by a16z compared to any other VC firms. It allows any company, funded or not by a16z, of any size, to request a meeting with a16z’s investment team to get feedback on their business, their industry and evaluate the potential to collaborate with a16z’s portfolio companies. With these briefings, a16z enlarges its reach, improves its deal flow and builds potential fruitful connections ultimately impacting their portfolio companies’ operations.

The success of a16z, which returned two times its first fund after two years (500 Startups, 2013), and manages around $3 billion 6 years after, raised several questions in the industry on the replicability of the model in other VC firms. More importantly, a16z’s success highlights the emergence of new key success factors in Venture Capital around VC firm’s branding, the appeal of a new profile of investors, operators rather than financers, and the potential impact of integrating a functional team on the VC firm’s competitiveness.
For a16z, adopting this model had a significant impact on the firm’s economics. In particular, a16z’s management fees and carried interest are at the upper range of the industry. a16z’s GPs also reallocated a large part of their management fees to hire new team members, some of them relying only on the carried interest and not earning any salary. Hence, these large functional teams might be hardly affordable for a firm that would not manage funds as large, or for a firm that would need to entirely reshape its internal organization. Peter Levine commented: “The economics do not necessarily work when you want to change your model. It works at Andreessen because GPs are operators, and because Marc Andreessen was famous”. However, sometimes influenced by a16z’s success, smaller emerging funds investing at earlier stages, and often benefiting from lower amounts of management fees, have also embraced a platform strategy at a smaller scale.

3.4. Platform strategies in early-stage VC firm

Earlier stage VCs’ platform strategy can be broken down into 4 elements: the hiring of in-house experts who bring expertise on very specific challenges shared by portfolio companies; the creation of a community of portfolio companies’ entrepreneurs; a content production strategy; and the expansion of the VC firm’s network to relevant third party companies or individuals with shared interests.

3.4.1. Tailoring the team to the firm’s internal organization and scope

Every VC I interviewed started by spending time identifying portfolio companies’ needs, and considering whether VC partners’ expertise and time could be complemented by a new team member. Mark Suster explained how Upfront Ventures’ platform strategy aligned with three of the firm’s goals: provide more value to portfolio companies, free up partner time, and improve processes inside the firm. It is therefore important to first measure the impact of integrating a functional team on the VC firm’s internal organization and its management.
Then, a way to deal with resources constraints, while providing efficient support, is to customize and limit a portfolio support strategy to specifics regarding the firm's investment stage and scope. OpenView Venture Partners, which invests mainly in expansion stage B2B software companies has built a team of specialists to cater to these companies' specific needs. ffVentures invests mainly at the seed stage. The firm realized that their portfolio companies required help mainly on financial aspects and hired a team of 11 people who help their portfolio companies dealing with accounting, building financial projections, or raising funds with follow-on financers. Upfront Ventures and Accomplice hired team members dedicated to marketing. In general, the success of such strategies relies on the alignment of the needs shared by the VC firm's target companies with the focus and specialization of the support team. This focus is all the more pertinent, given that it enables value-added VCs to differentiate and attract a relevant inbound deal flow. As Scott Maxwell, Managing Partner at OpenView Ventures, reflected on his blog, "If a VC is really going to add value, sector and stage focus is critical." Reviewing the aspects on which early-stage VC firm have focused on, it appears that VCs' support focuses on recruitment, finance, design, marketing and data science, in order of importance.

Nonetheless, the VC firms I interviewed still considered that there was a limit to the growth of such in-house teams. Beyond the constraint of management fees, VC firm's resources dedicated to support should only be considered as additional and not substitutive of portfolio companies' hires. In general, some of these value-added VCs still had in mind the failure of incubators of the 90's and considered that extended support teams would negatively impact both their firm and their portfolio companies. Furthermore, this shift also implies an internal reorganization that fundamentally modifies how VC firms are managed, because it forces GPs to suddenly become managers of much larger teams. GPs, who are primarily financers and not operators, do not necessarily have this expertise or want to play such roles. Some GPs would, for example, rather spend time building relationship with
entrepreneurs than managing an extended team of in-house functional experts (Feld, 2015; Wasserman, 2008).

3.4.2. Fostering horizontal connections between portfolio companies

A way to increase the VC firm’s value-add without spending too large a share of management fees is to organize collaboration and synergies between portfolio companies. VC investors’ expertise, and by extension value-add, comes from the knowledge they have built advising many companies facing similar challenges. This expertise could also as well be passed on between entrepreneurs without relying on the VC partner’s intermediation. Beyond advice, these connections can also lead to fruitful business relationships. Already in the 1990’s, Kleiner Perkins had a very thorough strategy to enhance synergies between its portfolio companies. Netscape, for example, struck several deals with another Kleiner Perkins-backed company called Excite in part because both companies shared the same VC investors. “We’re a Kleiner company. You’re a Kleiner company. Let’s get together.” declared Excite CEO’s at the time (Hodges, 1998). John Doerr, GP at Kleiner Perkins, even compared Kleiner Perkins’ portfolio companies to a Kereitsu, referring to the Japanese conglomerates (Hodges, 1998).

![Figure 6: Create Value-Add, not Value Ad(vertising)](image)

More recently, the two following slides from Phin Barns, partner at First Round Capital, at the Pre-Money Conference illustrates this shift in terms of value creation strategy (Barnes, 2015).

Notably, every VC I interviewed referred to the “community of their portfolio companies”. This evolution of the terms used by Venture Capitalists is more evidence that the marketing of their firms matters and they understand the need of being entrepreneur friendly. It also mirrors a new value creation strategy, turned into a key competitive advantage for VC firms.
Their strategy is both online and offline. First, VC firms organize events such as CEO or CTO days, and specialized events around recruiting, marketing, or design. Second, they leverage existing collaboration software or build their own to maintain relationships between entrepreneurs. In 2011, First Round started building their own online community platform with 8 people in-house constantly developing and improving the platform. The platform works as a typical forum with entrepreneurs answering each other’s questions around employee compensation, business development strategies or corporate culture. As Josh Kopelman, First Round Capital founding partner, mentions: “We invest in software companies so we understand the power of software to make more efficient connections” (Hempel, 2013). The power of this network even led Fortune to wonder whether First Round Capital’s network was “the most powerful network in the Valley” (Hempel, 2013).

3.4.3. Creating educational content

Another way to add value without hiring too large of a staff is to produce educational content branded to the VC firm. The idea is to revisit each of the challenges shared by entrepreneurs and to “productize” VC’s support by sharing educational content online. It can be creating a template for a board deck, crafting a generic contract for early hires, or letting one of the portfolio entrepreneurs describe how he developed a company culture. Again, the idea for VC firms is not to be the only advisor, but to enable knowledge sharing between portfolio companies and beyond. First Round Review (First Round Capital’s online magazine), NextView Ventures blog, or OpenView online resources for B2B startups attract very large audiences, sometime in several hundred thousands of unique visitors. The key here is to communicate as a firm, and not to rely only on the communication made by each of the VC partners: “The ones that succeed are those who place the Venture Capital fund first (not the partners)” commented Jay Acunzo. Making these resources available to anyone beyond their portfolio companies, VC firms also increase the awareness around their firm and attract an additional deal flow that is another justification for the fees allocated to content production. Some of NextView Ventures’ online resources focused on seed stage start-ups for example generated more than 200,000 views online and attracted companies to NextView’s deal flow, which eventually led to an investment.
3.4.4. Building and nurturing a network outside the VC firm

Finally, instead of hiring in-house support staff, VC firms can also build and maintain a network beyond their firm, that will bring additional value to their portfolio companies. Some VCs have even dedicated an entire team to the expansion of this network. The idea is to forge privileged ties with recruiting agencies, marketing agencies, large corporates and well-connected individuals in the industry, which would like to get access to early stage companies. Portfolio companies can then benefit from discount prices contracting with agencies, and from individual’s free expertise and network. NextView Ventures has built in 2015 a network of “superconnectors” called “Talent Exchange”. These “superconnectors” are well-connected individuals who freely refer potential recruits to NextView portfolio companies. Similarly, Primary.vc, a NY-based VC firm, maintains a network of 300 individuals ready to help their portfolio companies. As stated on their website: “We understand our limitations as advisors and aim not to answer questions dogmatically, but to connect our founders to true experts who have solved the same problems many times before ». Moreover, this network might also reciprocate, recommending the VC firm to promising entrepreneurs, thus improving the firm’s deal flow.

