GreenHills Ventures – When it Comes to Venture Capital, Do Like Warren Does

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All of a sudden, it is boom time again for venture capital funds, with over $10.3 billion in fresh capital raised by 578 funds in the 1st quarter, up 36% from 2012.

And high profile exits on deals like Nest, WhatsApp, and Occulus - where fund investors saw returns in excess of **20x** their original investments - have caught the public's fancy as to the power of startup and emerging company investing.

So it should come as no surprise that a lot of folks want in on the action.

But for the individual investor, is investing in a venture capital fund *really* a good idea?

It can be, as the return examples above attest, but more and more it has become a losing game.

Here's why:

Market Efficiency. With now over one thousand active U.S. venture funds - and with so many of them pursuing similar deal sourcing strategies and approaches - it has become extremely difficult for VCs to find and secure high potential, well priced deals.

The result has been a "regression to the mean" - with alpha performance by fund managers being driven as much by randomness and luck (as it has been with public market mutual funds for decades) as by coherent design.

Fees. The world of low and no load management fees that so transformed mutual fund investing for in the 80's and 90's is far from being on the VC radar.

In fact, as opposed going down, venture fund fees have been going in the other direction, with a number of higher profile funds upping their **annual fees to 3%** (along with asking for a greater share of the returns) versus the standard 2-2.5%.

These high fees obviously eat away at returns, and more profoundly are in contrast to the "disintermediation spirit" so at the heart of modern technology investing.

Friction. Little discussed in most venture fund models are the high costs of deal sourcing, diligence, and oversight.

It is not unusual for a venture fund to sort through thousands of possible investments, deeply diligence a few hundred, prepare and submit term sheets on a few dozen, and then do zero deals.

This all costs money.

And all this doesn't even begin to measure the management and oversight costs on the deals that are done – which at their barest minimum range from quarterly board meeting attendance to monthly, weekly, and sometimes daily calls and meetings with portfolio companies.

All this work is necessary to do venture capital right, but is also expense and friction filled.

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Now, funds do work to charge some of these costs back to their portfolio companies, but usually these offsets flow to the fund's General and not its Limited Partners.

So what to do?

Well, for those that love the startup and emerging company asset class, but are reluctant to either a) put all of their eggs in one basket via investing in one particular startup directly and / or b) get the problems with the current VC model per the above.

In short, when it comes to asset class, the advice here is to avoid the VCs and explore investment models – some new and some old – that provide access to it in a lower cost, higher expected return, and all-around more investor-friendly way.

About GreenHills Ventures
GreenHills Ventures, LLC., established in 2001 as a private investment holding company and General Partners for GHV Fund I and GHV Fund II, (GHV Fund), an early stage venture fund and GHV Wealth Management Holding, LLC. (GHVWMH), a wealth management firm focused on alternative investments for its single and multi-family offices and institutions. For more information visit www.greenhillsventures.com

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