

Inside venture capital firms 101: Going behind the scenes

NOVEMBER 15, 2018 35 MIN READ

Related Expertise

- [Emerging and High Growth Companies](#)

For emerging and high growth companies, obtaining venture capital (VC) financing can sometimes be challenging. In this competitive space, understanding what VC firms are looking for when investing can give your business an advantage when trying to secure capital.

Learning how a VC firm works behind the scenes is a good way to gain important strategic insights on becoming a more attractive investment. But understanding the ins and outs of a VC firm can be easier said than done, even for entrepreneurs who spend a lot of time speaking to investors. Osler hosted this presentation, by Christian Lassonde and Pauline Brunel of Impression Ventures, to help give you insights into the types of things VC firms look for when investing. Available in both webinar and PowerPoint format, the goal of this presentation is to help give you a behind-the-scenes look at VC firms and help you learn more about the following issues:

- Structure of a VC firm and Limited Partnership Agreements (LPA)
- VC investing – venture capital specificities including what VC firms invest in
- VC business model
- Understanding VC returns
- Position on the risk-reward curve and fund concentration

[Transcript](#)

[Inside Venture Capital Firms 101: Going behind the scenes](#) from **Osler, Hoskin & Harcourt LLP**

For more information, contact [Simon Leith](#), associate in Osler's Corporate Group, at sleith@osler.com or 416.862.4864.

This presentation is part of [Osler's Emerging and High Growth Companies 101 series](#), designed to help emerging ventures navigate through the various issues and legal requirements they will encounter throughout their growth cycle.

Video transcript

HOST: OK, guys.

CHRISTIAN LASSONDE: Yeah, thank you very much. Everyone can hear me OK? Yeah, and I think Pauline and I are fine taking questions along the way if. So if you have a burning question that we're in the middle of a slide, and we're not answering it, by all means, raise

your hand, and we can address right there.

So yeah, so Impression Ventures. We're not going to talk very much about FinTech today. Today is really about what are the economic incentives that drive the day-to-day decision-making of venture capitalists? And so you would think a relatively dry topic, but it's interesting when you start to get into the structure beneath the door front, if you will.

So yeah, so we're Impression Ventures. We're established here in Toronto. We have an office, and my partner is in Montreal. We're currently deploying capital out of a \$30 million fund. We only lead deals. We write checks between \$1 and \$2 million on average— So \$1 and 1/2 million on average, in \$2 to \$5 million rounds.

Founders can call that whatever they feel like calling it. We're agnostic. You want to call that a seed round? Great. You want to call that a series A great? You want to call it something in between? Great. We don't really care.

In fact, that we care that you care, in the sense that we understand that naming of rounds today is actually more of a marketing tool than it is anything else. So we're happy to support our founders, not just on marketing, but in fact, actually, on all their activities. Part of our philosophy as a lead investor is to be there week-to-week, day in and day out, as you need us. And we certainly hear that from our founders, as Simon mentioned.

We're an early investor into Well Simple. We led the seed deals on basically every other deal that we've done, including Sensible, which is a digital receipt management business here out of Toronto. Frank, I think, is in the crowd. I saw him representing from Sensible, Brim, which is a new credit card issuance platform that's just launched over the summer. You should definitely check, if you're in the market for new credit card, definitely check it out. Even if you're not in the market for a new credit card, you should definitely check it out. It's the best credit card program in the country by leaps and bounds.

Fineos, which is a digital marketplace for life insurance products, but we're building an entire marketplace for insurance products there across the board. And then, Cement is in debt recovery. We're essentially re-imagining how debt recovery is done through the same engagement tools that customer acquisition channels are using today, which are not being used in debt recovery, to vastly improve, frankly, the experience for both the customer and for the brand.

And it's very emblematic of the type of investment we'd like to do, where it truly is win-win. It's a win for the customer. They have a better experience. More money is kept in their pocket, and it's an all-digital experience, and it's a win for the company, where they, the company benefits and is changing the way financial services are delivered.

All right, so that's enough about Impression. Let's dive into how venture capitalists work.