3.5. Pros and cons of the model

Overall, the model has several pros and cons. The new generation of younger entrepreneurs, which has emerged in the last ten years, seems to have new expectations regarding early-stage investors’ support. Because they start fundraising earlier, at a moment when their company are by definition less complete, but not less promising, entrepreneurs of this generation sometimes demand more support from their VC investors. Hence, a Platform strategy can first be seen as VC firms’ response to the new expectations of this generation. Yet, the model has an adverse selection effect, because it could attract mainly the least experienced entrepreneurs, who represent an important share of this larger generation of entrepreneurs. The seasoned entrepreneurs —proven to have a higher success rate, need only cash from their investor and focus mainly on their company’s valuation. VCs embracing this value-adding strategy thus face the risk of being overwhelmed by a deal flow of poor quality. Furthermore, entrepreneurs generally consider that their company will be successful when they sign a VC term sheet, and thus focus solely on negotiating upsides. Hence, entrepreneurs will not necessarily look for VC’s operational support but will focus solely on the company’s valuation.
Secondly, a Platform strategy can be an interesting go-to-market strategy in the VC market, which has historically favored incumbents (Kaplan & Schoar, 2005). Furthermore, with the explosion of new types of funding and the increasing inflow of capital in the VC market, the best early stage deals have become increasingly competitive and pricy. Newcomers, which could not benefit from their track record of investments, found in their platform strategy a way to start building a reputation and compete on the best deals without having to wait for the end of a full VC cycle. Referring to First Round Capital and True Ventures, two firms with an extended value-adding strategy, Mark Suster reflected: “Both firms were able to establish themselves as clear market leaders in early-stage finance even though they were effectively start-ups 10 years ago in their own right because they did things a different way.” (Suster, 2016). However, it is worth remembering that the question of the VC firm’s reputation derives first and foremost from the firm’s legitimacy as an investor rather than from its ability to directly support start-ups’ operations. More reputable VC firms remain those which have been the most successful investors in the past (Nahata, 2008), (Hsu, 2004), and not necessarily those offering the largest diversity of services. Lastly, while we could have expected value-added VCs to leverage the value of their service to get entrepreneurs to accept lower valuations, this situation has not necessarily occurred in reality. A platform strategy is thus rather an interesting complement of other arguments helping VCs building a reputation.

A belief shared by every “value-added” VC investor I interviewed is that each of them considered that reviewing the best deals and being chosen by entrepreneurs was far more important than being able to make the right investment decision in order to succeed in venture capital. Chris Dixon, GP at a16z, commented: “The popular view of venture investing is that it is about picking good companies, because that’s what’s important with public equities. But you can’t apply the logic of public equity markets, where by definition anyone can invest in any stock. Success in VC is probably 10% about picking, and 90% about sourcing the right deals and having entrepreneurs choose your firm as a partner” (Eisenmann & Kind, 2013). The importance of the sourcing part and of their competitiveness on the best deals is actually the main driver of their value-adding strategies. Value-added VCs create awareness around the additional services they offer and thus attract new inbound deals. These come either directly from entrepreneurs seeking support or from referrals from other VCs looking for value-adding co-investors. In this
regard, these value-added VCs re-create a new funnel for sourcing dealing, relying mainly on inbound deals. The resources they allocate to their functional team can be seen as a way to pay for accessing deals they could not get access to before. One of the VC I interviewed clearly presented this strategy as a reallocation of the firm’s management fees; his firm prefers to allocate funds to portfolio companies’ support rather than hire people responsible for sourcing outbound deals. The rationale is pretty clear: “In the outbound model, you’re spending most of your calories on companies in which you will not invest. Whereas in our portfolio operator strategy we are spending most of our calories on companies in which we have invested.” ffVentures receives 5000 inbound leads each year and does not have any junior member sourcing deals. “We are known as a more value-added player than most of our peers, so entrepreneurs really want to work with us”, declared another NY-based VC investor. However, this reallocation is a clear trade-off, because best performing VC firms are also proved to be those which allocate the more funds to the sourcing part (Teten & Farmer, 2010). Ultimately, this strategy may work only if only few firms adopt it, thus continuing its role of market differentiator. Finally, a VC Platform co-investing with another traditional VC firm, without any support team, might not capture the totality of the value its in-house support team creates on operations. In this regard, this strategy would also make more sense for a stage-agnostic VC firm, like a16z, which will capture the entire financial benefits of the value it creates in their portfolio companies by taking larger equity stakes as company grow (by financing follow-on rounds).

Finally, this strategy can be cost-efficient for both the VC firm and portfolio companies. Instead of hiring costly service providers, thus spending the money invested by the VC firm, each portfolio company benefits from the resources shared across the portfolio. In exchange, the VC firm has the dual interest of positively impacting its portfolio companies’ performance, its own deal flow, and ultimately its overall competitiveness.
When combined, these two last points create two “reinforcing loops” (as described in Figure 7):

- A “selection effect”: the more a VC firm invests in portfolio support, the more it can communicate about its differentiators, and increase awareness around the firm’s specific value proposition. In return, the firm benefits from a larger deal flow, which increases VC investors’ likelihood to select more promising companies. More promising companies are then more likely to provide the fund with better returns. In the end, better returns help investors raise larger funds, and increase their expenses in portfolio support.

- A higher impact on start-ups’ operating performances: benefiting from their VC investor’s additional resources, their larger reputation in the industry, and from the collaboration between portfolio entrepreneurs, entrepreneurs are more likely to hit higher operating performances and grow faster. They will also provide the fund with better returns, which will VCs help raise larger funds to re-invest more in portfolio support.

Figure 7: The positive feedback loops of VC firm’s portfolio acceleration strategies
These reinforcing loops may reach their limit because it does not necessarily make sense to extend too much portfolio support teams, without having VC firms stepping out of their primary role of investor. VC Platform should also pay attention not to create any disequilibrium in portfolio companies in case these relied too much on VC's resources, which cannot scale as the company scales. Inside the VC firm, the size of the team dedicated to portfolio supports also needs to grow proportionally with the amount of management fees available, and thus with the fund size. Yet, a larger fund size cannot be sustained if the investment team does not grow in parallel. The investment team can’t be scaled indefinitely because taking investments decisions requires extensive exchange of tacit knowledge between VC investors, which becomes increasingly difficult as the size of the investment team increases (Wasserman, 2008). It is notably one of the main reason that may prevent a16z to grow further. Lastly, it should also be noted that while these loops are reinforcing, the impact remains marginal compared to many other factors driving start-ups and VC fund’s performance.

At the end of the day, it should also not shift entrepreneur’s attention to what remains VC's main value proposition: their investment and their partner’s time. A reputable VC firm without any portfolio acceleration strategy (such as Benchmark Capital or Foundry Group) will still win deals against these value-added VC. Finally, a last risk to mention is that, VC firms' economics may not work as well in bust periods. Hence, these large expenses on support teams can be sustained only if the firm can re-invest long term capital gains in the fund while compensating GPs mainly with carried interest. Therefore, one might wonder whether such strategy will survive the next down turn in the industry. A NY-based VC firm with a very thorough portfolio acceleration strategy commented: “It’s going to be firm dependent. It [The strategy] requires a great long-term belief in the viability of this model because it is such a « Get rich, slow » industry. So, I will anticipate that some VCs who did not fund unicorns might carve out their portfolio acceleration strategy, which happened in late 99.”
3.6. From value-added VCs to AngelList syndicates?
Asking him how he would re-invent another model of VC firm after a16z, Peter Levine, GP at a16z, said that he would try to expand the VC's network even further, creating "a virtual operator":

"Probably, if I created a Venture Fund, I would create a firm with virtual services, kind of like the a16z model, but without employing people. So I would get CPOs, Engineering Talent, Marketing people who wanted to be involved with the venture fund and provide services. The reach in that case may be greater than the reach we currently have. You would create a network of people who could help companies in all of that without necessarily hiring them. They would get shares, have the privilege of investing with the venture firm, maybe get a little carry. So I think there are ways you can actually create a virtual network of people, much greater than the internal network we have at a16z. Like a social network of Venture Capital operating people. Thousands of people as opposed to a few. It might be possible. I think we do a very good job [at a16z], but I am just thinking we could do more if you create this virtual group. You have to raise multi billion-dollar fund in order to hire 150 people. What if you keep the fund relatively small and have thousands of people helping you out through this virtual network? You could replicate the functionality of what a16z does, without having to pay everybody, that would be cool."

Under several aspects, an equity crowdfunding syndicate resembles to this new type of Venture Capital fund described by Peter Levine. Syndicate's backers form together a large network of people, with different expertise, located in different geographies, who pool their investment, and share the same incentive to add value to their portfolio companies. The next chapter is dedicated to online syndicates and tries to provide an answer to Marc Andreessen's question: "Maybe a16z is the last and most evolved dinosaur, and crowdfunding is the first bird." (McClure, 2013)
4. Can online syndicates compete with VC firms?

4.1. Online syndicates in the context of crowdfunding

In the last two decades, Internet has reshaped almost every industry. Even services industries, in which interpersonal relationship matters the most have been disrupted by newcomers leveraging the benefits of the Internet, and in particular lower transaction costs, to create more efficient business models. Entrepreneurial finance is no exception. Crowdfunding, or the practice of “raising capital from many people through an online platform” (Agrawal, Catalini, & Goldfarb, 2013), has emerged as a credible source of finance for entrepreneurs to fund their early stage company. The crowdfunding market was estimated at $34Bn in 2015, spearheaded by peer-to-peer lending platform which contributed $11Bn to this amount (Massolution, 2015).

We can distinguish four types of crowdfunding. One can now support early stage projects by donating funds (on platforms such as Youcaring), pre-ordering products (on platforms such as Kickstarter or IndieGogo), lending money (Lending Club or Prosper), or directly buying equity online on platforms such as AngelList, OurCrowd or Quire in the US or Crowdcube in the UK.

