

Abstract

Geographical clustering is an essential feature of the venture capital (VC) industry as proximity helps VCs to acquire **soft information** about early-stage companies and to conduct post-investment activities. However, whether the **VC investment model** based on in-person interactions is still justified in the age of online communication technologies remains an open question. In this paper, we address this question by using an **unexpected interruption in face-to-face meetings** during the recent pandemic. We document that VCs respond to this change by breaking their traditional norm: they invest in **more distant** startups. We find that this evolution goes along with selection criteria and syndication process changes despite some persisting behaviors. Thus, our study helps to understand how VCs revisit their investment model and sheds light on the value of in-person interactions for the VC industry.

Research Question

How important are in-person interactions for VCs?

How would a restriction on such interactions affect VC investments?

→ In terms of investment geography.

→ In terms of target company characteristics.

→ In terms of syndication.

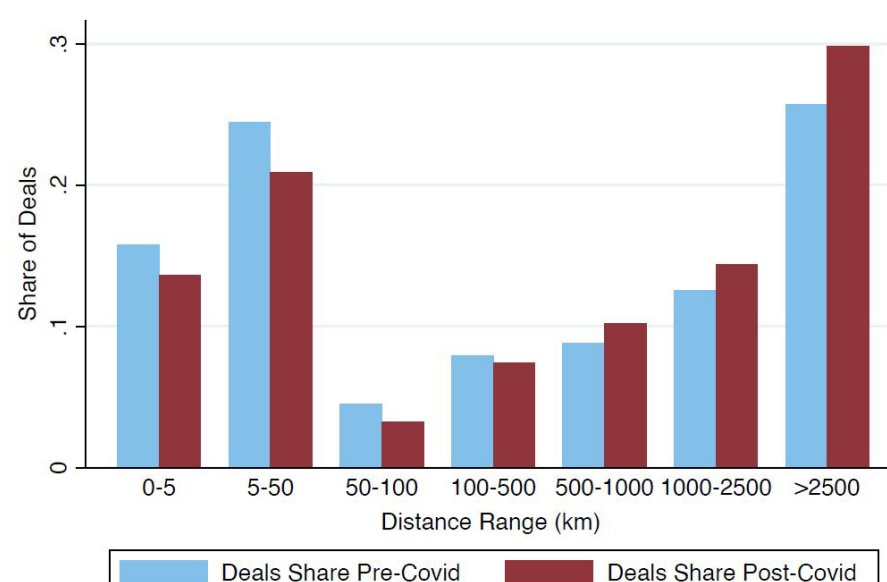
→ In terms of performance.

Increase in Distance

- Main specification:

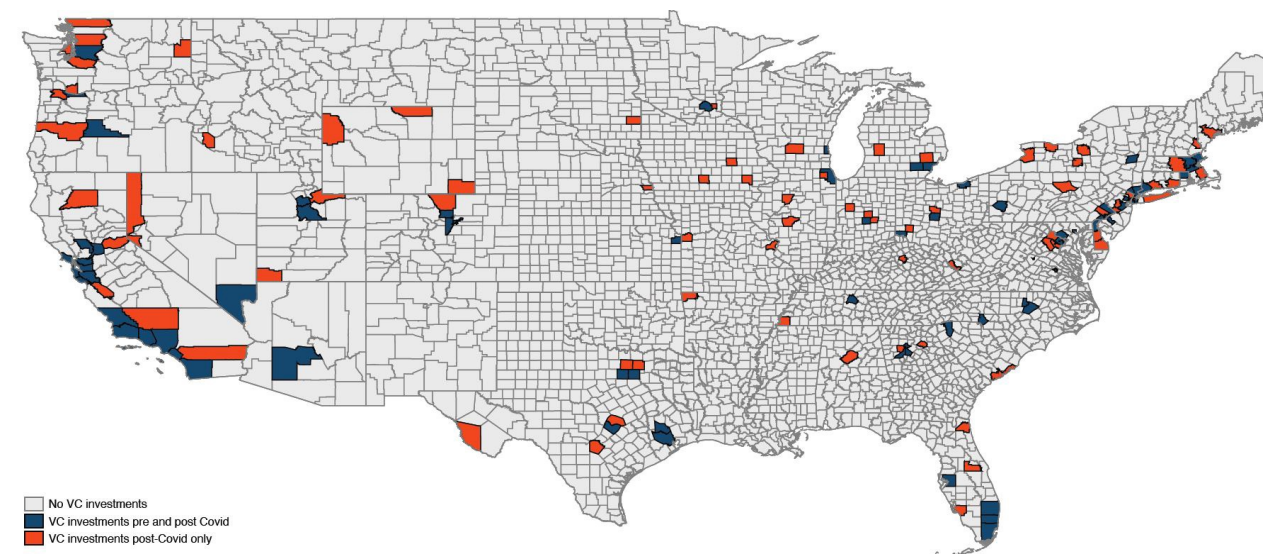
$$Distance_{j,i,t} = \beta_1 \text{Post Covid} + X'\theta + \alpha_i + \omega_l + \gamma_s + \eta_v + \epsilon_{i,j,t}$$

