INTO THE LAND LESS VENTURED: AN EMPIRICAL EXAMINATION OF TIME ALLOCATION IN VENTURE CAPITAL DUE DILIGENCE (INTERACTIVE PAPER)

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INTO THE LAND LESS VENTURED: AN EMPIRICAL EXAMINATION OF TIME ALLOCATION IN VENTURE CAPITAL DUE DILIGENCE

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Principal Topic

Due diligence is a critical component of the venture capital (VC) cycle. Within this stage, the assigned time and efforts largely dictate the probable success of an investment portfolio (Smart, 1999). Though, only a small number of studies have aimed to capture the methods and approaches employed in this process (Zacharakis and Shepherd, 2007). As a result, an understanding of how VCs spend their time during due diligence remains understudied (Jaaskelainen et al., 2006). According to Petty and Gruber (2011), what does exist in the realm of VC time allocation tends to center around the management of the fund’s existing portfolio, resulting in a disproportional emphasis on post-investment allocation of time. This study has sought to contribute to achieving a deeper understanding of this aspect.

Methods

A questionnaire comprised of open and closed ended questions was distributed to VCs at leading firms spread relatively evenly across the US. 100 VCs were contacted, and 50 responded – constituting a 50% response rate representing 39 firms.

Results and Implications

The analysis of our data collection yielded a number of interesting and seemingly counter-intuitive findings. First, a basic understanding of how VCs spend their time assessing key evaluative criteria was established: the market (21%), management team (17%), product/technology (16%), strategy (12%), financials (11%) and deal terms (10%). In addition, VCs reported the management team to be both the most important evaluative factor and the most common reason for investment failure -- yet the time assigned to evaluating the management team was significantly less than the market. Broadly, it seems reasonable to infer that if the allocated time is optimally aligned, where the management team receives the greatest amount of attention, that VCs may realize an improvement to the current failure rates, which have been reported to be as high as 60% (Zacharakis and Meyer, 2000).

Given the impact of time allocation on VC outcomes, we accordingly reason that the allocation of time merits further investigation. We hope this study stimulates greater interest in VC time allocation and that it provides a means to more comprehensively understand how VCs make decisions, and more importantly, how these decision processes can be improved.

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