

# Berle-Means

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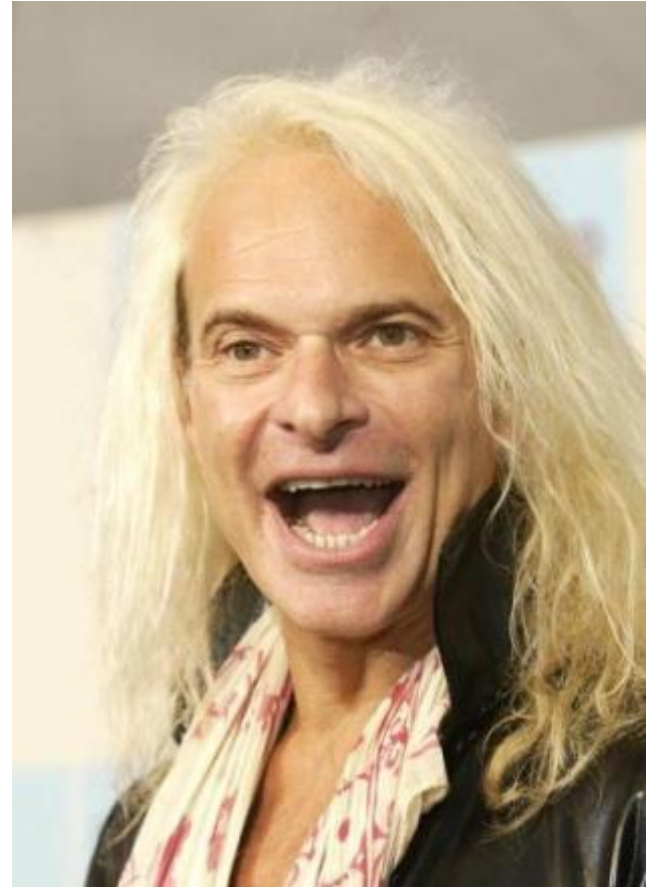
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March 21, 2013







When Does  
Unbundling Capital  
and Control Work In  
Entrepreneurial  
Finance?

# Premises

1. Startups often require and/or benefit from outside capital.
2. Startups are a “collective” endeavor that are not self-sufficient – viz., in addition to capital, a startup requires many external inputs.
3. Problems of entrepreneurial finance are extreme at early stage of company lifecycle.



