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Original Article

Venture capitalists' non-financial value-added: an evaluation of the evidence and implications for research

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Abstract

Much research has suggested that venture capital (VC) investors can contribute post-investment to the success of new ventures in ways other than financing, but the specifics of such post-investment non-financial value-added (NFVA) are still not well understood. We systematically review, organize and evaluate the empirical research on VC NFVA, and compile together results that were previously scattered across many papers. In the 20 salient studies of VC NFVA published between 1986 and 2005, we observe little consensus regarding the definition and measurement of value-adding

inputs and value-added outcomes, and little consensus regarding which of the VCs' value-adding inputs are most important. We further observe that NFVA studies have employed either qualitative methods or quantitative measures of retrospective perceptions. To guide future research, we propose a provisional model of VC exit success and a provisional eight-category typology of value-adding inputs that accommodates the findings in the literature. Two categories of the typology (legitimation and outreach) have an external orientation and six categories (recruiting, mandating, strategizing, mentoring, consulting and operating) have an internal orientation. The empirical evidence to date suggests that operating, outreach, consulting, mentoring and recruiting may be the most influential categories, but the evidence is far from definitive. We argue that future studies should examine ‘VC exit success’ as a high-impact dependent variable, and place greater emphasis on the measurement of directly observable events for both value-adding inputs and value-added outcomes.

Keywords:

venture capital | non-financial value-added | NFVA | non-financial contributions | new venture success | VC exit success

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Notes

1. This quote is attributed to Earl Storie, Managing General Partner of VenGrowth Asset Management Inc., a Canadian venture capital firm. According to the company website,

VenGrowth partners view themselves as ‘an extension of each of the portfoliocompanies: a financial strategist, human resources consultant, investment banker, and corporate “sounding board”’ (http://www.vengrowth.com/funding.asp?id=130, accessed July 2006).

2. Some research suggests that the strength and even the direction of the relationship between inputs and outcomes may depend on the stage of venture life cycle (Gomez-Mejia et al., 1990; Flynn and Forman, 2001), the level of VC involvement (MacMillan et al., 1989; Ehrlich et al., 1994), and the fit between the approach of the VC and the strengths and expectations of the management team (Perry, 1988; Sweeting and Wong, 1997). We argue that research on moderating factors is a promising and potentially high impact area of inquiry. At present however, there are little empirical data available. Thus, moderating factors, though important, are largely absent from this survey.

3. Preliminary results of the stage one literature review are surveyed in Muegge et al. (2005). The methods and results of that Working Paper were enfolded into this study, with the following changes. Step 3 (keyword search) was expanded to include additional keywords. Step 5 (manual scan of abstracts from selected journals and proceedings) was extended from an end-date of December 2004 to an end-date of December 2005. The scope of Muegge et al. (2005) was broader, and its analysis was largely qualitative. The present study focuses exclusively on VC NFVA; its scope is both narrower and deeper, and its methods are largely quantitative.

4. The seven journals are as follows: American Economic Review, Academy of Management Executive, California Management Review, Entrepreneurship Theory and Practice, Irish Marketing Review, Journal of Developmental Entrepreneurship and Journal of High Technology Management Research.

5. We do not intend this remark as criticism of the research methods of these studies. For example, several studies defined their research question such that the value-added outcome was outside the scope of their investigation.

6. For the purposes of this survey, Sapienza (1992) and Sapienza and Timmons (1989) are grouped together as one empirical study.

7. Theoretical treatments of the potential conflicts and differing perspectives between VCs and managers include agency theory and procedural justice (e.g. De Clercq and Sapienza, 2001) and game theory (Cable and Shane, 1997).

8. Ehrlich et al. (1994) intentionally embedded the MacMillan et al. (1989) typology within its own framework.

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