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New York Times

Venture Capitalists Are Hearing Footsteps

October 7, 2008,

By CLAIRE CAIN MILLER

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 V. Cannice, director of the entrepreneurship program at the University of San Francisco, who polls Silicon Valley investors, said venture capitalist confidence had plummeted to 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 continue to 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 option of defaulting and losing what they already had invested, finding a replacement or selling their stake at a discount to what is known as a secondary firm.

David H. 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 firm 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

closed a \$512 million fund in April, said it does not
on their commitments.

continue to raise billion-dollar funds and, in turn, invest
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.

Compared with buyouts and real estate, the other staples of what are known as
alternative assets, venture capital seems relatively safe, said Mark Heesen, president of
the National Venture Capital Association.

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, Calif., 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 A.
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
are 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, Tex., is the
allocation squeeze. Investors such as 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,” Mr. Siegel said.