

Confidence falling among venture capitalists

By **Claire Cain Miller**

Published: October 8, 2008

Venture capitalists are optimists by nature. They bet on start-ups that are little more than ideas and hope they have found the next Google.

But these days, even some of the sunniest venture investors are having dark moments of the soul.

Mark Cannice, director of the entrepreneurship program at the University of San Francisco, who polls Silicon Valley investors, said venture capitalist confidence had hit its lowest point since 2004, when he began the surveys. "Right now, everybody is really worried," he said.

Venture firms are not at the epicenter of the latest financial turmoil, yet they are increasingly concerned that Wall Street's virus will spread through Silicon Valley, pushing the industry into a crisis.

Fewer start-ups have gone public in 2008 than in any year since 1977, and companies looking to buy them have grown skittish. So venture firms have to keep putting money into companies they thought they would have cashed out of by now.

Meanwhile, the credit crunch is taking a toll on banks and insurance companies, which make up one-fifth of investors in venture funds.

Some wealthy investors and big companies that previously committed money to venture funds are now unable to supply it - leaving these investors with the options of defaulting and losing what they already have invested, finding a replacement or selling their stakes at a discount to what is known as a secondary firm.

David de Weese, who leads the global secondary business at Paul Capital Partners in New York, said he had been getting many calls from beleaguered investors. "We're drinking from a fire hose at the moment," he said.

Consider FTVentures, a San Francisco company that invests in technology companies that build services for the financial industry. Its lineup included some unlucky blue chip investors: Lehman Brothers, Washington Mutual, American International Group, Freddie Mac and Fannie Mae, all of which have failed or have been bailed out recently. FTVentures, which closed a \$512 million fund in April, said it did not expect any of its investors to default on their commitments.

A few venture capital firms continue to raise billion dollar funds and, in turn, invest hundreds of millions in start-up companies. In September, AustinVentures closed a \$900 million fund, Sequoia Capital closed two funds worth a total of \$1.7 billion and Battery Ventures raised \$250 million to tack on to its eighth fund, for a total of \$1 billion.

are other staples of what are known as alternative assets, Mark Heesen, president of the National Venture

But some clearly expect that to change. "I think we'll see some painful and steep markdowns in what people once perceived as a safe haven," said Chris Douvos, an investor in Palo Alto, California, who works for the Investment Fund for Foundations.

Investors are already shunning new, untested venture firms in favor of those with track records and higher returns. "Other funds have had problems," said Deborah Farrington, co-founder of a New York venture firm, StarVest Partners. Echoing the sentiments of many in the venture capital field, she said there had been a flight to what were perceived as higher-quality funds.

Some venture capitalists worry that if conditions continue to worsen, limited partners will lose hope and give up on venture investing.

"It's starting to look like fund raising in the V.C. world could become very problematic," said Tom Crotty, a partner at Battery Ventures.

One problem, said Phil Siegel, a partner at AustinVentures in Austin, Texas, is the allocation squeeze. Investors like pension funds and endowments set aside a certain percentage of their money for alternative investments, which include venture capital. Now, with their wealth evaporating, they either no longer have money to invest or they suddenly find that venture capital is a much larger percentage of their assets than they had planned, so they cut back.

AustinVentures met its \$900 million fund raising goal, but it was a difficult, 10-month effort. "I certainly won't tell you that the process was easy," Siegel said.