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Structural Changes in Venture Capital

Marc Andreessen, *Serial Entrepreneur*

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The "venture capital industry" does not exist, says serial entrepreneur Marc Andreessen. Rather, the landscape is a loosely-affiliated network of over 600 investment organizations, with only about 30 firms performing well and returning profit overall. In parallel, there is a rise in seed funding for new ventures and a rise in latter-stage investing for established companies as well.

Transcript

How are the economics of the venture capital industry changing? And in particular like what structural changes are going to happen to venture capital as a consequence of these economic changes? So first of all I don't believe there is such a thing as the venture capital industry. I don't think it exists. I think you've got a set of firms. You've got 20, 30, 40 boutique venture capital firms that do really well over time. And then you've got about 660 firms that will generally very much break your heart as an investor if you invest in them. They will return you less than the stock market with much higher risks. Venture capital is one of those things. Venture capital firms hedge funds, buy-out firms, investment firms operating in special markets that are ill-liquid or have special knowledge. You tend to have a few firms that generate all the returns. Then you tend to have a lot of people who want to generate those returns.

They can never actually figure out how to hurdle the bar. You can download this list online. If you pull up like venture capital firms in the US, it's like 700. And you can read through that for like three hours. And you won't recognize the vast majority of the names on that list. And how they get funded, I don't have the first clue. It's the same thing with hedge funds. There's like 8,000 hedge funds. You don't even know who these people are. The problem is when you talk about the venture capital industry, all that data gets rolled up.

And then they look at it and they say, "Well venture capital's terrible because venture capital doesn't make any money. It's like, "Well yeah. If you include all the bad firms, it's terrible." So it's this really a striking thing. What's interesting is entrepreneurs know this. And it's not like there is shortage. There is a bunch of good firms. But entrepreneurs are well aware that there is a set of firms that know what they're doing and there is set of firms that really don't. And so there is a whole adverse selection thing that kicks in. So there's two ways of asking the question. One is what's going to happen to venture capital broadly.

And I almost spend no time on that topic. To me the very interesting question is what's going to happen to the really good venture capital firms? And I think there is a whole variety of things that are happening there. One is there's this whole tier of angel or seed funding because it's so much cheaper to start these companies. There is a whole tier of angel or seed funding that has now appeared and is becoming very professionalized. And in fact a lot of the best angel investors are now starting actually raising funds. So for example, my colleague Ronnie's father, Ron Conway, is one of the really well known Silicon Valley angel investors. He's just raised a new fund to even wrap up this activity. And that's very exciting because the best angels are really good. And if anything the best angels are at least as good or better than the good VCs in a lot of cases. So on the very early stage that's very exiting on the one hand.

On the other hand there's this equally interesting phenomenon that's happening in later rounds. And the classic case study there is this Russian firm called DST that has become a major investor in companies like Facebook and Zynga and most recently Groupon. And so you may have noticed in the last ten years, since my last appearance here in April 7, 2000, there are very few IPOs. And so you've got companies like Facebook and Zynga and Groupon that are getting very successful financially and getting very large. And they're not going public nearly as early as they used to. And so there's this new category of investor that is coming in. Some of these are existing firms that are now getting larger. And some of these are new firms that are being created that are coming in and are investing later and later in the company life cycle. And some of these firms are taking ownership stakes of hundreds of millions of dollars in 500, 600 and 700 million of individual ownership stake in a high-growth company at a later stage.