Equity crowdfunding has been the latest type of crowdfunding to meet significant growth, in part because of the several challenges and costs underlying equity investing: the cost of discovering deals, the cost of due diligence, and transaction costs (Agrawal, Catalini, & Goldfarb, 2014). Crowdfunding platforms (non-necessarily equity based) reduce significantly the costs of being aware of investment opportunities by allowing entrepreneurs to publicly advertise their fundraising online to a large audience under the rule 506 (c) of the JOBS act. They also reduce drastically transactions costs enabling people to invest online and processing all the legal and back-office tasks (Agrawal et al., 2013). However, high asymmetric information and the related costs of due diligence remained too high compared to the small amount invested by each investor. Leveraging the various benefits of syndication in Venture Capital (Joshua Lerner, 1994), online platforms may have found, with equity crowdfunding syndicates, a way to overcome the problem of asymmetric information, creating a new division of labor between different types of investors (Agrawal et al., 2014), as described in the next paragraph.
4.2. An introduction to online syndicates

This section is a brief summary of the mechanics of how online syndicates work. It is based on AngelList’s FAQ.

Naval Ravikant, founder of AngelList, defines an online syndicate as a “Way for any angel investor to form a seed fund online on the fly to invest in a company, bringing their friends, supporters, value-added investors and passive capital” (500 Startups, 2015). Syndicates on AngelList were introduced in 2013, following the adoption of the JOBS act, which allowed start-ups to publicly solicit investors.

Creating a syndicate, an angel investor (lead investor), most of the time well known, with experience angel investing, invites other accredited investors (backers) to invest jointly in the deals he/she would have sourced, in exchange for carried interest (or carry). It allows the lead investor to invest larger amounts of money in larger deals.

Once a backer has decided to back an online syndicate, he/she can review the lead investor’s deal flow, and decide, on a deal-by-deal basis, whether or not he/she wants to invest. Each backer is required to invest a minimum investment of $1,000 per deal.

Each time the lead investor has sourced an investment opportunity, he/she informs the members of his/her syndicate of his/her investment thesis, of his/her potential conflicts of interest, and of the terms of the investment on which he/she has agreed on with entrepreneurs (e.g. Amount invested, valuation, legal terms). This information is generally only available to the syndicate backers.

Backers of the syndicate then perform their own due diligence or simply trust the lead investors to make their investment decision and bring funds to the deal. The regulation in the US (the SEC 99-investor limit) limits the number of investors per deal to 99 accredited investors. However, any qualified purchasers (individuals with $5M in investment assets and companies with $25M in investment assets), can be added to the syndicate on top of the group of 99 accredited investors.

If the deal is oversubscribed, the investment is first reduced pro-rata per backer until it reaches the minimum investment indicated by each backer. If the deal is still oversubscribed, the lead can then choose which backers gets to participate into the syndicated deals. Non-members of the syndicates can also join the round, but they have to agree to the syndicate’s rules, and pay the same carry to the lead investor.
Once the deal is completed, AngelList creates a specific investment vehicle, called LLC, in order to pool the investments of all the syndicate’s backers. This vehicle is managed by Assure Fund Management and advised by AngelList Advisor, which is a subsidiary of AngelList. Only the LLC and the lead investors get shares in the company and appear on the company’s captable. In terms of control rights, the LLC will usually vote with the lead unless the lead is conflicted, in which case it will vote with the majority of shareholders.

Depending on the terms of the initial investment, the syndicate can have pro-rata rights, in which case backers of the syndicate can deploy more money to maintain their equity stake in follow-on rounds. The carry of the lead investors stays at the same level if he/she re-invests to use his/her own pro-rata rights. If he/she invests less than her pro-rata allocation, his/her carry on the follow-on round is reduced to 5% and 5% is attributed to AngelList, which will thereafter vote independently from the lead investor. If the lead does not participate at all in the follow-on round, the lead does not get any carry on the investment made on the follow-on rounds, and AngelList receives 10% carry.

When the company is acquired or goes public, AngelList advisors and the lead choose the best time to sell their equity and distribute the proceeds to the syndicate. If the amount perceived exceeds the initial investment and the out-of-pocket costs (corresponding to the administrative costs perceived by AngelList at the time of the first investment), the syndicate’s backers pays the carry to the lead investor and 5% deal carry to AngelList.

Less than a year after the launch of syndicates, the number of syndicated deals exceeded the number of non-syndicated deals (Agrawal et al., 2014), and represented in January 2015 more than 70% of all deals happening on the platform. In 2015, AngelList reported 171 active syndicates, which had raised money from 3015 accredited investors, in order to invest around $160M in 393 start-ups. The biggest syndicate was led by Gil Penchina and was backed, as of February 2016, by $6.3M from 1,111 individual backers.

4.3. The increasing competition between VC firms and online syndicates

In many aspects, the design of online syndicates looks very much like the design of a VC firm. In addition, online syndicates benefit from the various advantages of the Internet—in particular lower search and transaction costs. As of January 2016, AngelList counted more than 20 syndicates backed by more than $1M per deal. Given such large amounts of support, one can start considering whether online syndicates have already become serious
competitors of VC firms, and wonder how this competition will evolve in the future.

Furthermore, if, on the one hand, VC keeps on investing at earlier stages (Blomquist, 2014), and, on the other hand, online syndicates can deploy increasingly larger amounts of capital per deal, the overlap between these two investors could become increasingly wide. Figure 8 gives a brief illustration of the underlying evolution of the early-stage financing landscape.

![Figure 8: Overview of the early-stage financing landscape's evolution](image)

Up until recently, constrained by the 99-investor limit and by an average investment per deal per backer not likely to be higher than $50,000 per deal (Stebbings 2016a), online syndicates could deploy a maximum of 0-5 million dollars per deal, and thus mainly competed with seed and Series A VC firms. The average backer’s check size at Flight.vc, a group of leading online syndicates (which I describe in greater detail in Chapter 5), ranged from $1k to $250k per syndicate, and averaged $6.8k (Lou Kerner, 2015). Similarly, investors in FundersClub, a competing equity crowdfunding platform, invested on average just above $10k per deal in 2015. The largest deal made by an online syndicate was a $2.8M investment in Beepi, and was led by one of Gil Penchina’s syndicates. As Gil Penchina put it: “What we are doing is
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just pushing VC further into later-stage rounds, into the larger check point zone” (Stebbings, 2016a).

Looking at all the deals disclosed on AngelList, one can observe that seed deals made up the largest part of the deals on the platform. However, the new inflow of institutional capital, invested directly in syndicates, does not need to fit within the 99-investor limit, and opens up new possibilities. Therefore, this competition might also extend to a larger part of the VC landscape, as I describe in the following part.

Competition is defined as “a situation of rivalry in which every seller tries to get what other sellers are seeking at the same time by offering the best practicable combination of price, quality, and service” (Business Dictionary). Applying the definition in this context, one can rephrase the question as: can online syndicates be a better financial intermediary providing capital to young companies facing uncertainty, information asymmetry, and high risk than VC firms?

I answer the question by segmenting it into four sub-questions:

- Can online syndicates attract sufficient amounts of investment to compete with VC firms?
- Under what conditions can online syndicates perform well in the future?
- How could online syndicates attract skilled investors as lead investors?
- What are online syndicates’ strengths and weaknesses vis-à-vis convincing entrepreneurs to accept their investment when we compare them with VC firms?

4.4. Online syndicates and their backers

The first step of the Venture Capital cycle consists in raising funds from investors. VC firms and online syndicates differ significantly in this step, because online syndicates, in their infancy at least, “crowdsource” their LPs, whereas VC firms mainly rely on institutional investors. Three factors indicate that online syndicates could attract significant amounts in the future.

First, the angel market, which is the first source of capital for early stage companies (OECD, 2011), represents a significant untapped potential, due to the constraints faced by angel investors. The U.S. counts 8.7 million accredited investors and only 7% of them took part in angel investment (Andrew, 2015). Angels generally deal with the problem of asymmetric information by investing in an industry that they know, and by investing in companies
located in their geographic area. However, these constraints lower the number of opportunities in which each angel can invest, and impact their potential returns. In particular, angel often cannot achieve the required level of diversification (Merle & Merle, 2015). Backing online syndicates, angels could gain higher returns and reach a higher level of diversification by investing smaller amounts of money online in companies outside of their domain of expertise, or outside of their own geography. Backers would also benefit from lower discovery and due diligence costs, piggybacking on the lead investor’s investment choices (Agrawal et al., 2014).

Second, the passage of Title III of the JOBS Act will allow companies to raise up to $1M from non-accredited investors. These will be able to invest from $2k to $100k as long as they invest less than 5% of their income (if it is less than $100k), 10% otherwise (Chance, 2013). The law was approved October 30th, 2015, and will come into force in April 2016. Analysts evaluate this market at $300Bn per year, part of which could be invested in online syndicates (Chance, 2013). AngelList has not declared yet, whether or not they would let unaccredited investors back online syndicates, but some lead investors like Gil Penchina express a desire to make space in their syndicates for this new type of investor, if the platform allows it (Stebbings, 2016b).

