



STANFORD FINANCING OF INNOVATION SUMMIT

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INTRODUCTION

On Nov. 29, 2018, the Venture Capital Initiative at Stanford Graduate School of Business hosted the Stanford Financing of Innovation Summit on campus. About 175 academics and venture capital investors attended the all-day event, which presented a range of speakers who discussed current research in the fields of innovation, venture capital, and other means of startup financing.

Stanford GSB's Venture Capital Initiative encourages academics, staff, students, and practitioners to explore research about issues relevant to entrepreneurs, investors, and policymakers.

Speakers at the November event generally agreed on the continuing potential of VC and other means of financing, despite their many complexities, and are optimistic about the future of innovation. The following summary highlights some of the ideas presented at the Summit.

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TOPIC 1

THE BIG SPILL

Speakers noted that innovation sometimes springs from independent startups and from the research and development labs at established companies. Such corporate-funded R&D spawns innovation not only for the company, but also by creating “entrepreneurial spillovers,” said Tania Babina of Columbia Business School.

Babina said that because corporate R&D sometimes produces intellectual assets that the parent company can’t use, those assets “spill into” the startup world when employees of the firm leave and start their own ventures, based on that new knowledge or technology.

These startups, often rooted in an idea that carries high-risk and high-growth potential, boost economic activity and often attract funding from VCs.

TOPIC 2

WHAT IS INNOVATION?

Whatever its source, innovation itself is notoriously difficult to compare and gauge. Some measures, such as counting the number of patents related to a supposed innovation, don’t provide the full picture, since not all valuable innovations have a patent, said Amit Seru of Stanford GSB. Tallying up the number of citations a patent receives isn’t a completely adequate method either, in part because information about citations isn’t available for all time periods.

To help determine if a patented innovation is novel or impactful, researchers have instead used text analysis, searching patent documents for similar words and word patterns to gauge similarity to prior patents and to later ones, said Seru. The less similar a patent is to prior patents and the more similar it is to later ones, the more innovative it is, he said, adding that this measure is a good predictor of future citations and correlates with measures of market value.

The ability to judge the quality of a patent is important because it increases understanding of where innovation is occurring and how it’s being financed, whether through VC, private equity, government funding, or other sources.

TOPIC 3

A SEAT AT THE TABLE?

Speakers generally agreed that gender bias occurs frequently in the overwhelmingly male-dominated VC industry but that it's difficult to pin down exactly how, why, and when it occurs.

Paul Gompers of Harvard Business School cited research showing that VC partners who have more daughters than sons are more likely to hire female partners at their firms, perhaps because having daughters makes men more aware of gender-equity issues.

The research also shows that firms with more female partners outperform their competitors, possibly because women may have business networks different from men's or because women are more likely to invest in the high-potential areas of healthcare and consumer goods. Additionally, a gender-diverse team may reduce "groupthink" and lower the chances that a team will repeat mistakes of the past.

Female entrepreneurs may in fact experience no bias at the early stages of the funding process but face it later, added Ilya Strebulaev of Stanford GSB. He discussed research in which some VCs received pitch emails purportedly signed by a female entrepreneur while other VCs received the same email but signed with a man's name. Messages with the woman's name received responses at a rate slightly higher than that for the messages with the man's signature.

Those results suggest that female entrepreneurs may start out on even footing but encounter bias later in the funding cycle, Strebulaev noted.

Speakers discussed potential motivations behind the hiring of female VC partners or investing in female-led startups. Many VC firms may sincerely want to promote gender equity. But, given the current increased awareness of gender bias in society and in the business world, VCs and other investors may feel they're under a microscope and thus go to great lengths to hire women or invest in female-led startups only as window dressing in order to stay out of the headlines.

TOPIC 4

INVEST OUTSIDE THE BOX

Speakers discussed non-traditional investment opportunities, including alternative vehicles that are directed by a general partner but are distinct from a main venture fund. The GP retains decision-making authority in these vehicles, which may offer more favorable economics to certain partners or avoid domestic tax obligations for non-domestic investors.

Performance of these GP-directed vehicles relative to main venture funds varies widely depending on the LPs investing in them, said Josh Lerner of Harvard Business School. “The LPs who historically have done well at choosing good main funds to invest in tend to also be good at choosing good alternative vehicles,” he said.

Another relatively new investment method is the initial coin offering, which sells digital assets, known as tokens, associated with a specific online platform. These ICOs allow “a broader range of investors to participate in the growth stage of new ventures,” said Sabrina Howell of NYU Stern School of Business.

At the same time, ICOs are largely unregulated, raising many questions about the legal status of digital tokens and disclosure requirements, she added.

Some mutual funds, too, are increasingly investing in larger companies that are “almost public,” said Yao Zeng of the University of Washington. Given their liquidity needs, mutual funds seek specific rights, such as redemption rights and IPO-related rights, to satisfy their investors and regulators.

Funds tend to prioritize those rights over other issues, such as board representation, Zeng said.

ABOUT US

The Venture Capital Initiative brings together faculty, staff, students, and practitioners to advance and promote research and teaching on innovation and venture capital.

Our goal is to advance understanding of the venture capital and innovation ecosystem through conducting research, collecting high-quality data, and developing teaching methodology. We aim to bring together leading academics and practitioners to help solve the problems that are highly relevant to entrepreneurs, financiers, policymakers, and researchers worldwide.

OUR TEAM

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