# Devils of Entrepreneurial Finance



**Uncertainty**

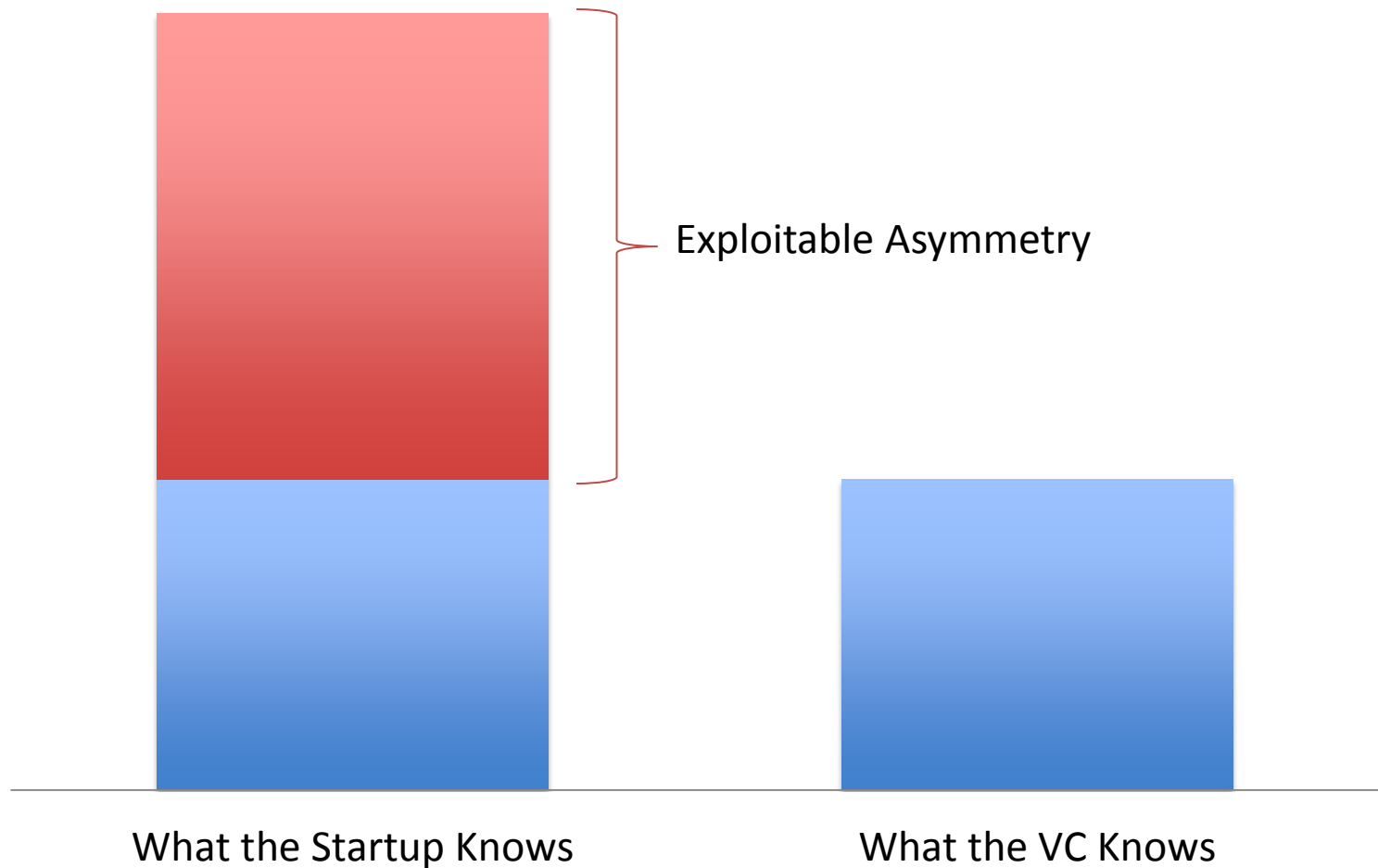
**Info  
Asymmetry**

**Misaligned  
Incentives  
(Agency Costs)**

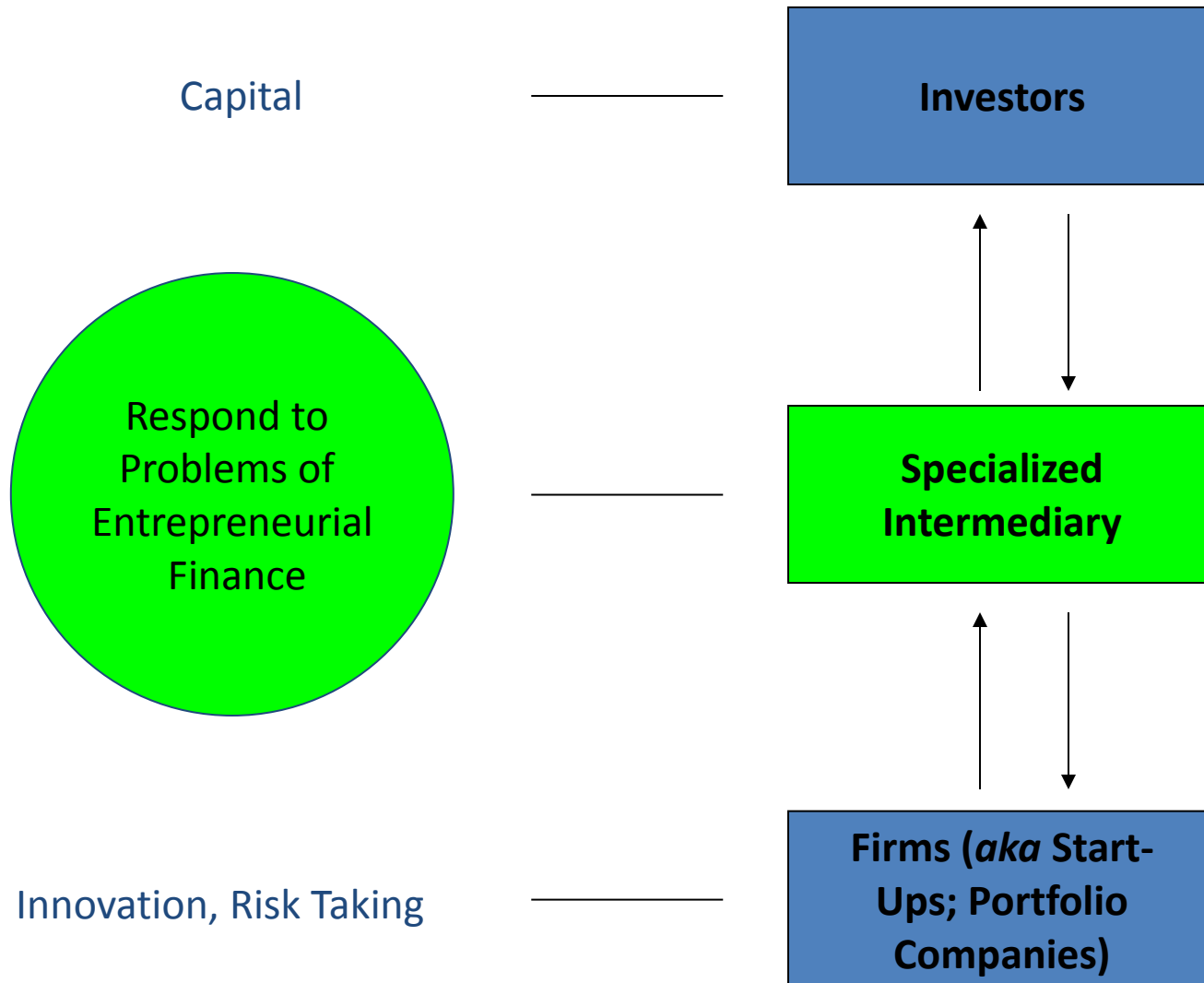
**Transaction  
Costs**



# Information Asymmetry



# The Specialized Intermediary Sandwich



Means

Berle-

# Why matter? Three hypotheses:

1. Low capital intensive startups are harder to justify costs of monitoring/control. Super Angels.
2. Capital moving efficiently into startups across geography requires mindfulness of non-monetary needs of startups.
  - 506(c) non-solicitation
  - crowd funding structures
3. Capital unbundled from monitoring/control, from the startup's perspective, may be "less expensive" (although less valuable) than bundles.