Nonetheless, in each of the syndicated deals, these two categories of angels will have to fit within the 99-investor limit, and will likely limit online syndicates to investing at the Seed or the Series A stage.

In contrast, Institutional investors, who do not need to fit within this limit, have started to show an increasing interest in online syndicates and could help syndicates invest larger amount of capital per deal. In particular, while they invested only 7% of the $104 million invested through syndicates in 2014 (Loizos, 2015), institutional investors participated in 40% of all the syndicated deals on AngelList in 2015 (AngelList, 2016). AngelList now counts two funds (Maiden Lane and CSC Upshot) whose sole mission is to invest institutional capital in online syndicated deals. Managers of these funds decide, on a deal-by-deal basis, which syndicated deal they want to back, and earn a carry interest from their LPs that they share with the syndicate’s lead investor (see Figure 10). CSC Upshot will invest $400M of institutional money in the next few years through syndicates, and can hence be considered as the largest seed fund worldwide (AngelList, 2016). Dustin Dolginow, manager of Maiden
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Lane, notably predicted that institutional capital and individuals will likely bring equal amounts of funds to syndicates in the near future (Venture Studio, 2016). Building a parallel with P2P lending platforms, some of them currently funded at 60% by institutional capital (Andrew, 2015), the attraction of Institutional Capital is an early signal of the growing importance taken by online syndicates in the early-stage financing landscape.

![Diagram of the traditional VC Model and the Maiden Lane Model]

Figure 10: Online syndicates: A new model to deploy Institutional Capital?

Compared to VC firms, this model encompasses several differences making it attractive for LPs. Lead investors and fund managers do not receive any management fees on the funds allocated by their investors. A lead investor also tends to invest a larger amount in each deal than GPs do in traditional VC funds (16% vs. 2%). Letting investors review deals one by one also provides more transparency on GPs’ activity. These three differences reduce the agency problem between GPs and LPs, which has been one of the most important criticism of the Venture Capital model in its history (Mulcahy et al., 2012). In particular, GPs might sell shares (Gompers, 95) or co-invest (Lerner, 94) at non-optimal prices for the purpose of raising a new vintage fund. Finally, LPs benefit from the double due diligence conducted both by the syndicates lead investor and the fund manager. In April 2016 though, some of the lead investors backed by Maiden Lane, started to have greater expectations regarding

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their compensation model. Some of them first asked Maiden Lane to commit to invest in multiple deals in advance and prevented the firm from reviewing deals one by one. As an example, a lead investor could for example require Maiden Lane to agree in advance to back 6 of the lead’s investor investment opportunities in companies graduating from Y-Combinator’s accelerator program. Doing so, some lead investors suddenly become fund managers, and started asking Maiden Lane for management fees! Although we are the very beginning of this new model in Venture Capital, a model without management fees might not last very long for the best lead investors.

In any case, supported by such large amounts of funds, the question of their competitiveness with VC firms could then be more related to the skills of each online syndicate’s lead investor, or to giving sufficient incentives to each stakeholder, than to the amount of capital available. In the next paragraphs, combining results of interviews, early quantitative results, and speculation as to whether online syndicates can embrace the same key success factors as VC firms, I assess online syndicates’ likelihood of achieving significant performance.

4.5. Can online syndicates perform?

4.5.1. Early empirical results
Analyzing all the syndicated deals that have been disclosed on AngelList since its inception, and crossing it with data from Crunchbase, I find that the top syndicates—backed by more than $1M and ranked by the amount of backing as of April 2015—show encouraging performance, as measured by the amount of follow-on rounds raised by their portfolio companies. Even though these disclosed deals represent slightly less than half of the amount invested through the platform, it gives us a first insight into future performances. Although online syndicates had a low contribution in the deals they participated in (10% on average for these syndicates), their portfolio start-ups have raised 2.5 times more funds on average in subsequent rounds. Since most of these investments happened in the past 3 years, this figure is an early indication of the quality of the deals of the best syndicates. Lastly, online syndicate had in March 2016 their first billion-dollar exit as General Motors acquired Cruise Automation. The company had been funded at the Seed and the Series A stage by two online syndicates.
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4.5.2. Performance criteria in early-stage finance

Beyond quantitative results, one can also assess online syndicate’s likelihood to perform well using the performance criteria established in the early-stage finance literature. First, if angel investors rather than Venture Capital partners mainly lead online syndicates, one may wonder whether angels are as skilled as Venture Capital investors at selecting and adding value to their investment. The literature shows that top-performing groups of angels have an efficient selection process and can efficiently add value to their investment. They have also earned similar returns as Venture Capital firms (Kerr et al., 2014). Thus, if they can achieve similar performances investing at the very early stages, which are also the riskiest, why could they not compete participating in larger deal sizes?

The literature also shows that high-performing Venture Capital firms are those that benefit from the best networks (Hochberg, Ljungqvist, & Lu, 2007), which enable them to efficiently source investment opportunities, syndicate deals and find follow-on investors. The best VC firms also have the widest industry experience (Hellmann & Puri, 2002). For the moment, online syndicates led by renowned angel investors do not benefit from established VC’s networks, reputations or brands. This may ultimately undermine their performance investing in VC rounds because they will have to pay higher valuation at the time of investment and will probably have harder times convincing the best entrepreneurs to opt for their investments (Hsu, 2004). Nonetheless, top online syndicates’ lead investors are
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experienced angel investors, as measured by their track records of investment. They are also well-known if we refer to the number of their followers on Twitter (Eder, 2015). In the end, their experience angel investing might help them catching up with VCs, when they participate in later-stage rounds. The success of First Round Capital or Softech VC, two funds created by two former angel investors, proves that angel investors turned VCs can be particularly successful.

Moreover, the literature shows that newcomers in the VC markets expand their networks by investing in companies that raise follow-on rounds with prestigious VCs (Hochberg et al., 2007). Several start-ups, backed by online syndicates in the early stage, now count some of the most reputable VC firms as shareholders. Therefore, the signal associated with raising funds from online syndicates might become a signal of quality, and online syndicate’s networks might also expand faster than expected.

Online syndicates and VC firms’ decision-making process and division of labor also differ. Nonetheless, the literature proves that this difference should not lead to lower performance. Analyzing the performance of Venture Capital investors moving across different Venture Capital firms, Ewens & Rhodes-Kropf (2015) show that the human capital linked to VC partners individually is 2x to 5x more important than the VC-firm’s organization capital (e.g., the benefits of taking investment decisions collectively, or the attractiveness of the VC as a firm rather than as an assemblage of GPs). This result is consistent with the very low correlation found by Kerr, Nanda, & Rhodes-Kropf (2014) between the number of votes gained by a specific company from a VC firm’s investment committee prior to the investment and the latter’s performance subsequent to the investment. The competition between VC’s GPs could even be detrimental to the VC firm performance as a whole (Wu, 2015).

Hence, even if online syndicates’ lead investors were making investment decisions alone, not benefiting from the collective reviews of their backers, their performance should not be significantly worse. Venture Capital investors even make riskier investment decisions (in younger firms with less educated and experienced founding teams) when they invest their own money in investment opportunities that their VC firms have passed on. These investments ultimately provide them with similar, if not better, returns than the investments they make through their VC firm (Wu, 2015).
Dustin Duginlow, manager of Maiden Lane, recently reflected: “There is evidence that there is another approach that can at least perform as well, and in many cases outperform consensus-based investing, and that’s when an individual has an insane amount of conviction in some combination of product, team, and space and you have enough trust with them to let them pursue that conviction and take a bet. The next chapter of Venture Capital is, besides consensus, what else works? And, this is what I am working on with Maiden Lane: where does institutional capital belong?” (Venture Studio, 2016).

Based on these results, one could argue that if the same GP was investing the funds of his/her own online syndicate rather than the funds of his/her VC fund, online syndicates could perform as well, if not better, than VC firms, at least at the earlier stages. Finally, Wu (2015) argues, for example, that VC investors gather within the organization of VC firms for the purpose of raising funds from institutional investors, who would rather allocate larger amounts of funds in one firm than invest in several VC firms managed by a single GP. Now that they can raise funds from other sources of capital, investors who have access to the best deals may be freed from this constraint.

4.5.3. Online syndicates’ strengths and weaknesses

A venture capital investor who would rather invest through a syndicate than through a VC fund is first freed from all administrative and legal tasks related to raising a VC fund: those are managed by online platforms. Gil Penchina likes to say that he had never become a VC before launching his syndicate because he did not like “lawyers, accountants, and LPs” (Stebblings, 2016). It can also be faster to raise funds from the crowd than from institutional LPs. Foundry Group raised the equivalent of a $25M fund in less than 6 months, whereas the average duration to raise $20M in the industry is 11-16 months (Mahendra, 2015). However, online syndicates might not attract investments for any type of deal. In particular, accredited investors may be keener to back deals with companies developing consumer-facing products, which are easier to assess than B2B companies. In a bust period, online syndicates also face the risk of having a reduced amount of money to invest since they cannot rely on any lock-in funds.

