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WHEN VENTURE CAPITAL SYNDICATION GOES BAD: THE SOCIAL NETWORK CONSEQUENCES OF FAILED INVESTMENTS (SUMMARY)

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SUMMARY

WHEN VENTURE CAPITAL SYNDICATION GOES BAD: THE SOCIAL NETWORK CONSEQUENCES OF FAILED INVESTMENTS

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Principal Topic

Despite the high prevalence of VC syndication, there is still relatively little understanding of the dynamics of syndication relationships. In this paper, we examine whether and how investment outcomes affect the likelihood that syndicate partners will invest together again. Based on attribution and behavioral decision theories, we argue that syndicate partners draw inferences from their current investments about their ability to work together. On the whole, we expect that investment success will increase the likelihood of future co-investment, while failure will reduce this likelihood. But we also expect that the partners' prior investment experience will make the success and failure of the current investment more salient and asymmetrically so; they matter only if they serve to affirm the partners' perceptions of their competence or incompetence. Accordingly, we expect that current outcomes matter less when the partners have no prior experience. In addition, we expect that current success matters more in the context of prior success and less in the context of prior failure; similarly, current failure matters more in the context of prior failure and less in the context of prior success.

Method

From the *VentureXpert* database, we created a dataset of 925 first-round, early-stage investments that took place between 1980 and 2001, involved exactly two VC firms, and did not involve any additional investors in subsequent rounds. We traced and recorded the date and nature of the ultimate outcome of each investment. We also recorded whether and when the two VC firms invested together again, and derived their joint investment experience prior to the current investment. We organized the data into 1,506 duration spells and used a Cox model to estimate the hazard of future co-investment and test our hypotheses.

Results and Implications

We find that the likelihood of future co-investment (1) decreases with the failure of the current investment, (2) does not depend on the success of the current investment, and (3) increases with the prior co-investment experience of the partners. Moreover, current failure does not matter when the two partners have no prior joint experience. Finally, the current success decreases the likelihood of future co-investment when the partners have higher prevalence of failure in their prior experience. These results hold interesting theoretical and practical implications.

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