PAULINE BRUNEL: Yes, before we dive into how a VC firm works behind the scenes, maybe it's better to start with a bit of context around VC investments. So here, you have your whole options around investment as a startup. This is your whole list of investors. So depending on your stage, as a VC fund, we invest— we started pre-seed right before IPO, and we are an option on the whole in the whole growth cycle of the company. We overlap with business angels when you look at pre-seed rounds, and we overlap with PE funds in later-stage deals. But what is important to understand is VC funds, the earliest stage they invest, the riskier they are, in the sense that as companies grow and fail, the business gets de-risked as well. So early-stage VCs tend to be riskier and higher-return than later-stage investments.

Who are we? We invest other people's money. So unlike business angels, for example, or

unlike PE funds, for example, we are in the asset management business. In that sense, we are looking for a risk-return adjustment in our investments. So if you look at the 7% average return for the S&P, we need to beat that, for sure. Riskier than the S&P, so we need to beat that.

What do we invest in? We don't invest in technology. That's not the first thing we invest in. We invest in growth, and that's probably one of the most important things we look for we look. We look for growing markets, and we invest in companies where our investment can definitely help that company to grow to provide a bigger market share. So definitely, technology is an enabler of that type of responsibility, but we don't invest in technology. We invest in growth businesses. More on the structure?

CHRISTIAN LASSONDE: Yeah. So OK, so we invest in hypergrowth. So how do we do that? So this is a relatively straightforward legal structure. So we have- to the top left, we have what's called the general partner. And the general partner is typically made up of a number of managers who are key persons in the fund. Below that, you actually have the limited partnership. And the main reason the structure exists, actually, is for tax purposes. In other words, if you were to invest all this capital out of a corporation, and you got capital back, it is very likely that that capital would be deemed an income, a revenue, versus a capital gains. And anyone in the tax business knows that capital gains are much better-treated than revenue.

So by having all the investments and disbursements in a limited partnership vehicle, you essentially ensure that the gains are taxed at a capital gains rate, rather than at a revenue rate. Plus, of course, these limited partnerships are also flow-through vehicles in the sense that there's not a tax entity in and of themselves. They just pass on all the gains directly to the individual- the person, whether it's an institution or individual- and then they report on their own tax basis what's going on. But essentially, then, [INAUDIBLE] that fund, of course, invests in other companies.

But it's not so simple, unfortunately because what you really find out is that when you really dig into this business, it actually get to a relatively complex structure relatively quickly. So the general partner, typically, is like- for us, it's our Impression Venture Capital II, Inc. So it's not a name that you would hear on a regular basis. The name you would hear when you interact with us and what's on our business card is Impression Ventures, Inc. And that's the management company.

So the management company is- essentially all the investment decisions are essentially given from the GP into the management company. And then, similarly, below that- again, thank you, the tax purposes- but below that, you'll actually have parallel funds. And the reason you have parallel funds is, again, more tax reasons, unfortunately. Which is, if you have investors here in Canada- and this is very similar in other jurisdictions- so resident taxpayers are put into one fund, and non-resident taxpayers are put into a different fund, largely to separate the tax liabilities between those two groups of people.

So as you can see, it gets complicated pretty quickly. And then, it gets even more complicated as you have multiple funds. Because now, you have, essentially, that structure which I just indicated across multiple different funds, which are invested in their own series of companies, and they're essentially all reporting up to the management company. This creates some interesting situations that, certainly, we've encountered. I'm sure other funds have encountered them as well. Because when you have an advisor for a fund, for example, is the advisor advising one of those limited partnership groups, or are they advising the management company?

And so in and of itself, not a deep philosophical question, but it's one that doesn't keep me

up at night, but certainly makes me go home late in the evening, if you will. So I wish I had great answers to that, but that's— so it can get complicated pretty quickly when you're dealing with venture firms that have multiple funds under management.

PAULINE BRUNEL: Yes, so we're going to talk now in more details about the LPA— so the limited partnership agreements, the management of the funds and the management company, and the general partner, and the limited partners of the funds, or the investors. So first, the LPA. So it's a contract that is actually signed between the LPs— so the of investors— and the general partner. It sets all this all the terms of the fund.