Online syndicates change investors’ compensation model: they do not receive any management fees for their work, but earn higher rewards on performance using deal-by-deal carry instead of fund-carry. Unless lead investors are particularly wealthy, they are
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hence less likely to work full time on their syndicate. Furthermore, they also have less incentive to support companies in difficult situations or to provide advice on operations, compared to a VC investor. Another issue regarding management fees is that they normally help Venture Capital firms pay for the expenses of their internal organization, helping them hire analysts or functional experts. Online syndicates have come up with interesting solutions to operating without management fees, building networks of people ready to help source deals without being directly compensated, but gaining priority access to the deals—and sometimes even getting a piece of carry on the deal. Flight.vc, Gil Penchina’s group of syndicates, has, for example, a network of 100 people, whom they call “scouts”, actively looking for deals (Stebblings, 2016).

Overall, online syndicates’ design encompasses several advantages and drawbacks compared to VC firms. While traditional VC firms might limit each individual investor’s initiatives, online syndicates, by not compensating lead investors with any management fees, also bet that part-time investors could be as successful as full-time investors. Nonetheless, benefiting from lower transaction costs, more flexibility in their investment criteria, and the ease of setting them up, online syndicates are likely to attract an increasing number of experienced lead investors. They will be angel investors who never turned VC, VC partners looking for more flexibility, or entrepreneurs willing to dedicate time to investments. In this regard, one can see these syndicates as a logical follow-up after the explosion of Micro-VC funds created by previous entrepreneurs in the last 5 years (Frost, 2015). The attraction of such skilled investors, who have access to the top deals, is in any case the cornerstone of online syndicates’ future good performance.

4.6. Online syndicates’ value proposition for entrepreneurs

The subsequent challenge for online syndicates’ lead investor is then to convince entrepreneurs that their investment can be as valuable as that of a VC firm. What arguments can they leverage? How different is their value proposition compared to a VC firm?

4.6.1. Entrepreneurs’ evaluation criteria

One can expect entrepreneurs to use the same evaluation criteria with online syndicates as they would use with any VC investor: the personal relationship with their investor, the
capacity of the VC firm to take pro rata rights or even lead follow-on financing, the firm’s reputation, its networks, and its potential differentiators with other VC firms.

The personal relationship between investors and entrepreneurs does not differ much. A lead investor represents its syndicate, as a VC firm’s partner would represent his/her VC firm. An entrepreneur might have to communicate more extensively with an online syndicate’s LPs at the moment of the fundraising. Yet, subsequent to the investment, it is the lead investors’ responsibility to manage communication with syndicate backers. Pooling all the backers within one LLC managed by AngelList, which follows the lead investors’ decision, also allows entrepreneurs to keep a simplified captable and does not create any complexity regarding governance.

Pro-rata rights are an interesting example of online syndicates’ change of scale in the early-stage financing industry. Limited by their own wealth, and because it would prevent them from achieving the right level of diversification, angel investors almost never asked for pro-rata rights before the advent of online syndicates. Neither did online syndicates at the beginning (Walk, 2014). Nonetheless, last year, some of the top syndicates started to require them, and use them afterwards (Moran, 2015). One can imagine that the support of Institutional Capital might also enable some of the top online syndicates to lead follow-on rounds. However, as of 2016, no follow-on round led by a syndicate has been disclosed.

For the moment, online syndicates’ reputation and network suffer from online syndicates’ lack of experience and investment track record. Although lead investors may be renowned angels, their syndicates clearly do not benefit from established VCs’ brand recognition. Brand and reputation matters in Venture Capital, because it plays a signaling effect that helps start-ups backed by reputable VCs find early customers, recruit, raise follow-on funds, or line up IPO underwriters (Hsu, 2004). Early-stage start-ups therefore prefer to opt for the investment of a reputable VC firm, and sometimes even sell their equity at a lower price to get this certification. Ex-post, their rationale is also justified by the fact that firms backed by more reputable (Nahata, 2008) or experienced (Sørensen, 2007) VC firms are also those, that are the most likely to be successful. They are more likely to go public, and access public markets faster with higher asset productivity. The higher performance of more reputable VC firms is due both to their higher selectivity, but also to their higher ability to add incremental value (Nahata, 2008).
In this regard, VC firms retain a significant competitive edge against online syndicates. These will not be able to take advantage of their reputation until the end of a first venture capital cycle, when they have done several investments and achieved significant returns.

Although online syndicates’ lack of reputation may currently penalize their performance, the emerging funds outlined in the second chapter have overcome this challenge by leveraging their renewed value propositions compared to established VC firms. In this perspective, online syndicates can also draw on three differentiators: the increased visibility that they offer to their portfolio companies, their larger flexibility regarding investment terms, and the advantages of having a larger network of investors.

4.6.2. An extended visibility
As AngelList becomes the hub of the start-up ecosystem online, raising funds with a syndicate on AngelList significantly impacts the company’s visibility. It attracts entrepreneurs seeking for PR or seeking to increase awareness around their product offering in general. This might be a particularly compelling argument for startups developing consumer facing products. It was for example one of the main reasons leading Beepi to accept Gil Penchina's syndicate investment of $2.8M in its recent $72M-Series B. Finally, a higher visibility on AngelList also helps entrepreneurs recruit new profiles more easily on the platform.

4.6.3. The flexibility of online syndicates’ investment terms
Online syndicates might also make use of more flexible investment terms for two reasons. First, lead investors could keep using the same investment terms as when they were angel investing. Angels notably ask for less control rights than traditional VCs ((Ibrahim, 2008), (Goldfarb et al. 2013)). Second, online syndicates do not need to abide by their LPs’ rules requiring that a minimum percentage of ownership be held in each of their portfolio companies. They can also be more flexible when negotiating downside protections. More than naivety or uninterested complacency with entrepreneurs, this flexibility could become another competitive edge. As an example, Gil Penchina won a deal against a competing VC firm, because he could agree with the entrepreneur to require fewer control rights in exchange for a lower valuation (Stebbings, 2016).
4.6.4. A value-added network of investors

Because they rely on accredited investors in addition to institutional money, online syndicates benefit from a large network of individuals, who share incentives to help portfolio companies. If it can be activated, this network of value-added LPs is a key competitive advantage, when one considers its size: “We have a lot of LPs, 16,000 investors in 51 countries, from a variety of industries, from very different backgrounds. 75% are GPs, VP or C-level executives who can serve our portfolio. There is a limit to everybody professional network, that we try to overcome by activating our network of LPs” declared Alex Mittal, CEO of Fundersclub. As an example, Alex Mittal recalled how Meldium, a FundersClub portfolio company, accessed Salesforce’s Appstore, because its director was part of Fundersclub’s community of LPs.

Although syndicate backers are incentivized to add value to their portfolio company, the first feedback is not unanimous, for the moment. Notably, Foundry Group ended their FG angels experiment disappointed by the low level of engagement of their syndicates’ backers (Feld, 2016). Brad Feld elaborated on his blog: «We have struggled to build a broader network of angel investors [...] I thought more of the Angels would be proactive about developing a relationship with us. That was an incorrect assumption on my part. » One of FG Angel’s backers also commented: “I benefited tremendously from my participation. Excellent diversification for a small amount of capital. [But] it made me realize how hard it is to add value to a portfolio that big.” In this regard, enabling accredited investors to back syndicates with commitments as low as a thousand dollars per deal may not provide angel investors with sufficient incentive to engage in value-adding activities.

It is too early to assess the real value of such large networks of small co-investors but several solutions can be envisioned to increase their value in the future. Lead investors could limit the costs incurred by their backers to help portfolio companies by asking them to perform very simple tasks on dedicated online platforms. Flight.vc has developed an internal platform called Angelmob, in which their syndicates’ backers earn points by promoting portfolio companies’ products on social media or by introducing portfolio companies’ executives to relevant business partners. Those who have earned the most points then gain access in priority to the top deals. Similarly, FundersClub has developed its own internal
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software to connect entrepreneurs with its community of LPs, who gain VenturePoints as rewards.

Lead investors could also leverage their ability to pick the right investors deal by deal to optimize the potential value-added of their network of co-investors, while abiding by the constraints of the 99-investor limit. AngelList now facilitates this by asking backers to indicate how they individually can help each company.

Lou Kerner, lead of the Israel Syndicates at Flight.VC, provides an illustration: “When we launched the Syndication of Zirx, a parking service for enterprises, we initially just made it available to backers in the 10 cities in which Zirx operates, so we could get the most effective advocates for the fledgling brand” (Kerner, 2015). Similarly, syndicating Beepi’s deal, Gil Penchina gave priority to investors from Phoenix, where the company was launching its business at the time of the investment. While it may go against the entire democratization of start-up investment advocated by crowdfunding platforms, it could also make online syndicates increasingly competitive.

4.7. Conclusions

At the end of the day, to become true VC firm competitors, online syndicates will have to demonstrate that they can provide investors with similar performance. While the syndicate may perform well as a whole, it will hardly be achievable to satisfy each backer, who can only invest in some of the syndicated deals. Considering the power law that governs venture capital returns, many of them will even earn negative returns. Hence, it is likely that some of the top lead investors will earn positive returns, when most the backers do not.

