

# Venture Capital Exit Rights

## C. Bienz and Uwe Walz

Discussion by

Merih Sevilir

University of North Carolina, Chapel Hill

# What is the paper about?

Analysis of exit rights in VC contracts

Main finding: Exit rights are more likely in VC contracts

1. for higher investment rounds
2. when the VC has specific exit expectations
3. If the VC has a closed-end fund

# Hold-up Theory

- VC and entrepreneur make relation specific investment.
- Due to contractual incompleteness, there will be ex-post renegotiation/bargaining.
- The party with a stronger bargaining position (greater ex post bargaining power or stronger outside option) will hold-up the other party.
- Anticipating ex-post hold-up leads to ex-ante underinvestment.

# Predictions of the Theory

- Start-ups that require greater relationship *specific investments* would be more prone to hold-up.
- *Specificity of the investment* affects the structure of the contracts ex ante to mitigate the hold-up problem.

# Proxies for presence of hold-up

- Higher investment round
- VC's exit expectations
- Closed-end fund

# Comment I

- Not clear whether higher investment round is associated with more severe hold-up problem.
- An alternative interpretation  
Higher investment round, less uncertainty regarding the investment, greater ability to write complete contracts, ex post renegotiation and hold-up less likely

# Comment I, continued

- A second interpretation

In later investment rounds, VC's input/effort is more important to the success of the start-up than the entrepreneur's input/effort.

Hence, the contract optimally allocates more rights to the VC to maximize his incentives to exert effort.

# Comment II

- Not clear why VC with certain exit expectations will be more prone to hold-up.
- An alternative interpretation  
VC with certain exit expectations is more informed about the progress of the start-up, resulting in a greater ability to write more complete and detailed contracts.

# Comment III

- Not clear why VC with close-end fund will be more prone to hold-up.
- An alternative interpretation  
Close-end fund could be a signal of superior VC quality/ability. More able VCs will have greater bargaining power, and greater ability to write contracts allocating themselves more exit rights.

# Other Comments

- Almost all exit rights are allocated to the VC. It is more likely that VC is holding up the entrepreneur, rather than other way around.

## Efficiency implications of exit rights

- Any evidence that VC's exit rights affect his ex ante incentives to exert effort and start-up performance ex-post?

# Summary

- Interesting paper with great data set
- It is not clear whether the paper is testing the predictions of the hold-up theory
- Results are consistent with more than one story
- It is important to clarify which theory is most consistent with the results, which theory is ruled out.