

Startups working with venture capital firms perform the best

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It's a familiar idea that venture capitalists, or VCs, are the “money of invention” and fund firms with high growth potential, helping bring their products to market. However, entrepreneurs have many options when considering funding. There are corporate venture capitalists (CVC), which typically work within a larger corporate structure and seek to acquire innovative startups that would blend well with the parent company. Governments also support innovation by issuing grants for groundbreaking research for early-stage development of entrepreneurial ventures. These funding partners vary significantly. With three options on the table, how do entrepreneurs know which one is best suited to fund their firm?

A recently released study by entrepreneurship researchers from the University of Washington and Stanford University found that venture capital firms are the answer to fuel innovation.

We studied almost 200 medical device ventures in the United States, over a 22-year period, and tracked which ones received the highest number of patents and FDA approvals. We found that the ones that worked with VC firms performed the best, and here's why:

1. VCS are driven by better-paced and more motivating milestones than either corporate VCs or government agencies
2. VCs have a closer advisor relationship with the venture and value face-to-face contact (i.e. sit on the Board) more so than either corporate VCs or government agencies
3. VCs are typically professionals with business expertise to help guide more formal processes (i.e. product development, strategy or professionalization of management)

In comparison, corporate VCs turned out to be less effective partners because the complex division of labor within corporations, and broader strategic goals, seem to hinder progress and slow the decision-making process. The corporate hierarchy and culture appears less likely to channel the resources, mentoring, and discipline needed for ventures' innovation.

Meanwhile, the entity with perhaps the most altruistic reasons for seeing society advance through scientific and technological innovations proved to be the least effective funding partner. Government agencies work to treat all ventures equally, which resulted in particularly passive mentoring relationships, cookie-cutter approaches and “one size fits all” resources.

The primary government agency that funds medical device firms in the US is the National Institutes of Health (NIH), which issues grants to support both technical breakthroughs that advance science, and commercial innovations that can improve public health. We were hopeful that the NIH’s approach of highly autonomous entrepreneurs would encourage scientific discovery and greater technical innovation, but our findings indicate that it does not. Because of their hands-off approach, they remain largely out of reach, which is disappointing given the NIH’s immense technical and informational resources.

So what does it all mean? Well, in a world of innovation and technological advancements, the ability to create technical breakthroughs and turn them into products is central to survival and success. By studying the population of medical device ventures since the sector’s inception, we observed that ties with particular types of funding partners lead to major innovation differences.

Our empirical evidence shows that although all funding partners — venture capitalists, corporate VCs or government agencies — proved to be good at selecting innovative ventures and having valuable technical and commercial resources on hand, VCs came out on top. Traditional VCs, especially those in boutique firms, are deeply engaged with the entrepreneurs they fund, proving that relationships matter.

So when your firm finds itself in need of capital to continue to innovate and commercialize a product or service, remember that it goes beyond just the financial resources gained. A VC’s expertise may not always lie with your particular technology, but their value as skilled business advisors, able to translate technical insights into successful products, will be particularly effective.

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Notes:

- *This post is based on the authors’ paper [Who Takes You to the Dance? How Partners’ Institutional Logics Influence Innovation in Young Firms](#), in the journal *Administrative Science Quarterly*, June 17, 2015 0001839215592913.*
- *The authors acknowledge Joylyn Tanner’s assistance in writing this research summary.*
- *This post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.*
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