Frontiers of Entrepreneurship Research

Volume 26 | Issue 3
CHAPTER III. VENTURE CAPITAL
Article 15

6-10-2006

IT'S NOT WHAT YOU KNOW BUT WHO YOU KNOW: STRATIFICATION AND STATUS IN VENTURE CAPITAL (INTERACTIVE PAPER)

Jennifer M. Walske
Boston University, jwalske@bu.edu

INTERACTIVE PAPER SESSION

IT'S NOT WHAT YOU KNOW BUT WHO YOU KNOW: STRATIFICATION AND STATUS IN VENTURE CAPITAL

Jennifer M. Walske, Boston University

Principal Topic

Prior research has shown that the venture capital (VC) industry is renowned for its homophily, regionalism, and cliquish nature. Research has also shown that venture capitalists (VCs) specialize their investments by geography and industry, and syndicate their investments in order to share both resources and risks. However, the venture industry has also experienced robust growth in the number of firms and capital under management. From 1980 through 2003 the VC industry grew from 89 to 919 firms and from $3.7 billion to $257.5 billion in capital under management. As a result, the author asks if the recent growth may have caused an insular industry to become fragmented, and if this fragmentation has resulted in a stratification of elite vs. non-elite firms.

Method

The author hypothesizes that in recent years, due to industry growth, only pockets of the industry remain highly embedded, and that this embeddedness is between elite VC firms. The dataset used is from the National Venture Capital Association (NVCA) and VentureXpert. The dataset is devoid of some of extreme bubble periods of growth and decline, while still using a more recent subset of the data in year 1996. The data sample includes VC investments in 116 new ventures by 290 VC firms. Elite versus non-elite firms are identified based on collaborative work between Hamilton Lane and HBS Professors Hardymon and Lerner, as referenced in the HBS Best Practices case (Case N9-805-167). The strength of ties is analyzed by capturing the mean frequency of co-investments using UCINET.

Results and Implications

Results show that a handful of elite venture firms maintained closed, highly embedded networks, while non-elite firms participated in large, fragmented networks. This research has made two important contributions. First, this is the only known work that delineates significant differences in elite versus non-elite syndication patterns amongst VCs based on tie strength. Second, this paper gives insight into how the recent growth in the industry may have affected historical notions of industry embeddedness, by lending evidence to a potential bifurcation in the industry. To fully elaborate on the second contribution, further research comparing the industry in its earlier years, versus its more recent years, is recommended.

CONTACT: Jennifer M. Walske, Boston University, 595 Commonwealth Avenue, Boston, MA, 02115; (T): 617-232-4714; (F): 617-232-0447; jwalske@bu.edu