So you have the investment strategy. Here you'll find the fees. You'll find the duration of— if it's a 10-year fund. And you'll find all the details and the responsibilities of the GPs and the LPs as well. You have— among the partnerships, you'll find LPAs that go to more details around the investment strategy. So you'll have LPAs that tell you, oh, you have to invest in seed companies only from 1 to 2 million, or LPAs that don't give you this kind of granularity in terms of details.

But what is common to all our PAs is it clearly states that the GP has to invest and act in the best interest of the LPs all the time. Every single investment and action is to be made in the best interest of the LPs. This document is a private document. You'll never, as a founder or anyone else, actually, have the ability to read it. That being said, the investment strategy is typically disclosed on our website, or happy to actually tell you more, a bit about that, as we did at the beginning of this presentation.

And as a founder, it's going to save you a lot of time to understand that, and to target only FinTech VCs, or early-stage, or later-stage, or anyone. That is going to save you a lot of time to understand, what are the investment strategy of the VCs? And the fund management, so we talked about the management, the difference between the management company and a general partner. So the management company typically controls the general partners, the multiple general partners, and is a separate legal entity that owns the brand of the fund and goes beyond the GPs and the life of the funds. And this entity is usually responsible for all the expenses— so operating expenses, salary, office lease, phone bills, or conferences, or anything else.

The investment expenses typically come out of the pocket of the fund. So paying the auditors, paying— if you have to go to a board meeting, for example, that would be an investment expense, but that doesn't come out of the pocket of the management company but out of the pocket of the fund. General partners, they are legal entities, so separate entities again, and they hold the liability for the partnership. So limited partners, or the management company, cannot be pursued for any legal action or anything. That's the general partner. So they have to really have— they're limited liability.

Yes, the life duration of a GP, it's going to exist only during the life of the fund, and it's going to shut down as soon as the fund is closed. That's a [INAUDIBLE] on the GP. The GP is in charge of managing the fund and taking the investment decisions. Typically that would be given back to the management company and this whole investment decision responsibility, but that lies with the GP in the beginning. And again, the GP must manage the fund in accordance with the LPA, which is the governing document, and then the most important piece, the most important document.

Yes, we'll talk about that more later, a little bit later, but it's mentioned here, the GP owns a small percentage of the fund. Typically, it's just a nominal share, because they have to be in the partnership. But the partners who are involved with the GPs, which are typically who we call the general partner. So that would be Christian and Maor, in our case. But they would typically invest in the fund as well. And the industry average is 1%. So you expect the

partners of the GP to have an ownership in the fund– so industry average of 1%.

CHRISTIAN LASSONDE: Yeah, so, obviously, a good sign of a strong manager, of course, is one that has more than 1% as a limited partner. And the view there is you want as much GP and LP alignment as you can, because what's in that case, what's good for the GP, then, is good for the LP. And LPs, ultimately, are the bosses of venture capitalists. Even though they're limited in the sense of legal liability, they are truly the shareholders of the fund.

And they're broadly broken up into two separate groups. Group number one are institutional investors. And probably the most prominent group out of that– in the US, anyways– is foundations and endowments. These are long-term investors. So the typical fund is a 10-year fund– usually eight years plus two years extension– which aligns pretty well with the average duration to exit of a venture capital deal, which is– in the US, I think it's 8.2 years.

So you think of, by the time– the average is 8.2. After 10 years, given it a normal distribution, the vast majority of the deals will either have gone to zero or have exited in some capacity, and you can unwind the fund. Occasionally, you'll have deals that go on beyond 10 years. And obviously, in the LP agreement, there are rules to stipulate how that's dealt with.

So if you think about who, then, fits with that investment profile, your money going to be locked up for 10 years. Most people are pretty allergic. So the individual retail investor would be extremely allergic to that, because typically, they need the ability to have liquidity very quickly. So retail is out. So we need to align our duration with the type of investors that are looking for that type of duration.

So pension funds and endowments are, obviously, big. There's a number of fund of funds out there as well that invest for long duration, so that's to be expected. More and more, we're seeing family offices, especially family offices that are run more like institutional investors, entering the venture capital space. And insurance companies are also big investors in venture capital, given they especially have a set of long liabilities. They, of course, want to have a duration risk that matches that, so they'll go into a long-duration fund like venture capital.

