Power in Pairs

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Just as certain venture firms perform better than others, so do certain combinations of VCs. The tendency for particular syndicates to see repeated success, investors say, is no coincidence.

Successful venture capitalists usually like to credit great returns to their portfolio company entrepreneurs and firm partners. Rarely, if ever, do they point to another VC firm as instrumental in the process.

But looking at home run venture outcomes, it's clear co-investors play a weighty role. Just as some firms have a history of outperforming their peers, certain venture syndicates also have a track record for delivering top-tier returns.

The phenomenon of "power syndicates" dates back to the early days of the venture business. In the 1970s and early '80s, the small number of active investors meant the same VCs frequently found themselves sitting on the same boards. Firms such as New Enterprise Associates, Sequoia Capital and Kleiner Perkins Caufield & Byers have a long, rich, and often lucrative history of co-investing together in such seminal companies as 3Com, Juniper Networks and Google.

Fast-forward to more recent times, and it appears some new power duos are emerging. On the East Coast, Union Square Ventures and Spark Capital have formed a rewarding alliance, co-investing in social media juggernauts Twitter and Tumblr. On the seed-stage end, First Round Capital and Floodgate Fund (formerly Maples Investments) have done pretty well, too, backing ModCloth, a fast-growing online fashion shop, and TaskRabbit, a tool for farming out small jobs.

Older firms are also forming fresh alliances as they bring on new partners and carve out early positions in fast-growing sectors. Sequoia and Greylock Partners, for instance, have taken a leading role in the social networking space, co-investing in LinkedIn, Instagram and Airbnb. NEA and Lightspeed Venture Partners have also had some lucrative returns from early bets a few years ago in next-generation data center technologies.

VC firms that have done well co-investing together say prior successes motivate them to try and work together in the future. And though the prospect of a compatible syndicate partner is never the reason to back a particular company, it does make an already attractive investment even more appealing.

"You never really know who you're going to be aligned with until you work with them," says Pete Sonsini, a partner at NEA. "So you tend to gravitate to those syndicates that have worked well in the past."

With that in mind, VCJ has compiled a collection of longstanding and emerging venture "power couples." We name seven of our top picks, zeroing in on stage and strategy, recent co-investments, and prior high-return exits. (Click on the Related Articles link on the right to see the list.) We also delve into what venture industry players say makes certain partnerships click—or not. Turns out, just as VCs gravitate to serial entrepreneurs with a track record of building successful business, they also prefer syndicate partners with a proven history of profitable co-investing.

Aligned Minds

Certainly deep pockets and rich networks are valuable assets in a syndicate partner. More often, however, VCs describe their ideal co-investor as someone with whom they can find agreement on controversial decisions. Such tough decisions crop up when a startup falls upon hard times, though, there are plenty of contentious issues involved in managing a successful investment, too.

For Spark Capital and Union Square Ventures, consensus on how to deal with a fast-growing startup played a role in the scaling of two of their most successful companies, Twitter and Tumblr, says Bijan Sabet, a Spark general partner.

Sabet says he believes most VCs would have pushed the companies to capitalize on their tremendous networks. But for Spark and Union Square, the fact that the companies were able to operate with capital efficiency made it possible to focus on growth and to delay concentrating on revenue generation. Tumblr, for example, had just two people running the blogging site for more than a year. Even today, with 168 employees, it's a lean staff for a tool that features close to 80 million posts a day. As for Twitter, with a reported private valuation of about $10 billion, few would argue that delaying a profit-generating strategy hurt its long-term value.

"In the early days of Twitter and Tumblr, our shared view was that we should focus on user adoption and scale rather than monetization," he says. "If we had conflicting views, that would have been challenging for the company."

Another good indication of a successful partnership is one that gets repeated. Spark's portfolio overlaps with Union Square more than any other firm, according to Sabet, having co-invested in at least nine deals together. In addition to Twitter and Tumblr, other co-investments include Foursquare Labs, Boxee, Kik Interactive and Skillshare. The two firms work well together in part because they have a similar investing style and focus, Sabet says, seeking out early-stage companies whose business models have a built-in "network effect."