At that point, some debates might emerge around lead investors’ compensation model insofar as they are compensated on a deal-by-deal basis, and thus share only the upsides with their backers. The model might also give them incentives to take unjustified risks.
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The entrepreneurial finance literature tends to show that their design should not undermine their performance compared to a VC firm. However, they will have to wait for a full cycle to build a reputation and start competing with some of the best firms. Their performance will mainly derive from their attractiveness to a new generation of investors, who will be lured by their flexibility and by the compensation model. However, this new generation may be discouraged from working full-time on their investment because they do not gain any management fees. Hence, the underlying bet is to consider that part-time investors, be they former VCs or entrepreneurs, with specific access to interesting deals, could perform as well as full time VC investors. It will also be interesting to measure how lead investors succeed to activate their wide community of LPs, as it is probably their most promising competitive edge when compared with a VC firm.
5. Online syndicates in the future early-stage financing landscape

5.1. VCs' early reactions after online syndicates' advent in 2013

Angel investors establish ambivalent relationships with VCs. On the one hand, they rely on each other's investments: angel investors take the first risks and VCs provide follow-on financing to fund companies' growth further down the road. On the other hand, they also compete on late-stage angel rounds or early-stage VC rounds (Hellman et Thiele, 2014). In particular, angel financing is a springboard for companies to raise venture capital in many countries except from the US, where the VC market is more developed (Kerr et al. 2014), (Hellmann, Schure, & Vo, 2015). When the amount of money flowing in VC markets is larger, VC firms tend to invest smaller amounts of capital at earlier stages. It enables them to get more investment options and to reduce the problem of asymmetric information at the rounds at which they traditionally invest (Ewens et al., 2015). Adopting this strategy, VC firms also compete with angel investors. Lastly, less capital-intensive companies or companies not willing to relinquish too much control rights can also opt not to raise VC funding and rely only on angel investors.

Online syndicates, enabling angel investors to invest larger amounts of capital, change this equilibrium between VCs and angel investors, and their introduction in late 2013 has therefore unclenched several reactions in the industry.

Famous angel investors, such as Jason Calacanis, predicted that thanks to their online syndicate, they would soon be able to crowd out second tier VCs from the venture capital market: “the bottom half of VCs will now be wholesale replaced by folks like Kevin Rose, Dave Morin and myself. The three of us have $1M in backers in the first week. That means if we collaborated on a project we can do an A-Round after a brief conference call” (Calacanis, 2013). On the other hand, some VC investors also published several predictions regarding how online syndicates could ultimately endanger early-stage firms, as well as the industry in general. Their critiques can be summarized in four points. First, VC firms are used to allocating a minority part of their rounds to value-added angels. However, insofar as VC do not want to extend this allocation, angel investors willing to deploy more capital using their online syndicates would either crowd out other value-added angels of such deals, or simply do not get access to them (Walk, 2013). In this perspective, it
could be detrimental for startups to choose an online syndicate as an investor, considering that the syndicates’ lead investor would be the only angel to add value to the company, whereas in the previous model, several angels would. Others VCs predicted that entrepreneurs backed by an online syndicate would incur a refinancing risk. They argue that, in case the company was not as successful as they had promised when they first brought the investment, lead investors could have harder times convincing their backers to invest again (Kolodny, 2013). In other words, VC firms would be ready to refinance companies that online syndicates’ backers would not, primarily because syndicate backers would lack investing experience. First-tier VCs also argued that online syndicates would most probably compete only with second-tier VCs, acting as passive investors, and not leading rounds (Kolodny, 2013). This critique echoes with the main criticism VC investors have voiced when they contested the skills of previous angel investors, empowered by their online syndicate, to become lead investor in VC rounds (Wilson, 2013), (Suster, 2013). A lead investor is the first investor to commit to an investment round, takes a large part of it, defines its term, and has a signaling effect to other investors. Once the investment is completed, a lead investor also takes a board seat, supervises companies’ operations and helps raise follow-on rounds. As former successful angel investors, online syndicates’ lead investors have experience following but not leading, and would thus lack the experience needed to play a role that is fundamentally different.

5.2. VC investors’ current views on AngelList syndicates

Three years after their creation, the reactions of VC investors I have gathered first show that online syndicates are now an integral part of the early-stage financing landscape. “What is happening is that most of the top angel investors are turning into VCs, which is fine and we love working with VCs. We think that this is a very cooperative industry. So we also think that syndicates on AngelList could be a good partner for us”, commented a NYC-based VC. Moreover, a majority of the VCs I interviewed mentioned that their LPs were looking closely at what was happening on the platform, “LPs see AngelList as a threat for the early stage VC industry. Yes, definitely”, declared the same NYC-based VC investor.

My research may be biased because I interviewed mainly first tier VCs, from seed fund to large spectrum VCs, but none of them considered online syndicates as a true competitor to
Online syndicates in the future early-stage financing landscape

The VC investors I interviewed all had a specific strategy to increase value-added services and aimed at leading rounds. “Our cash is greener because our cash is associated with more resources, that an individual angel can’t realistically afford”, declared another NYC-based VC investor. “It adds value and improves the ecosystem, but it won’t replace or disrupt us too much because we’re so hands on”, commented Jay Acunzo at NextView Ventures.

Nonetheless, two of these value-add VCs mentioned that they were now indifferent between having a second tier VC, not taking board seats or an online syndicate as a co-investor. In some cases, they even preferred an online syndicate because of 1) the speed at which they could complete rounds, 2) their specialization (“We encourage our portfolio companies to work with the investor group that is most likely to be a good match for them prospectively. We had a drone company who looked for investors with domain expertise in drones on AngelList” reflected the NYC-based VC investor), or 3) the publicity it creates for portfolio companies to raise funds on AngelList. Nonetheless, a drawback of this extended visibility is that successful entrepreneurs sometimes prefer not to disclose their key metrics to an audience as large as the one of syndicates’ backers.

Moreover, VC investors also observed that online syndicates often were the last investors to join the rounds in which they participated in, writing the last check for several hundred thousands of dollars. These comments suggest that, so far, online syndicates were interesting complements of leading VC firms, and sometimes substituted second tier VCs. “If your strategy is to be hands-off, and tag along a lot of deals, you should pay careful attention to what’s happening on AngelList” commented another Boston-based VC.

The complementarity between leading VCs and online syndicates on one hand, and the substitution of second tier VCs on the other hand, may present some limitations. Syndicates’ backers are not entirely passive investors and may be biased by their inexperience when they assess deals. “Ultimately, most of your backers are choosing themselves [between deals]. Everybody thinks they are a VC. They’re actually not backing on the deals that you think are good, but they’re backing you because they think you have access to the deals and, after, they decide which of the deal they want” said Lou Kerner, who syndicates the deals of his own VC firm with his syndicate on AngelList. Backers’ preferences ultimately
impact the range of deals completed on the platform because backers look for more easily assessable signals than professional investors to make their investment decisions. "AngelList likes companies with traction, and big name VCs as investors. And B2C over B2B. You have to tick all the three boxes", reflected Lou Kerner.

The fact that backers require "big name VCs" as co-investor confirms that online syndicates are not likely to substitute VC firms, at least not until the end of a first Venture Capital cycle, and the disclosure of online syndicates' performance. At the end of the cycle, one can imagine that online syndicates, which will have performed well, will be able to benefit from their own reputation. They will then be freed from the need of investing alongside reputable VC firms to convince their backers.

5.3. Analysis of online syndicates' deals since 2013

Summary of the key findings:

By ranking syndicates according to the amount of backing at their disposal, and analyzing the data available on every disclosed deals that happened on AngelList crossed with performance data available on Crunchbase, I found that only a dozen syndicates (in the first tier) actually competed with VC firms. These top-tier syndicates participated in Series A rounds, while other tiers took part mainly in angel or seed rounds. I also found significant discrepancies between tiers regarding level of activity, amount invested per deal and size of the deal. In particular, syndicates from the first two tiers are much more active than syndicates from the lower two tiers. Across all tiers, online syndicates mainly played the role of co-investors, bringing a rather low contribution averaging 20% per deal. This contribution also decreased every year for first tier syndicates since 2013. These results suggest that online syndicates from the first tier have mainly been crowding out second-tier VCs at the Series A stage, but that they rarely played the role of lead investor.
I first crossed the data available on AngelList on all the disclosed deals that happened on the platform until January 2016 with performance data available on Crunchbase. I then segmented online syndicates in four tiers according to the maximal amount of money each syndicate can invest per deal (backing):

i. Tier 1: Backing > 1M$
ii. Tier 2: $1M>Back ing>$500k
iii. Tier 3: $250K>Back ing>$500k
iv. Tier 4: Backing < 250k$

According to this segmentation, only syndicates from the tier 1 and 2 competed with early stage VC firms. On average, syndicates from tier 1 and tier 2 were more than twice as active than syndicates from tier 3 and tier 4.