Banks and corporates you're seeing enter venture capital on occasion. I think it's more from a strategic basis than it is a return of capital basis. And then, of course, you have individual investors. And family offices are probably the biggest group in that bunch. And this is family offices– somebody tells me, if you've seen one family office, you've seen one family office. So they're all very different, and certainly, that's our experience as well.

But high-net-worth individuals, again, they're high-net-worth individuals who are looking for a long duration risk-adjusted return. And, of course, the advisors of our fund, typically, are also– the advisors of a fund– and certainly, our case is no different– are also limited partners in the fund.

So all important stuff to know, because while the initial check that you're getting from VC, likely, you'll really get no exposure to who the limited partners are, they're questions that are actually worth asking, because there's the short-term– in the short term, a big value-add for most VCs will be access to the limited partners. In other words, if you have institutional investors– like in our case, we have financial institutions that are LPs in our fund, and access to those financial situations to our FinTech is something that is looked forward to, and we certainly provide that. We also have access to our advisors, and so forth.

What's maybe not quite as obvious is the co-investment in provider rights that a fund has. So in every single deal that we've done, in every single deal that we've, certainly, seen as part of the terms and conditions of the financing is this concept of pro rata rights, which is I have a

future— me, as an investor, has a right to maintain my ownership percentage, and, by the way, I can pass those investment rights on to other people in my fund.

And so certainly, something that we see at later stage deals, like in C rounds and D rounds, is funds that can't actually absorb the entire amount, because they just don't have that much capital left over in their fund, will actually give those pro rata rights to their LPs. And so this is long-term thinking, but if you are an entrepreneur, you're thinking, who are the LPs of this venture fund? Because they actually may end up showing up at my cap table sometime in the future. I mean, technically, they're already on your cap table through the fund, but they may actually end up directly on your cap capital.

So anyway, it's worth thinking. It's certainly not going to break or make a deal. So if somebody gives you a term sheet, and you like them, you're not going to not take their investment because of this particular potential future risk. But I think it's just worth mentioning and worth thinking about. And then, of course, the GPs should be— like I said, GPs should really be reasonably large investors in their own fund, if nothing more, as a show of confidence and alignment of interest.

So how do VCs make money? You'd think it's relatively straightforward. We invest in companies. They have big exits. We make money— which is not far from the truth, actually. It very much is.

But it's broken out, actually, into three sort of buckets— near-term, and two forms of long-term. So the near-term one, obviously, the management fees. Venture capital firms, for the most part, operate on a 2 and 20 model. Slightly different than the hedge fund 2 and 20 model, in that we don't take the 20% every year based on a mark-to-market. We only take the 20% carried interest on exit of the entire fund as a whole. So it's a lot less egregious than the hedge fund model, even though it has exact same nomenclature. I just like to point that out. It's clearly a sore point for me.

So management fees— so most funds charge about 2% of the capital under management on a yearly basis. That typically will ratchet down after the investment period. Investment period is typically four years to five years on the long end. The reality is, when you really get into fund economics, as a GP, the vast majority of your gains as a GP actually come from your capital gains. It does not come from carried interest.

Now, you could have this massive 100x win, in which case, possibly, the vast majority of gains will come from your carried interest. But the reality is, if you really model out multiple funds over a long time with a normal distribution of deal flow, the vast majority of gains actually come from capital gains, which is an interesting standpoint. Which goes back to, the best fund managers really should be investing in their own fund, given that's actually where you're going to get the most capital return back. Carried interest becomes, then, a nice accelerator, if you will, of that return capital.

Most VCs are not in it for the management fees. This is really the capital that's used— certainly in our case, it's capital used to keep the lights on and, to keep operational on a day-to-day basis— to make sure that the team is staffed and that we're doing all of the necessary fiduciary duties to manage the money correctly on a day-to-day basis. Is this super dry, or interesting? I'm just temperature-checking the room. OK, all right, thumbs up— excellent.

So of course, the fee structure is typically kept private, but on average, it's pretty straightforward. Obviously, in bigger funds, as you get into the multi-million dollar funds, 2% fee tends to start to come down. And it's just simply a matter of, as we go back to the original size, just risk-versus-reward that Pauline put up. In early-stage venture capital, the average 75-year US historical return, I think, is around 20, 24% IRR. So if you're making 22% IRR, no

one cares if you're charging 2% a year. In other words, the difference between 20 and 22 is relatively inconsequential for you as an LP.

