

# Pensions & Investments

## After storm, who will be left?

*Firms big and small expected to be among list of casualties*

by Arleen Jacobius

Venture capital today is survival of the pluckiest.

About three quarters of the estimated 1,500 venture capital firms now in business worldwide aren't expected to be around after they finish investing their current portfolios.

And those leaving the venture capital arena aren't only the lesser-known firms. Just last month, Silicon Valley stalwart Draper Fisher Jurvetson Portage Venture Partners executives acknowledged the firm will close after the existing portfolio is invested.

Still, there are survivors, and even new entrants. Some venture capital firms managed to close funds in 2009 — a year that had the fewest number of funds raised since 1993 and the lowest amount of capital since 2003 — while others were able to exit existing investments and make new ones.

Venture capital stalwarts Kleiner Perkins Caufield & Byers, Greylock Partners, Sequoia Capital and VantagePoint Venture Partners are expected to thrive.

Kleiner Perkins, Greylock and Sequoia invested in some of the largest venture capital deals of 2009, according to the MoneyTree Report of PricewaterhouseCoopers and the National Venture Capital Association.

VantagePoint is an investor in Tesla Motors Inc., which recently filed to go public.

Among others mentioned by industry sources as likely survivors:

- New Enterprise Associates Inc., which closed its 13th fund last year with \$2.46 billion, the largest venture capital fund raised in 2009, according to NVCA and Thomson Reuters data. The fund has already made 15 investments;
- Sofinnova Partners, which closed its sixth fund with €260 million (\$363 million) in capital commitments;
- Northgate Capital Group, which closed the second-largest fund last year, with more than \$1 billion in commitments;
- Foundation Capital, which invested — along with Kleiner Perkins and Northgate — in Silver Spring Networks Inc., a Redwood City, Calif.-based software firm; and
- Andreessen Horowitz, which in July simultaneously announced the firm's formation and the closing of its initial \$300 million fund — the largest fund sponsored by a new firm that closed last year, according to NVCA and Thomson Reuters.

The firm, formed by experienced investors Ben Horowitz and Marc Andreessen, invested \$50 million in Skype Ltd. in September.

But for most firms, it will be tough slogging.

### Survival depends on name, investment story

Venture capital returns have been challenging for the past 10 years. During the past two years, the lack of a public market, especially for smaller companies, and a smaller number of acquisitions and mergers virtually stopped the flow of distributions to investors. These days, the average time from initial investment to exit has grown to well beyond seven years from the previous norm of three to five years, said David Fann, president of PCG Asset Management LLC, La Jolla, Calif.

PCG predicts that within five to seven years, the number of viable venture capital firms worldwide will drop to 500 from an estimated 1,500 today.

The venture capital industry already has contracted. NVCA membership dropped 10% in 2009 and association executives expect membership to decline another 15% in 2010, said Mark Heesen, NVCA president.

Survival depends, in part, on a recognizable name and a compelling investment story, industry insiders say. But a name brand alone is no guarantee.

"Many older venture firms are facing generational changes. Those 'great investors' that invested in the 1970s and 1980s are retiring as they don't want to stick around and commit to another 10-year fund," Mr. Fann said. "The next-generation venture capitalists just aren't as compelling in proving that they could create great companies."

NEA Co-founder Dick Kramlich has said he will be stepping down as a full time partner after the firm's latest fund is wound down.

**Some firms have managed to make the transition gracefully. Reid Dennis, founder of Institutional Venture Partners, switched to strategic partner when the firm raised its last fund, \$600 million IVP XII, said Todd C. Chaffee, general partner. The five general partners on the firm's 12th and latest fund had been with the firm for a decade.**

**Mr. Chaffee said the fund, which surpassed the \$300 million 11th fund, was oversubscribed. The firm is hiring new**

**associates and grooming the next generation of IVP investment executives.**

**“Venture capital is very much an apprenticeship business,” he said.**

Eric W. Wright, partner in the private investment funds group of law firm Ropes & Gray LLC in San Francisco, said the historical front-runners might not remain in the lead. Pushing some older executives to call it quits is the 10-year performance numbers, which plummeted dramatically now that the 1999/2000 fund vintages are no longer included to buoy returns, Mr. Wright said.

“Venture capital firms have legacy problems,” said Stephen L. Nesbitt, CEO of consultant Cliffwater LLC, Marina del Rey, Calif. “They have a lot of resources tied up with existing portfolio companies.”

Out of close to 200 funds, only about 50 are doing well, with only about a dozen venture capital firms doing very well, Mr. Nesbitt said.

These include well-known large venture capital franchises as well as small groups that developed very strong brands with repeatable performance, he said.

Still, Mr. Nesbitt noted whenever an asset class is declared dead, with few investment dollars going its way, is when the investments will perform the best.

### **Competition for money**

The NVCA's Mr. Heesen said many firms that stayed out of the fundraising market in 2009 will find themselves competing with other venture capital firms already scheduled to raise money in 2010.

Those that do close funds will be raising much less capital than before, he said. That would be devastating to the future of venture capital because the smaller the fund, the fewer investment executives needed. The younger executives, those in their 20s and 30s, will be shown the door, he said.

The result is that in 10 years, when firm founders are nearing 70, there will be no junior executives in the wings to carry on the firm's work Mr. Heesen said.

Despite the doom-and-gloom forecast, venture capital firms still are investing money, noted Peter T. Martenson, La Jolla, Calif.-based director at placement firm CP Eaton Partners LLC.

“Venture capital firms are raising new capital for new companies,” he said, but not all of them are doing so by raising new funds. Pressured by investors to distribute profits, firms such as Sequoia, 3i Group PLC and Sevin Rosen Funds are selling portfolio companies on the secondary direct market to other venture capital firms. Secondary investment firms like Cipio Partners LLC, Industry Ventures LLC and Saints Capital are doing a booming business buying portfolio companies from other venture capital firms, Mr. Martenson said.

“It provides liquidity for venture capital firms that can't take companies public, sell them or have too many companies in their portfolios for too long, he said.