# Appendix

# Responses to Challenges of Ent Finance



**Specialized  
Intermediary**

**Reputation**

**Time**

**Private  
Contracting  
(Economics,  
Control  
Provisions)**

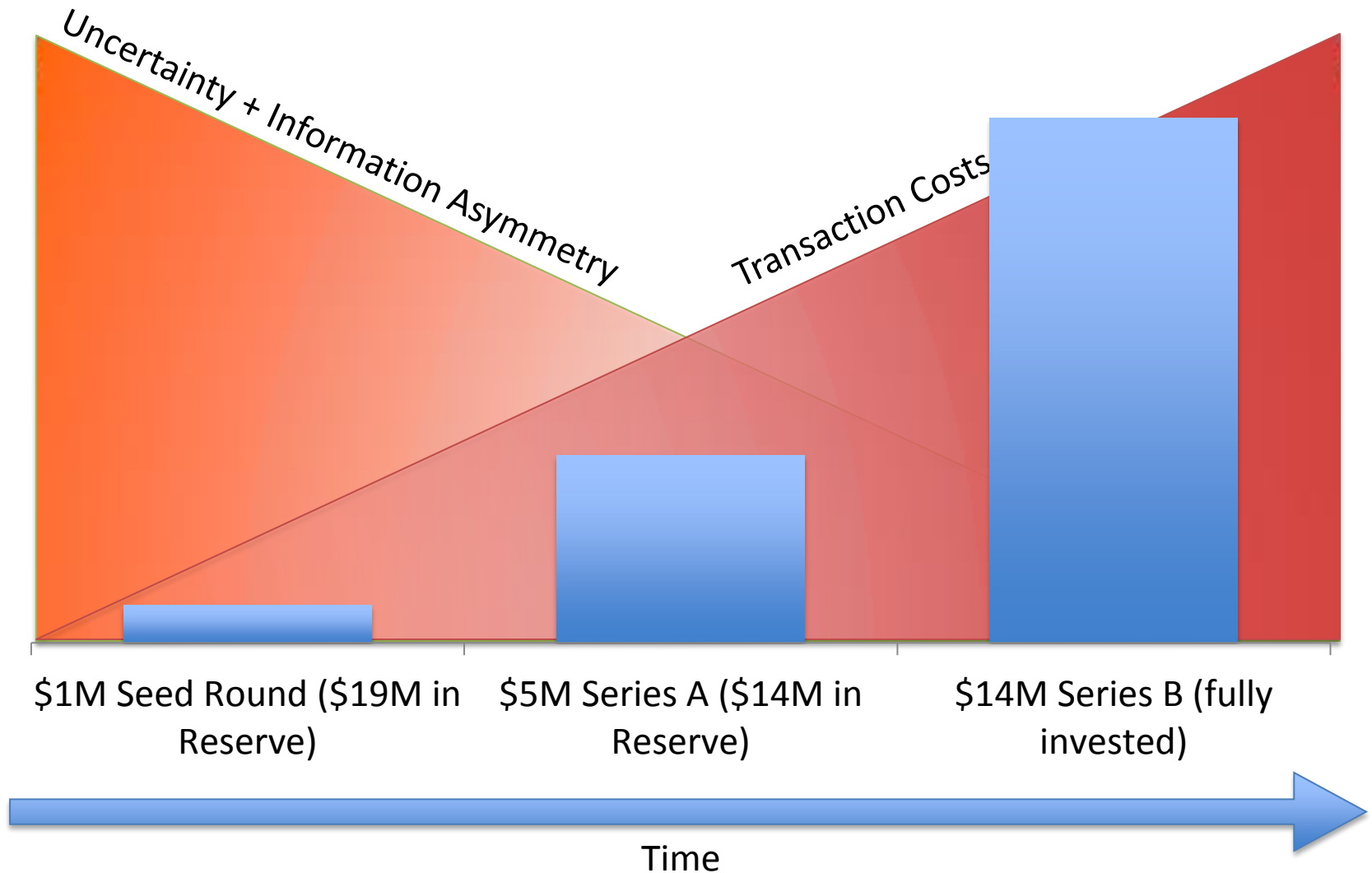
**Legal  
Background**





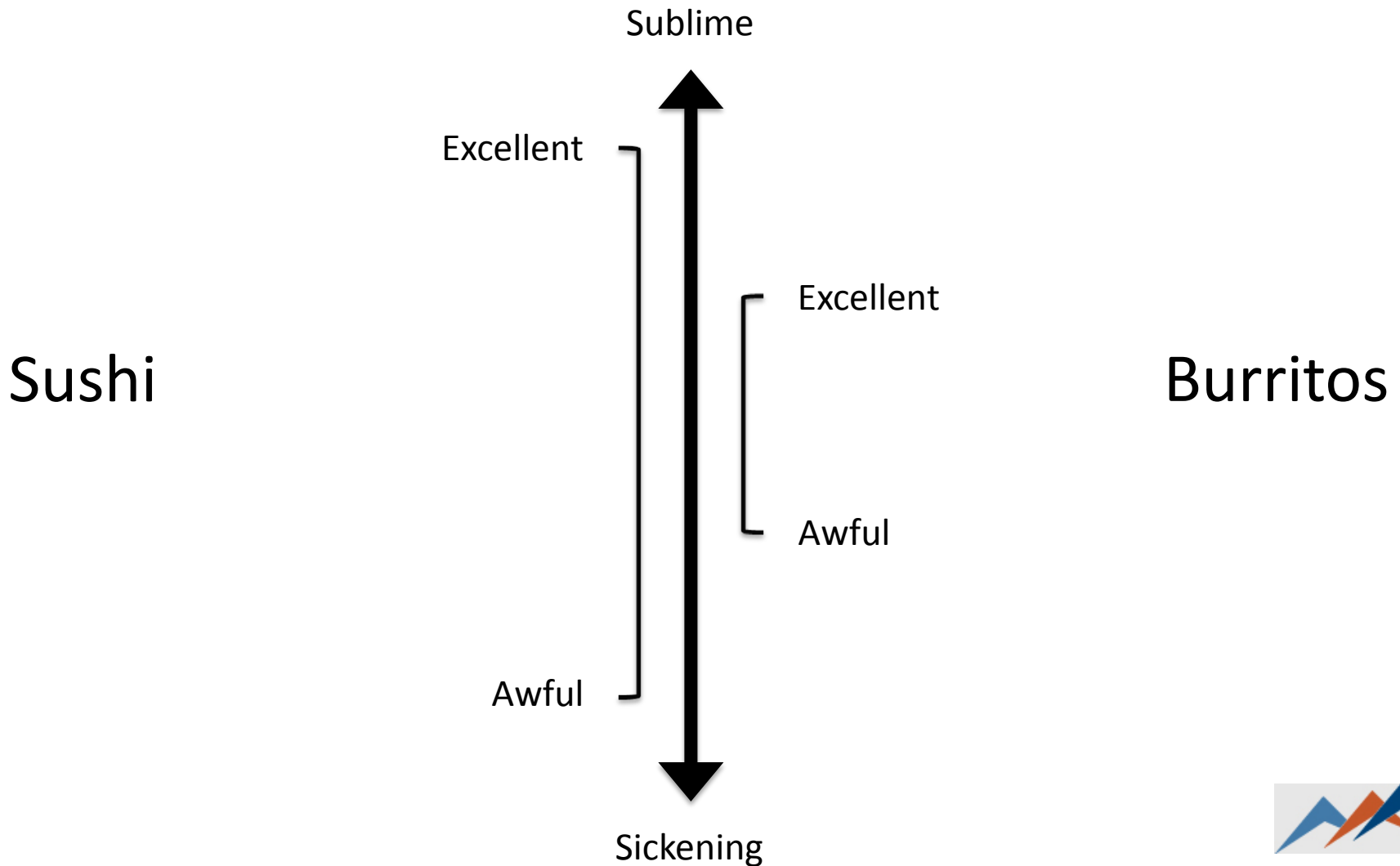
# Investors Use Time

(assume the company needs \$20M; non-syndicated investment)



# Sushi & Burritos

High Variance in VC Performance



# When Reputation Matters

Behavior  
observable by  
others

Shared expectation  
of certain behavior

Competition in the Market

Adverse Consequences of Bad Behavior

Multi-Play Game



# What will successful crowdfunding arrangements look like?

1. Higher cost of capital and harsher economic terms to compensate for greater risk associated with fewer controls, unless risks are mitigated
  - Berle Means problem. Controls provisions difficult to implement due to conservation of discretion problems.