<table>
<thead>
<tr>
<th>Tier</th>
<th>Number of syndicates</th>
<th>Number of rounds</th>
<th>Average number of investments per syndicate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 4</td>
<td>21</td>
<td>29</td>
<td>1.4</td>
</tr>
<tr>
<td>Tier 3</td>
<td>60</td>
<td>114</td>
<td>1.9</td>
</tr>
<tr>
<td>Tier 2</td>
<td>16</td>
<td>82</td>
<td>5.1</td>
</tr>
<tr>
<td>Tier 1</td>
<td>13</td>
<td>52</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>110</td>
<td>277</td>
<td>2.5</td>
</tr>
</tbody>
</table>

*Table 1: Overview of online syndicates’ deals disclosed on AngelList*

Moreover, one can observe that online syndicates took part in financing rounds of different sizes. In particular, online syndicates from the first tier differ from other tiers; they invested twice as much per deals in rounds that are more than three times as large in average (cf. Table 2). These results show that only online syndicates from the first tier have been investing at the Series A stage, while syndicates from the three other tiers focused mainly on the seed stage.
5. Online syndicates in the future early-stage financing landscape

<table>
<thead>
<tr>
<th>Tier</th>
<th>Online syndicate's investment</th>
<th>Average size of the funding round</th>
<th>Average total funding of a syndicate backed company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 4</td>
<td>$221,207</td>
<td>$3,224,931</td>
<td>$6,544,917</td>
</tr>
<tr>
<td>Tier 3</td>
<td>$254,193</td>
<td>$3,580,184</td>
<td>$5,815,544</td>
</tr>
<tr>
<td>Tier 2</td>
<td>$267,134</td>
<td>$2,433,951</td>
<td>$4,539,157</td>
</tr>
<tr>
<td>Tier 1</td>
<td>$571,519</td>
<td>$8,947,654</td>
<td>$17,076,127</td>
</tr>
</tbody>
</table>

*Table 2: Performance assessment of online syndicates by tier*

Their performance, assessed by the total amount raised by each of their portfolio companies, also differs. While online syndicates from the first tier invested at later stages, their portfolio companies have also grown much further subsequent to the investment. As of January 2016, there was no difference in terms of performance between other tiers.

I then assessed the dynamics of the rounds, in which online syndicates participated, by measuring the ratio of funds brought by the syndicate compared to the total size of the round (henceforth referred as online syndicates’ contribution). This analysis also helped me measure whether or not online syndicates played the role of lead investors, considering that the latter bring at least a third of the total size of the round.

The data shows that online syndicates have on average brought a minority contribution in the rounds they participated in, and that this ratio tends to decrease over time.
If we discriminate by tier, one can observe that online syndicates from tier 1 and tier 2 took larger stakes, but overall these remained rather low, below the threshold of 1/3. Hence, these first quantitative results are aligned with online syndicates playing the role of co-investors rather than really leading rounds.

<table>
<thead>
<tr>
<th>Tier</th>
<th>Online syndicates' contribution per round</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 4</td>
<td>13%</td>
</tr>
<tr>
<td>Tier 3</td>
<td>18%</td>
</tr>
<tr>
<td>Tier 2</td>
<td>25%</td>
</tr>
<tr>
<td>Tier 1</td>
<td>21%</td>
</tr>
</tbody>
</table>

*Table 3: Online syndicates' contribution per funding round*

Analyzing the data year after year, this contribution tends to decrease for the top-tier syndicates, while it increases for syndicates of smaller sizes.

*Figure 14: Online syndicates' average contribution per tier per year*
Finally, looking at the data deal by deal, the best performing companies are those in which online syndicates actually had relatively low contributions.

![Figure 15: Total amount raised by companies funded by an online syndicate vs. Contribution of the syndicate in the funding round](image)

Hence, as of January 2016, these first quantitative results are consistent with the elements brought up during qualitative interviews. Only a small number of syndicates from Tier 1 actually competed with VC firms, and they rather competed with second-tier VC firms by playing the role of co-investors.

### 5.4. Case study: the example of Flight.vc

An interesting evolution of syndicates, which happened in 2015, is the emergence of Flight.vc, founded by Gil Penchina. Gil Penchina is the most active investor on AngelList. Flight.vc is a collaboration between 26 syndicates, managed by 25 lead investors. Four of these syndicates are part of online syndicates’ top 20 in terms of backing, 9 of them are in the top 40. Each syndicate is focused on one specific industry or one specific geographical region. The strategic path taken by this aggregation of online syndicates shows that the new model they’ve invented is not the one of a traditional VC firm. It rather fosters a new way of investing, which aims at participating as co-investor in the best deals rather than really leading their own deals. The model Flight.vc moves toward is closer to that of mutual fund
than that of a VC fund, and enables backers to decide themselves of their investment focus. « The analogy behind Flight.vc is to be the Fidelity Investments of crowd funding. Started in 1946, Fidelity has an all star group of fund managers managing a diverse group of 576 mutual Funds for 24 million customers " reflected Gil Penchina (Stebbings, 2016b). The model has several advantages. First, it optimizes the likelihood of having backers investing fast, because they've already expressed a first preference deciding to back one syndicates rather than another. Second, it aims at engaging in a larger collaboration with syndicates' backers. An accredited investor backing Flight.vc’s bitcoin syndicate is likely to have a specific expertise or at least an interest in bitcoin, from which the syndicate as a whole could benefit when conducting due diligence themselves. He/she is also more likely to be able to add value to the portfolio company after the investment.

Except for Gil Penchina, the 25 other syndicate managers are working part-time for their syndicate. Some of them are entrepreneurs, others partners at a VC firm. When they join Flight.vc, syndicates' managers accept to share their carry with the organization but they retain the final investment decisions on each of their deals. Unlike traditional VC firms, Flight.vc does not have any investment committee but syndicate managers benefit from each other’s expertise, gathering an informal investment committee every month. Each syndicate manager benefits from Flight.vc’s networks, brand and from the large community of Flight.vc’s backers, which can be engaged through AngelMob (cf. Chapter 4). Moreover, each syndicate manager has one intern screening and referring deals to him/her. Five people also work full time for Flight.vc, conducting due diligence for Gil Penchina, and are compensated directly by Flight.vc. Finally, the organization has a network of a 100 voluntary associates, who allocate time to source and review deals for the company.

In 2015, Flight.vc’s syndicates invested a total amount of $17M in 40 companies, but they lead only three deals. In total, more than 3000 accredited investors support Flight.vc’s 26 syndicates, bringing the total amount of backing across all the syndicates above $21M per deal. The average investment per backer averaged $6.8k per deal. The average investment made by Flight.vc’s syndicates was $400K, showing again their focus remained mainly on the very first funding rounds.

Lou Kerner, manages the Israeli syndicate at Flight.vc, but he is also working full time to invest a VC fund. First trying to assess if online syndicates were actual VC firm’s competitors,
my interviews with VC investors drove me to the conclusion that there could be interesting synergies between the two organizations.

5. How do VC firms take advantage of AngelList syndicates?
Analyzing the first 20 syndicates in terms of funded backing, one can observe that ten of them were led by VC firms or by individual investors working full time in a traditional VC firm. The VC fund provides VC investors with locked-in funds and management fees, while their online syndicates present four additional advantages that I describe below.

5.1. Opportunities to increase VC firms’ investment capacity
In 2015, several VC firms raised additional funds using their online syndicates on AngelList or announce their intention to do so in the future. Lou Kerner invests on average $2M per deal with his VC fund, but he also allocates $400k to his syndicate in every deal. Hence, in the best case, his syndicate allows him to extend his firm’s investment capacity by 25%. Similarly, former Softech VC’s partner, Charles Hudson raised a $25M seed fund, and decided to raise funds for follow-on rounds using his syndicate on AngelList (Chapman, 2015). Notation Capital, a pre-seed fund based in NY, announced its intention to fund its portfolio companies’ follow-on rounds gathering its own LPs and other accredited investors on AngelList (Notation Capital, 2015). AngelList introduced its new Specific Purchase Vehicles (SPVs) at the end of 2015 with the objective to make this process even more seamless for VC firms (AngelList, 2016). The schema below explains how VC firms can leverage AngelList’s SPVs to simplify the process of raising additional funds from their own LPs, other business partners or funds managed by AngelList.

![Figure 16: SPVs on AngelList](image-url)
VC firms have also started to use their firm's syndicate, or their GP's personal syndicates, to complete rounds faster than they would if they had to wait for another VC firm to co-invest. In June, TJ Mahony, GP at Accomplice, used his personal syndicate to complete a seed round in LovePop for example. Seth Levine, Partner at Foundry Group, reflected on how fast deals syndicated online go: « FG Angels Syndicate investments go FAST. Foundry committed to invest through FG Angels on a Friday. On Monday, our deal went live and almost all the funds raised from FG Angel's syndicate were in process by the following Monday (within one week) » (Levine, 2014). One of the criticism of this model is that VC firm end up investing their syndicate's money while they are compensated by management fees paid by their institutional LPs. Notation Capital has come up with an interesting solution to mitigate this issue, by agreeing with their LPs to redistribute the potential carried interest gained through their deals syndicated online in the VC fund (Notation Capital, 2015).

