COVID-19 is an opportunity to challenge problematic VC culture

In the midst of the global COVID-19 pandemic, Sequoia Capital, one of the largest and most influential venture capital (VC) firms in the world, issued a grim letter of warning. They warned their portfolio companies of deals falling through, with slowing sales and a tough fundraising environment. They encouraged reducing expenses, spending “wisely” and “raising productivity” by reducing headcount.

There was no mention of providing solutions to pressing societal challenges. They did not focus on questioning the societal value of the companies. Instead they focused on preserving value through financial management. We view this as a symptom of problematic assumptions that have infected our innovation ecosystem creating a culture relying on hypergrowth exit values.

We question the very basis of what entrepreneurs deem the holy grail of ultimate growth – the monetary value of a venture exit. Young budding entrepreneurs are asked from the get-go, “What is your exit strategy?” There is a paradoxical nature to this exit strategy question. Even if innovators want to generate value to society, they are expected to convince others of their product’s potential for hypergrowth to yield the greatest and fastest financial returns for investors. Societal impact takes a backseat to fundraising initiatives set to prop up eventual exit valuation. One snapshot shows that the average successful startup raised $41 million in venture capital and exited for $242.9 million. So, convince others of your growth, raise money, and exit big.

There are systemic societal implications baked into this formula. It does not work for those who truly care about creating innovations that are meant to make a lasting impact. This negatively affects both the nurturing of crucial societally beneficial inventions and their inventors.

Redundant inventions

Our article explores how certain potentially world-changing innovations that are not able to bulk up to the expectation of ‘hypergrowth’ (eg. cleantech solutions) might lack interest and investment from VC firms. Yet, a recent phenomenon has also emerged where redundant innovations that can successfully convince others of their formulaic hypergrowth potential are given capital to claim a stake in further convoluting a saturated market, adding marginal (if any) value to society.

Take the example of the food courier/delivery sector that has emerged as an essential service in the last few months. The online food delivery services market is forecasted at over $111 billion in 2020. In the United States, four large companies with various subsidiaries dominate the industry. These companies are backed with significant capital. The online food ordering and delivery sector has attracted $5.8 billion in VC funding.

Most of these companies are not providing anything innovative to our society, just replicating a standard formula focused on hypergrowth exit. The more money they raise to compete in a crowded market, the more they are able to leverage marketing dollars to keep on growing. As they grow, they buy out other players that cannot keep up, thus reinforcing their dominance in a concentrated market, even while new technologies call into question centralised organisations. The recent acquisition of Grubhub and rumoured acquisition of Postmates are just two examples of the manifestation of this hypergrowth mindset, which in turn harms precarious workers that work in this low-income, contingent industry. Not only is society worse off, but hypergrowth preys upon the vulnerability of marginalised workers and commodified labour.

Who set the rules for growth?

The demand for hypergrowth trickled down from the main benefactors of exploitation, those rooted with privilege and power. And they have differential impacts for those with less societal power. Take an example from the last five years – of the $58 billion invested by VC investors in U.S. start-ups in 2015 only one per cent went to black-owned enterprises. Gender and racial inequalities have been a staple of VC investment decisions, as recent research still finds.

While VC firms instruct their portfolio companies to financially adapt to change in this period of uncertainty, this ignores questioning the status quo of how success is measured, what it takes to be successful, and the biases these pillars of success were built upon. As the pervasiveness of racial injustices are garnering increased attention, we must call into question this VC hypergrowth blueprint, and how those who do not play under this dominant mentality are not set up for success.

The future of innovation

Innovation systems that focus solely on exiting and generating investor profits are not designed to help nurture the best innovations for society. At their worst, they are no better than a pyramid scheme, where early investors exit at a profit and leave the new owners without sustainable solutions.

This global pandemic has showcased how even the best laid plans for growth will be obsolete if the innovations themselves have little societal value. As VC firms warn that their portfolio companies' growth targets will be missed in the first quarters of 2020, we argue that this is time for us to ask if the these hypergrowth targets are meaningful in the first place, or simply a distraction from more pressing questions of societal value and impact.

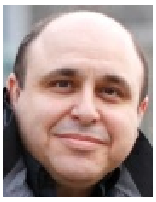
This is a clear opportunity to challenge the dominance of the hypergrowth exit mindset, and hopefully help an innovation system that helps a more equitable society emerge.

♣♣♣

Notes:

- *This blog post is based on "Hypergrowth Exit Mindset: Destroying Societal Wellbeing through Venture Capital Biased Social Construction of Value," in the Journal of Management Inquiry,*
- *expresses the views of its author(s), not the position of LSE Business Review or the London School of Economics.*
- *Featured image by Andy Beales on Unsplash*
- *When you leave a comment, you're agreeing to our Comment Policy*

Laura Lam is an incoming Ph.D. student in industrial relations and human resources at the University of Toronto in Fall 2020, currently completing her Master of Arts in immigration and settlement studies at Ryerson University. Her research interest is at the nexus of migration, employment and gender inequality. She completed her Bachelor of Commerce at the University of British Columbia with a specialisation in marketing and sustainability and was selected as part of the Commerce Scholars Program. She has previously worked in a marketing capacity with various startups and technology accelerators.



Marc-David L. Seidel is the RBC Financial Group professor of entrepreneurship, director of the W. Maurice Young Centre for Entrepreneurship and Venture Capital Research, and associate professor of organisation behaviour and human resource management at the Sauder School of Business at the University of British Columbia. He is an associate editor of *Administrative Science Quarterly*, a HIBAR Research Alliance fellow, and former division chair of the Academy of Management Organization and Management Theory Division.