Tough Calls

Twitter aside, the difficult questions co-investors face are usually not about handling exceptional growth. The more common scenario, NEA's Sonsini says, includes such tough calls as determining when to hire a new CEO, reduce burn rate, or accept an earlier-than-expected acquisition offer. And partners at his firm, who have been in the venture business long enough to have co-invested with pretty much every established VC, can attest that not all syndicates are equal when it comes to wisely handling these critical issues.

NEA, for instance, has done well in co-investments with a select group of venture funds. In the enterprise software arena, Greylock Partners and NEA have worked together, co-investing in Workday (currently a $10 billion public company) and Data Domain (acquired by EMC in 2009 for $2.4 billion). On the infrastructure side, NEA and Lightspeed Venture Partners have co-invested, with their most prominent recent success being Nicira Networks, a virtual networking company, which VMware bough last summer for $1.26 billion.

It's no coincidence that NEA and Lightspeed have been winding up on a lot of the same boards, says John Vrionis, at partner at Lightspeed who specializes in networking infrastructure. The two firms were among a small group of VCs actively backing infrastructure startups several years ago, betting heavily on next-generation data center technology and software-enabled networking.

In addition to sharing a sector focus, Vrionis says, NEA and Lightspeed also took a similar hands-on approach to working with entrepreneurs. Essentially, both are willing to invest in companies at the early stage that target large markets, but still have technical risk. Partners mitigate the risk somewhat by working with credentialed entrepreneurs, as in the case of Tintri, a developer of virtualized storage technology founded by former VMware R&D chief Kieran Harty. But they're also open to tackling big projects that are not cheap to carry out and will probably undergo many strategic shifts along the way.

"There are very few firms or even partners within firms who are company builders," Vrionis says. "But since we are very theme driven and get in early, we like syndicate partners who are, like us, company builders."

Rightsizing Syndicates

Beyond compatible investment styles, partners involved in finding co-investors cite syndicate size and available capital as top considerations. Too many investors can negatively affect board dynamics and decision-making processes, particularly for early stage rounds.

"Two VCs in a given round is a good thing," says Spark's Sabet. When it expands to more than three, "it gets to be a bit unnatural," at least until the company is ready to close a later-stage round in which it's expected to have more investors.

That said, for potentially capital-intensive startups, keeping syndicate size down means finding investors with the deep pockets to see them scale. In the enterprise infrastructure sector, Lightspeed's Vrionis says it's preferable to invest with a fund of significant size (generally $400 million per fund and upwards). Large funds are helpful because it takes more than $60 million to see a company in that sector through its ups and downs as it races toward profitability.

In addition to keeping the syndicate size down, balance of power among members also matters a lot, says Anthony McCusker, a partner in the technology practice at law firm Goodwin Procter. Like Sabet, he sees groups of two investors often working out well, especially when both have a meaningful stake and can commit time and effort to the company. Less successful are syndicates in which one investor holds a disproportionately large stake.

"It's nice when they are equal or close to equal in terms of ownership stake because that helps with voting. They both have to agree and lock arms," he says.

McCusker says the way a syndicate is formed also seems to impact a portfolio's chance of success. He's more optimistic about companies in which initial backers reach out to potential co-investors or give entrepreneurs input regarding others offering term sheets. He's less confident when VCs agree to partially fund a company, but then leave it to founders to find other backers.

Looking Ahead

With all the complications around forming a syndicate, it's understandable that venture investors may prefer to explore the possibility of going it alone. As the venture industry consolidates, with more capital going into the hands of fewer large, established firms, funds certainly have the financial capacity to do more solo rounds. But few are predicting syndicates will have a diminishing role.

One possibility, Vrionis says, is that large firms will simply use their expanded dry powder to delay the point at which they take on co-investors. Thus, he says, it's likely we'll see more solo early-stage rounds, with syndicates forming later.

One recent example of that approach was Tintri. NEA funded the Series A round alone. Lightspeed approached the company and NEA to join the next round. They co-invested in the Series B round in 2009, and also participated in the C and D rounds. While they don't disclose revenue, Vrionis of Lightspeed says they are now bringing in sales in the tens of millions of dollars, with those numbers more than doubling year-over-year.

NEA's Sonsini says that the question of whether to bring on a co-investor is not just a financial one. It's also about building and sustaining long-term relationships with other well-connected venture capitalists.

"It's all about deal flow in this business," he says. "And often deals come from other venture firms."