5.5.2. A simplified process to aggregate value-added angels

Long before online syndicates’ advent, VC firms already allocated a part of their investment to value-added angel investors. Creating its own syndicate, a VC firm can now co-invest with a much larger number of angel investors seamlessly. In particular, the firm does not need to gather each angel investors’ signature or capital commitment. Everything is handled online through AngelList. Another advantage is that angel investors participating in the syndicate cannot interfere with the VC firm’s relationship with entrepreneurs. They need to agree to follow the VC firm’s voting decisions when they first invest. In this case, AngelList syndicates (and SPVs) can be seen as a modern form of the sidecar funds that top VCs like Kleiner Perkins often use to let their business partners co-invest in their deals (Hodges, 1998).

5.5.3. Youtube vs. Viacom

As mentioned in the first chapter, VC firms are now fully aware that they need to work on their firm’s branding. Relatedly, those who have realized the importance of AngelList as the online hub of the entrepreneurial ecosystem, create their own syndicate with the goal of increasing the awareness around their firm, as well as that of their portfolio company. In this regard, Lou Kerner builds a telling parallel, arguing that online syndicates will be for traditional VC firms what Youtube is now for Viacom. Viacom has not disappeared since Youtube exists, but Viacom has found interesting synergies with Youtube, notably investing in the production of shorter video advertisement for their films. The competitive edges that
Viacom derives from using Youtube are very similar with those that a VC firm would create leveraging its own online syndicate: an increased visibility, a new tool to communicate and engage with their community of backers/fans, and an innovative way to increase the competitiveness of their funds/films.

5.5.4. A new way to improve deal flow

A last strategy employed by VC firms to take advantage of AngelList syndicates consists of backing online syndicates managed by other investors. By backing a syndicate that takes part in a company’s early funding round, a VC firm gets a foot in the door and is then in a favorable situation to pre-empt the latter’s subsequent round. It is also a way to mitigate the problem of asymmetric information in the next round. Accomplice, the VC firm at the origin of Maiden Lane and the first institutional investor in AngelList, employs this strategy. The firm invests its institutional LPs’ money to back the BOSS Syndicate and TUGG, two syndicates investing in seed rounds, when Accomplice’s investment focus starts at the Series A stage. The interesting idea behind the BOSS Syndicate is to support a network of 50 Boston-based entrepreneurs in their investment decisions by bringing $250k to any deals one of these entrepreneurs would like to lead. Since its creation 2 years ago, Accomplice deployed $8.7M via the BOSS syndicate. The BOSS syndicate as a whole invested $13.4M in total in 38 companies. 62% of them already received follow-on financing. In particular, Accomplice already led 2 Series A in a company funded at the seed stage by the BOSS Syndicate.

5.5.5. Risks of combining the two investment vehicles

Taken together, the four aforementioned advantages increase the VC firm’s overall competitiveness. Thanks to his online syndicate, Lou Kerner mentions that he has been invited to co-invest in deals he could not get access to when he was investing only the funds of his VC fund. According to him, being able to engage the community of his online syndicates’ backers to promote entrepreneur’s products and the spotlight put on start-ups raising funds on AngelList are the two main reasons explaining his new popularity. Notwithstanding these advantages, one can still mention at least three risks of combining the two investment vehicles. First, the possibility of having underperforming backers, who would have chosen to invest in the underperforming deals can potentially tarnish the VC firm’s reputation, even though the syndicate as a whole performs. Second, building on
Foundry Group’s feedback at the end of their experimentation with AngelList, and as AngelList grows, it will be of primary importance to engage more effectively with the community of backers, so that they are not completely passive investors. For now, because they invest such a small amount of money, these backers might not have enough incentives to actually help portfolio companies. Finally, Foundry Group’s experiment also shows that investors who use their syndicate to fund earlier stage deals than those of their core scope of investment might not deploy amounts of capital large enough to generate significant returns compared to the time investment these syndicated deals require.
6. Conclusions

Less than a decade ago, a new generation of VC firms, spearheaded by Andreessen Horowitz, and currently known as “VC Platforms”, emerged with a renewed value proposition for entrepreneurs. This generation hired operating professionals and offered new services to entrepreneurs, in addition to investment capital and their partner time and expertise. Building on interviews with VC investors and reviewing industry experts’ publications, I analyzed the drivers of this new VC Platform strategy, outlined its key elements and assessed their advantages and risks.

Although it is not the first time VC firms have tried to expand their internal teams beyond their investment partners, firms of this generation differ from those of the past insofar as they aim to provide additional value to their portfolio companies’ operations without replacing their portfolio companies’ employees. Among other things, they strive to strengthen the ties within the community of their portfolio companies and engage with a larger network of third-party business partners. At the VC firm level, this strategy’s most important impact is that it improves the firm’s visibility and its branding. Subsequently, VC firms that embrace this strategy can expect the number of their inbound deals to increase. Investors also benefit from new arguments to convince entrepreneurs to opt for their investments rather than those of another firm. Ultimately, offering new value-added services has enabled VC firms to start building a reputation, although many of them had no investment track record. The VC Platform strategy has been a successful go-to-market way to enter the VC market, which normally favors incumbents.

Now, at the industry level, integrating a larger number of functional experts is not a one-size-fits all approach to increase VC firms’ competitiveness. A platform strategy plays first and foremost a role of differentiator between VC firms, and, hence, cannot be duplicated from one firm to another. To succeed, VC firms should customize the additional services they offer to their firm’s specificities and especially their target companies. A platform strategy also comes with certain risks that any VC firm might not wish to take. It forces general partners to become managers of larger teams and jeopardizes their firm’s economics. Finally, it should be considered only as a complement of what underpins VC firm’s long-term reputation: their investment track record and their partner’s expertise and time.
AngelList gives rise to a larger form of “platformization” in early-stage investment. After bringing additional transparency to the market and facilitating the connection between entrepreneurs and VC firms, it currently allows entrepreneurs to raise funds entirely online. The results of my research show that, more than a substitution of traditional venture capital, equity crowdfunding syndicates are more of a complement to the existing players in the industry. Almost three years after online syndicates’ introduction, AngelList has become an “operating system” for investors that opens up a range of new possibilities:

- Online syndicates empower individual investors, angels, entrepreneurs, or former VC investors, who benefit from the ease of setting up an online syndicate, to become micro-VCs. These syndicates give rise to a new generation of lead investors, which institutional LPs would not necessarily have backed. As of today, qualitative interviews and data on the first online deals, show that these syndicates have played the role mainly of co-investors in early stage deals. Nonetheless, the new inflow of institutional capital might allow them to get access to larger deals in the future. The fact that some of the top lead investors start becoming fund managers (requiring institutional investors to back them on multiple deals, and asking for management fees), shows that there is an underlying process of professionalization currently happening within online syndicates.

- VC firms can create their own online syndicates and co-invest with a wider network of angel investors: It’s all the more interesting that syndicates enable VC firms to increase awareness around their firm and around their portfolio companies, while strengthening the ties with their business partners.

- Finally, using their online syndicate to pool additional funds from their own LPs, or from other external investors, VC firms can seize a new range of interesting investment opportunities they used to pass on. It can be investing in deals that are more early-stage or gathering additional funds to use their pro-rata rights in follow-on rounds.

Yet this evolution does not come without any risk. It gives rise to a new generation of early-stage investors, who have access to deals, but do not necessarily work full time on monitoring their portfolio companies. In particular, online syndicates’ lead investors might not have sufficient incentives to do what traditional VC investors do on a daily basis: monitor the vast majority of their middle-performing portfolio companies. Moreover, as of
today, online syndicates cannot benefit from the advantages of having locked-in funds, which is according to Marc Andreessen “The great saving grace of venture capital” (Griffin, 2012). Online syndicates may hence be more sensible to panic, or general volatilities in the economic environment, in case accredited investors suddenly decided not to back their deals anymore. In this regard, it would be interesting to observe if the money flowing in equity crowdfunding syndicates follows a similar evolution as the money invested in venture capital funds.

In general, the US regulation—which limits the number of accredited investors getting access to each deal to 99— and the new appetite of institutional capital for online syndicated deals might also crowd out some accredited investors from the community of the best syndicates’ backers. In this regard, equity crowdfunding syndicates might ultimately achieve something fundamentally different from what crowdfunding aims at: giving access to start-up investment to anyone. The best online syndicates could for example mainly allow already-renowned angel investors, who already had access to startup investing, to invest in a larger number of deals, rather than let any anonymous investor buy equity stakes in promising start-ups. From this perspective, it would be interesting to analyze the diversity of investors who were allowed to invest in the best performing syndicated deals at the end of a first Venture Capital cycle. Is it always the same investors, meaning that top online syndicates’ lead investors constantly pick the same backers? Or is the community of top online syndicates backers wider and more diverse?

We are still at online syndicates’ very infancy, and the lack of quantitative data regarding their performance prevents us from drawing definitive conclusions. We will have to wait until the end of the first venture capital cycle, in at least 5 years, to be able to really assess their performance. Nonetheless, qualitative feedback from industry experts, including VC investors, is encouraging. The rapid growth in the amount of money flowing into syndicates—especially from institutional investors— is also an early signal of the quality of the deals syndicated online. A last performance driver is likely to stem from the synergies between online syndicates and established VC firms. These could increasingly co-invest in their best deals with online syndicates, either their own or those of other lead investors. Combining these three reasons, online syndicates are likely to keep growing substantially and to embody the gradual adoption of an online model in the early-stage financing industry.

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