# What types of companies are likely to be able to create value with new means of capital formation?

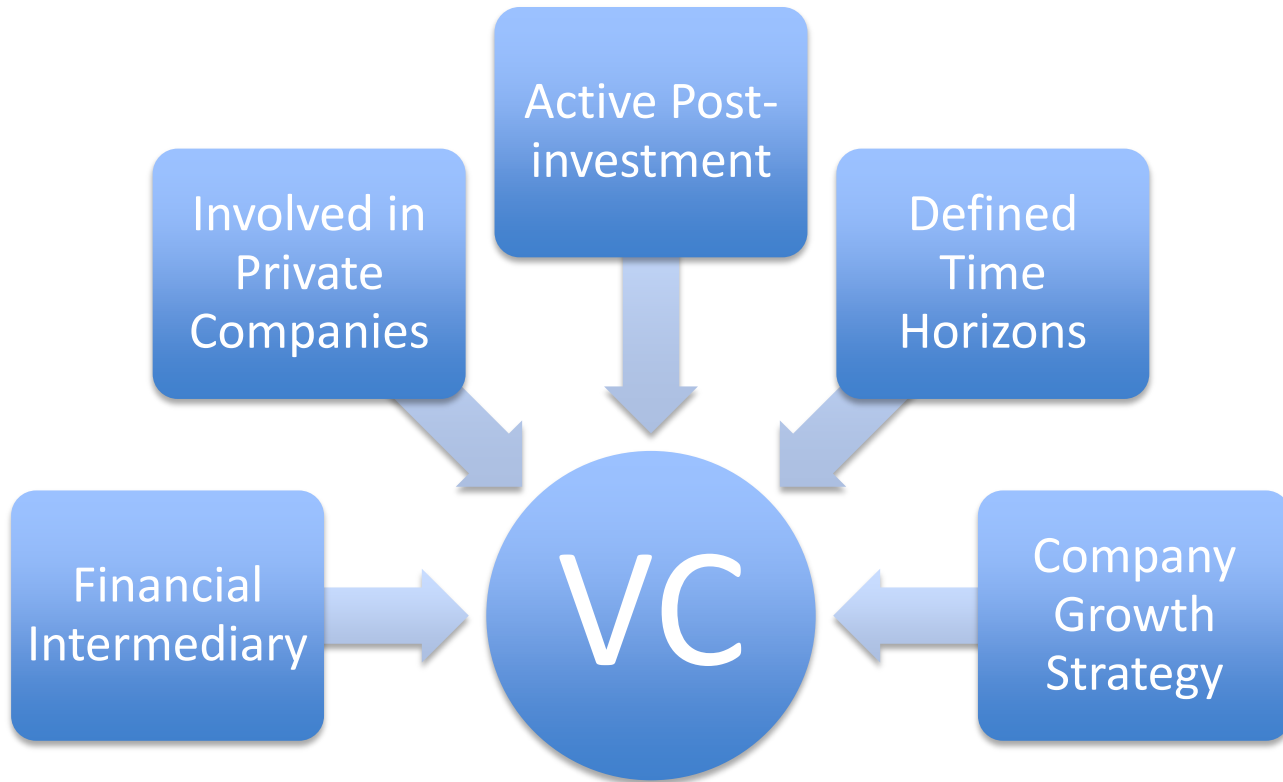
- Later stage, more proven (reduced uncertainty)
- Companies with reputational intermediaries already attached
- Not exactly types of companies that the JOBS Act intended to help

# Will the specialized intermediary be disintermediated?

- No.
  - Existing intermediaries will avail themselves of crowdfunding to “finish” out and amplify rounds.
  - Intermediaries may have role in resolving illiquidity and lock in problems for crowdfunding investor.
  - New intermediaries will emerge as signals of startup quality. Accelerators, super angels, and electronic platforms likely to take greater weight.