If you're invested in a later-stage fund that's generating 8% per year gross, and you're charging 2%, you're suddenly now at a 6% rate of return, which is now below what you get with the S&P 500. And so we're seeing some pressure, in the current rate environment, to drive down the much larger funds into a lower fee structure. Because the reality is you probably don't need 2% of an \$800 million fund, for example, to operate the fund on a year-to-year basis.

So why does this matter to you as a founder? It doesn't, really, but I think it's useful to know. It gives you an indication of, are the fund managers in for the fees, or are they in it for the return of capital? And the reason you care for that is, all things being equal, you would rather have an investor at your table that's it for the return of capital, because their interests are going to be aligned with your interests, which is to build a phenomenal business that's going to generate an outsized return. If they're in it for the management fee, the likelihood of them actually really helping you to build the business is not- the incentive is not there as much. So just useful to know.

PAULINE BRUNEL: Returns- yes, so the nicest part of the venture. So one thing that is important to understand, the biggest takeaway of this section, is that this is reporting return in terms of IRR, so internal rate of return. IRR is both a function of exit multiple and time holding period, in the sense that if you enter the company, and it's a times 3 after two years, it's way better from a return perspective than exiting the company after nine years and doing a times 10. so. This is something we have to keep in mind all the time. It's both a function of exit multiple and holding period.

AUDIENCE: Is that exit multiple on the valuation or [INAUDIBLE]?

PAULINE BRUNEL: It's on the valuation of the capital we have invested. So going back to the fund level, same thing here. The investment horizon, we discussed that a little bit. So the average duration of a fund is 10 years, but we actually- I mean, VC funds actually only hold cash and funds for around six years, just because we're not in the cash management business, so we're going to call funds gradually. We're not going to call just 30 million from day one. We're going to call capital when we need it, so when opportunities arise. And we're going to also redistribute the proceeds of our investments when we exit the companies. So we're not going to keep that liquidity in our bank accounts. So really-

CHRISTIAN LASSONDE: It's worth pausing there for a second. So I think it's a really important point that we're not in the cash management business. We do not carry, do not keep cash in our accounts. So if you sign a term sheet with a founder on Friday and expect to have cash injected into your account on a Monday, it's not going to happen, because we need to actually go to our LPs and ask them, can you put money in our cash accounts so that we can fund our investments?

And the cash always shows up, because there's deeply punitive action that happen if you don't follow up your capital call. But it's just there's a function of time there. Don't expect the capital to show up day one.

PAULINE BRUNEL: Yes.

CHRISTIAN LASSONDE: Sorry.

PAULINE BRUNEL: That's OK. It's a good point. And it's six years, as an average. And it's typically a bit longer for early-stage funds, that they hold positions for a little bit longer. And

typically, a bit shorter for later-stage funds that invest in companies at series D, for example. So that's for the investment horizon at the fund level.

Regarding the expected return, so again, we're in a risk-adjusted asset management kind of class, which is highly risky assets. And to be rewarded for this high risk, we are going to target a minimum of 20% IRR. That's what we are going to target.

So if you take an example of a \$100 million fund, that means that after six years, we actually want to return you 300. That is going to be equal to this 20% IRR. So 20%, if you give 20% or the 300 back to your LP, they're going to be happy with it. [INAUDIBLE] with the money, and you're making the return [INAUDIBLE], and they're not going to be euphoric, right? The best VCs do better than that. The truth is, the vast majority of them don't even get close to this 20%.

So here is a historical average for the US VC funds over the years. And you can see that early-stage VCs are doing better than the later-stage. But what you certainly see is we see them doing worse than, actually, the NASDAQ and the S&P's indexes on average. So on that, you have VCs that reach that [INAUDIBLE] and some that are— have invested in Instagram and then are, maybe, probably way higher than that. So on average, VC is below to the NASDAQ and S&P indexes.