- Distance increases by 43-51% in the cross-section and by 30% within a VC firm's portfolio
- Change in distribution of deals by distance:



The Geography of VC Investments

- VCs broke with their proximity culture and broadened their geographical reach.
- Post-Covid, the probability to invest in the VC's own state **decreased by 15%** (in the cross-section) and 5% with VC fixed effects.
- There is a redistribution of the number of investments from hubs toward other areas.
- However, there is no striking change in the geography, suggesting they are taking careful steps.
- Example - Investments by Californian VCs Post Covid:



Investment Characteristics

- Do VCs find a way to balance the limited access to soft information by adjusting selection and monitoring?

	Portfolio Company's Age		N. of BoD Appointees	
	(1)	(2)	(3)	(4)
Post Covid	0.157** (0.074)	0.144* (0.074)	-0.050*** (0.012)	-0.050*** (0.012)
Ln(Distance+1)		0.054*** (0.013)		-0.003 (0.002)
Observations	4,304	4,304	3,982	3,982
R-squared	0.261	0.264	0.380	0.380
Controls	✓	✓	✓	✓
Deal Type FE	✓	✓	✓	✓
Industry FE	✓	✓	✓	✓
State FE	✓	✓	✓	✓
VC FE	✓	✓	✓	✓

Syndication

- As syndication helps to share risk and information on investments, do VCs also change their syndication process?

	P(Syndicated Deal)		Ln(Avg Distance b/w Members)	
	(1)	(2)	(3)	(4)
Post Covid	0.070*** (0.020)	0.070*** (0.020)	0.202*** (0.049)	0.130*** (0.047)
Ln(Distance+1)		0.005 (0.003)		0.189*** (0.010)
Observations	4,026	4,019	7,875	7,863
R-squared	0.383	0.382	0.313	0.355
Controls	✓	✓	✓	✓
Stage FE	✓	✓	✓	✓
Industry FE	✓	✓	✓	✓
State FE	✓	✓	✓	✓
VC FE	✓	✓	✓	✓

Performance

- We showed that VCs adapt their investment process, do these adjustments help VC investments perform as well?

	P(2nd Round) within 18 months			P(IPO or M&A) in 18 months		
	(1)	(2)	(3)	(4)	(5)	(6)
Post Covid	0.109*** (0.023)	0.091*** (0.032)	0.090*** (0.031)	-0.024 (0.028)	-0.019 (0.031)	-0.018 (0.031)
Ln(Distance+1)			0.003 (0.006)			0.002 (0.002)
Observations	2,024	1,519	1,518	1,983	1,485	1,484
R-squared	0.054	0.304	0.304	0.063	0.351	0.352
Controls	✓	✓	✓	✓	✓	✓
Seed round FE	✓	✓	✓	✓	✓	✓
Industry FE	✓	✓	✓	✓	✓	✓
State FE	✓	✓	✓	✓	✓	✓
VC FE		✓	✓		✓	✓

Conclusions

- The pandemic challenged the VC investment model based on in-person interactions.
- VCs expanded the geography of their investments.
 - **Implications for the diffusion of entrepreneurial activity and innovation** spillovers outside traditional hubs.
- VCs select startups that are representative of remote investments.
 - **Online interactions do not seem to fully substitute** for in-person communication.
- VCs balance off risks by relying on syndicate partners.
 - **Increasing importance of VC networks.**
- Preliminary evidence** suggests that companies deal-sourced online are **not performing worse** in terms of:
 - Probability of receiving a second round of financing.
 - Early exits.
- These results are likely to be relevant for industries relying on soft information.

Get in touch!

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