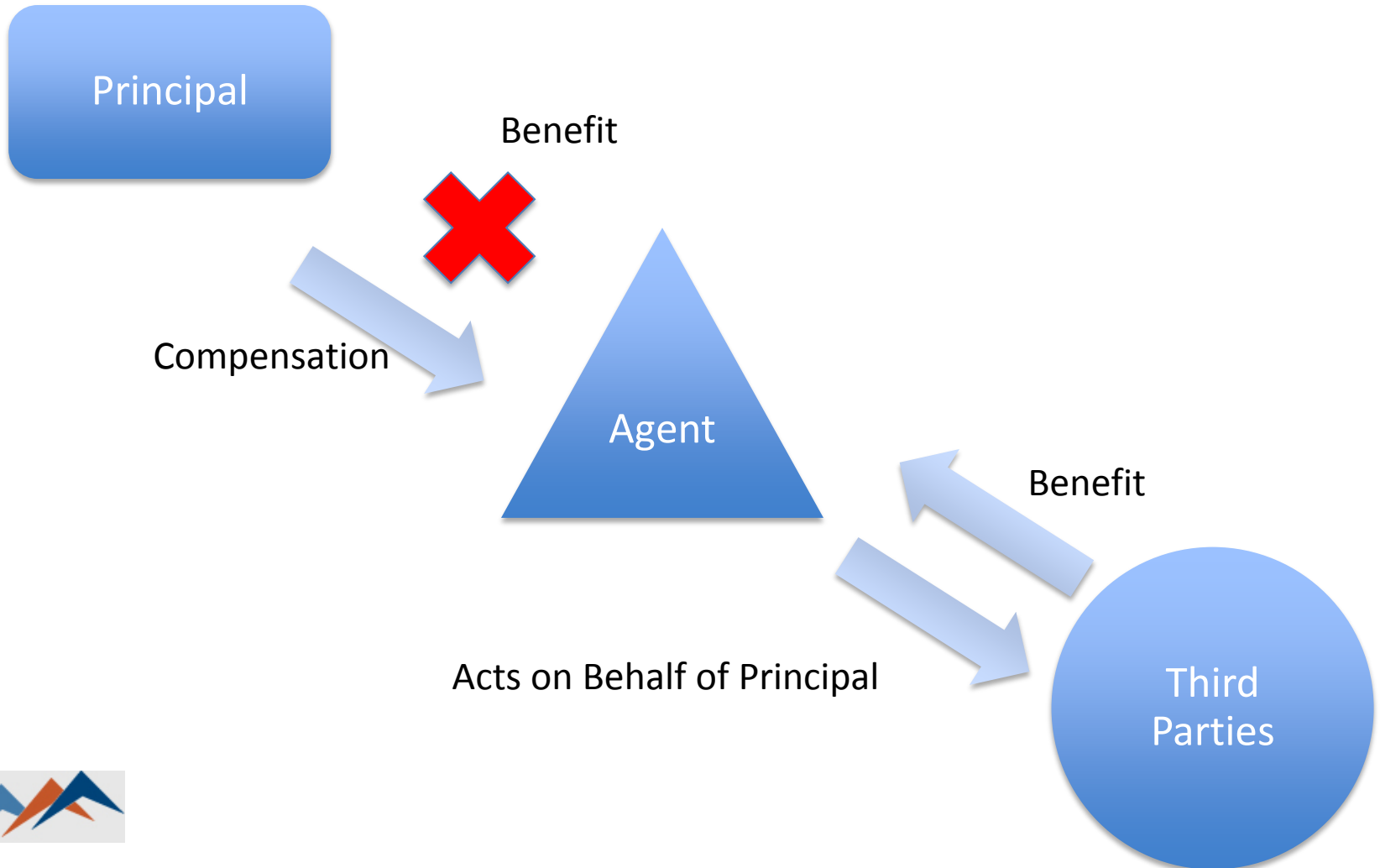
# Appendices

# 5 Traits of a VC



# Agency Costs

Where an agent acts opportunistically at the expense of the principal.





**Will there be a market?**

**Can the team execute?**

**Will the product work?**

**Will future events affect  
the industry?**

**Ocean of Startup Uncertainty**