CHRISTIAN LASSONDE: This is a great example of averages lie, where— so the 10th decile funds, which are not even on this chart in terms of their returns, they're way, way above it. And in fact, the Canadians are also on this chart. They're just below the 5% line that you can't even find them. The BBC back in— I think it was April— gave us the five-year and the 10-year percent marks, percentages for venture funds, the average of venture funds across 70 venture funds in Canada. And the numbers for 10 years was minus 5%, and the five years was minus 2%. So just to give you a sense of this, the venture class is very much a tale of two cities. You have a small number of funds that vastly outperform, and then the vast majority of funds that outperform.

PAULINE BRUNEL: So going back to our example of the \$100 million fund, what is important to understand is in this space, the normal distribution doesn't apply to returns [INAUDIBLE] in a sense that 1/2 of the companies are going to die. And we prepare for that, and we certainly don't want that to happen. And our job is to increase the odds of living. But half of it, half of them, are going to die.

So if you look at your returns, the big piece of it is coming from your winner. And you need that winner to be able to return the 300 to your LPs. Otherwise, you're never going to meet this 20% IRR.

So what is it important to understand in that slide is the biggest piece of the return is your winner, is your home run investment, and you need that. And what is important for you as a founder to understand that is because you need to show that to the VC and to your investors. You need to show that there's a path to this 3x exit. You need to show that there's a way that you can [INAUDIBLE] 1 billion, like 100 million— let's start with that— at some point.

CHRISTIAN LASSONDE: No, I'd go for a billion, though.

PAULINE BRUNEL: You need to show that there is a path. Sure, it's unlikely. You may not have it. And our job is to believe in it and to help you to realize that vision. But you need to show that there is a path. Otherwise, if we invest in companies that are going to leave and do a 3x, where [INAUDIBLE] this 20%.

And the last point is also very important. We've turned down great businesses. So we see

companies coming to us that are great businesses. The founders are going to make a couple of millions a year. It's great, but it's just not for us in the sense that it's not going to grow to this \$1 billion valuation. So it's not personal when we say no. Sometimes it's just— I mean, it's a great business, a great opportunity. It's just not for us, and we're not just like the right fit and the right investors.

CHRISTIAN LASSONDE: Yeah, so it's the last sort of— I've got two more slides of general commentary, which is my grab bag for all the other stuff that I couldn't fit anywhere else. So yeah, so, obviously, we talked in a very general sense, maybe a bit skewed towards early-stage venture capital. But, of course, venture capital itself has multiple stages, from funds that focus on A, to funds that focus on D. And you've got the SOFEX Vision Fund, which does I'm not sure what, but it's a lot of money going into some very late-stage companies.

But so the view of it is at the later stage, that the less risky the investment should be, and therefore the less expected return from that investment should be. And so depending on where you are— and the reason I bring this up is depending on where you are as an entrepreneur that's out there raising capital just shifts the numbers a little bit based on where you are in the lifecycle of a company.

Fund concentration, I think this is— if there was a right answer, we'd all be doing the same thing. So that's my number one caveat. We run a very concentrated fund. Our thesis is very much that concentration, if you concentrate all your investments into a very small number of investments, any one outsized impact will potentially have a multiplier effect on the overall returns of the fund. Vis-a-vis— with that example, if you have 1/3— let's take it to extremes. If you have one investment, and that's a 30x, your fund returns 30x. If you have 100 investments, and you have one 30x, and you've invested equally across all of those companies, that 30x actually is a lot less impactful for the overall return of the fund.

So somewhere along that spectrum from 1 to 100 lies the perfect number of investments that any one fund should have. I don't know what that is. I don't think anyone does. Our view is— our personal view is that 10 is the ideal number, and we certainly invest with that strong conviction. But we've seen everything from, is 11 that much different than 10? Is 9 that much different than 10? Is 20, actually, that much different from 10?

I think 50 is, and we certainly have a view on that. But the more concentrated you are, the higher the volatility of returns you expect. Of course, if you diversify perfectly, in the sense that if you invest in every single thing out there, your expected returns will be the market. It just makes sense, which means your expected returns are 7%.

So if you perfectly diversify, it doesn't make sense to me from a venture capital perspective. Because remember, your returns will be be 7%, minus your fee. Let's say it's 2%. So your expected return, net return to your LPs will be 5%. It's underperforming.

