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Strategies and Techniques for Venture Investing

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With a buoyant U.S. stock market as we put this issue together, and with the hopes it will stay with us, it is a good time to look at the process of selecting companies to fund, valuing them, bringing them to market, and judging our over-all returns against other alternative investment classes. As such, our articles follow that pattern, although data are used from other than simply the U.S. markets. In addition, we include articles on how best to start a career inside a venture capital firm and a comment on investing in an entirely new and different type of deal: power generation plants.

Everyone wonders how much difference it makes when a deal is brought to the market by a venture capitalist. Campbell and Frye review 881 deals brought to market in 1993 and 1996, and follows those companies for five years. How well do the two groups perform, those with VC backing and those without? Does it matter if VCs monitor the company by continuing as a director or large shareholder? Does it matter if analysts follow the stock? Or how many VCs are involved with the company? Or the size of the VC's funds under management? These interesting questions, along with several others, or covered in our lead article this issue.

Stepping back a moment to where investments start, Fiet and Patel present a set of patterns on which to judge the potential success of business plans. The authors then conducted an experiment, training three groups of individuals—without prior investment experience—to select the best deals from among 34 business plans. These three groups include one of MBA students, one of welfare mothers, and one of technically trained employees. They then matched the outcomes of each group against the actual outcomes from the business plans. Even given the small sample size, the results of their training and the predictive ability of the three groups lends strength to the validity of their patterns with which to judge business plans. How well does your evaluation criteria match up with theirs?

We all have to make tough decisions on how we evaluate our privately held companies. What method do you use? Sophisticated mathematics or back-of-the-envelope estimates of worth? How much is art and how much is science in arriving at your valuations? Petersen and Plenborg review techniques with a large group of Danish corporate advisors and private equity investors who use the present value approach. How many of them comply with the recommended techniques? How much judgment is required?

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How often do they admit to guessing? Do they look at beta values for peers, or just for betas on the industry? These findings will help you reflect on your process of valuation.

An even bigger question is how well does the venture capital industry perform when compared to other investments often open to our limited partners. Tom Grossi takes a look and helps us think about the “beta”—the degree to which VC returns vary from general stock market returns—for the venture capital industry. Understandably, he estimates that the beta varies in different periods, and that makes for the fascinating question of what type of period we are in now. Will the VC industry outperform our lively stock market or not? The answer is central to everything our limiteds do, and this paper gives us some data to think about.

How effective are government regulations about private placements in changing the nature of that type of fund raising? I’d bet most of you would say that government regulation in that area has quite a powerful effect on the amount of funds raised and from whom. Carpentier, L’Her and Suret analyze over 11,000 private placements raised in Canada between 1998 and 2004 and review the effects of changes in regulation. Their find-

ings may surprise you, as they did not quite have the anticipated outcome.

Everyone wants to be a in the private equity business these days, wither as a VC or in a buy-out shop. But what does it take, after you are in the front door, to advance as a venture capitalist? Conrad Wang completed a series of interviews with junior-level venture capital employees to understand, from their point of view, what it takes to move forward. Think you know what they will say? Test your perceptions with this piece.

Our final piece this issue is a comment on a new type of investment very few of us know much about: power generation facilities. Power is very much on the mind of all of us, never more so then when we fill up our gas tanks. Allan Marks brings us up to speed on the whys and hows of an investment like this, particularly why the return looks different today and how to enter this type of deal. Many fortunes have been made in the power industry over the last century. Is it time again for outsized returns?

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