So worth thinking about it from those perspectives. Again, another common thing that venture funds do is they reserve capital for follow-on investing. There's been a couple of studies done out there where funds that are targeting a 20% return can generate, basically, a 27% to 30% return based on simply follow-on investing. So it's pretty common practice today to reserve 1/2 of your capital for follow-on investing into the deals you're invested in.

Fund size, obviously, you want to look at the VCs you're talking to, how big is your fund? Can they still write checks out of it? How many deals do they have left?

Most VCs will constantly be in fundraising mode. One my the common topics that people come to see us to ask, I'd love to get into capital. I ask, do you love fundraising? It's the first question I ask them. And they go, no, I hate fundraising. And I'm like, well, then venture

capital is not really for you.

Because we're portfolio managers, and portfolio managers need to be out there raising capital. Otherwise, we don't get to invest in startups. So most managers will be out there raising capital on a regular basis. And then, of course, the more exits a fund has, the more likely they will have more capital to invest into deals.

We've talked largely today about- how are we doing on time? We're doing OK on time. We talked earlier today about the common model for venture capital, the typical GPLB structure. But there are a lot of other different models out there, and we just didn't have time to talk about all of them, and we're also less familiar with all of them.

But I wanted to talk- I wanted to put four fairly common models that we see out there. The first is the deal-by-deal fund structure, or the angel syndicate, what we're seeing out of AngelList. And these are really you created a GP/LP structure for, essentially, every single deal that's done.

Amazing economics for the GPs. Why? Because we get carried interest on every single deal. So you could have- you can make 100 investment. You could have 99 wipeouts, have a net overall portfolio return, but if that one deal returns 6%, you're walking on with the carried interest check.

And the economics for LPs are also amazing if they're really good at picking winners. If the LP goes into that one deal and does 100x, the LPs do amazing. As you can see, I'm a little bit- I have some skepticism towards the single-fund model, because I think it genuinely hurts LPs, because the LPs are just not going to be better deal-pickers than the GPs. By very definition, the GPs should be- they're being paid to go pick deals. You either trust them or you don't trust them. If you do trust them, trust them to invest uniformly across all their deals. And the best way to do that is through an LP structure. So anyway, I'm a little skeptical of the whole idea deal-by-deal model as an LP.

Short-duration funds, these are an interesting little innovative thing that we've seen recently, which is basically raise capital on a year-on-year basis and get all that capital deployed. The challenges, I would say, with it are more related to conflict of interest between funds. So if you give your pro rata rights from one fund to another fund, different set of LPs, are you giving those pro rata rights- the knowledge you have of an excellent company, are you using that knowledge to benefit a non-current investor? Possibly.

Of course, if you're comfortable with that as an LP, you're going into this fund knowing that it's a short-duration fund, and that's what you're buying. So that should be something you know about. For you as founders, it's just useful to know- again, I think the more information you have, the better-equipped you are.

Corporate funds really measure the returns not based on- they'll say that they're measured based on pure return of capital, but really, what we see out there, what we see actively out there in terms of their incentives is that they act in the sense that they are being measured by the bottom line of the company as a whole, as their parent company as a whole- which is not good. It's not bad. It's just different, and it's worthwhile knowing.

And then, evergreen funds. These are funds that exist in perpetuity, essentially, and only get to reinvest capital when they have exits. It's really an investment vehicle for extremely long-duration funds. So this is something that a pension fund with a 50-year view of things might set up. And again, there's nothing necessarily bad about it, nothing, necessarily good about it. It's just a different model.

So that's the end of my grab bag of random stuff. So we have time for a couple of questions.

AUDIENCE: [INAUDIBLE] and do they fall into one of those models, or are they creating new models?

CHRISTIAN LASSONDE: They typically fall into- what I have seen has been a cross between the angel syndicate model. And so the question, [INAUDIBLE] the question is, how do startup accelerators, incubators, how do they fall into this business model? And I would say that it's a grab bag across the board. They have an extra challenge, certainly with my experience, about six, seven years going out with the next [INAUDIBLE], which was set up as a charity, and it has had an investment vehicle alongside with it.

So they had some extra challenges from a structuring perspective, the fact that charities aren't really in a position to invest in startups, so how you get around that relatively big problem. So they figured out a way around it. But I have seen most times, they use the LP model. Good question, though. Any other questions? Frank, over here.

FRANK: Yes. Is the concentration of a fund always stated in the LPA, or is that- do you have a general idea of how many investments you're going to make and the relative size of them, or do you make it up as you start to invest?

CHRISTIAN LASSONDE: So most funds that enter an LPA in their investment mandate will stipulate the size and shape of the type of investments that it would make and what the rules around those investments are. And again, there's extremes of specificity. There's one extreme, which is basically gives the GPs complete leniency to do wherever they want, as long as it's in venture capital and including doing venture debt.

On the other extreme will be very, very detailed investment mandates that, if you differ at all, if you shift at all from that, you actually have to go to the Limited Partnership Advisory Council, or Committee, to get a dispensation for doing that change. That's the LPAC.

We didn't really talk about the LPAC, but the LPAC, think of it as your board of directors. We can't call it a board of directors, because that would make them- that would breach the limited liability shield, if you will, so they're called a limited partner advisory committee. But basically, any time a fund wants to do something that's against the rules, for all intents and purposes, they can as long as they get permission from their LPAC. Any other burning venture capital questions?

AUDIENCE: So I guess so much of your time is spent on due diligence on the founders, on the companies and whatnot. Would you suggest is appropriate types of due diligence that they should perform on you or on VCs, the investors?

CHRISTIAN LASSONDE: Great question. So we advise- and actually, it's not even from my time as a venture capitalist, when I was in the Valley. When I was trying to raise capital, I got very good advice, almost 16 years ago now. And it was go look at the portfolio page of a VC, and start calling the founders that's in their portfolio. And that's advice I give to this day.

So it's not my advice. It's advice that was given to me, and it's really your best way to do due diligence. What I typically find is I allocate an hour. In the first half-hour of that call, they're going to tell you how wonderful the VC is. And you're going to have a nice conversation with them, and their guard will eventually come down, and they'll tell you the truth, which may be that they're wonderful VCs.

But I remember one particular call I had with one founder, and it went exactly that way. The first half-hour was how wonderful the VC was and how should you deal with him, with that,

blah, blah, blah. And then, we started just chit-chatting, and then, the last 20 minutes, he told me how horrible this guy was, and how he was a nightmare on the board, and it was just—and I'm like, should I still do a deal with him? And he's like, ah, I'm not so sure. And I'm like, that's a solid no.

Yeah, so ask around. What I found is, my time as a founder— and I'm sure it's no different today— is founders love talking to each other and helping out and supporting each other. That is your number one best resource to do due diligence on an venture fund.

AUDIENCE: Is it true that the US VCs are more risk-takers than Canadian VCs?

CHRISTIAN LASSONDE: So I don't know where— well I know where that came from, because if you look at the genesis of venture capital in Canada in the late '90s, they all came out of banks. Every single bank in Canada basically launched a venture fund at one point or another, and they stocked them with bankers, with their friends, the people they knew.

And so I think that did create a cohort, if you will— many of them still with us today— that do have as their very core culture more of a banker culture than an entrepreneurial culture. And that does drive less risk-taking than their US counterparts of the same vintage, if you will. But I don't ascribe to the notion that Canadians as a whole are less risk-takers than Americans. That's actually genuinely false, I mean, if you just look at the Venture Exchange and the mining deals that get done. They're extremely risk-taking deals.

So we know, as Canadians, we are absolute risk-takers, and we know how to take risk. Just historically, I think that's been seen in the venture space, given the players that have been involved. And I think that has largely changed today. If you look at a number of new venture funds that have launched in the last five years, Impression included, they're much more founder-led. They're much more entrepreneurial-led. And I see them taking a lot more calculated risks than the historical funds have been taking.

All right, is everyone still awake? All right, now this a subject that's near and dear to my heart. I could talk about this stuff all day. I find super fascinating. But I also know that I'm really strange. So I know I don't— I understand that this might not be the topic for everybody. But hopefully, you guys learned something about venture capital, what drives us, what motivates us, and that that is useful to you as founders.

PAULINE BRUNEL: Yeah.

AUDIENCE: OK, thank you.

[APPLAUSE]

HOST: Thank you, Christian and Pauline, on behalf of everyone at Osler and all their clients here.