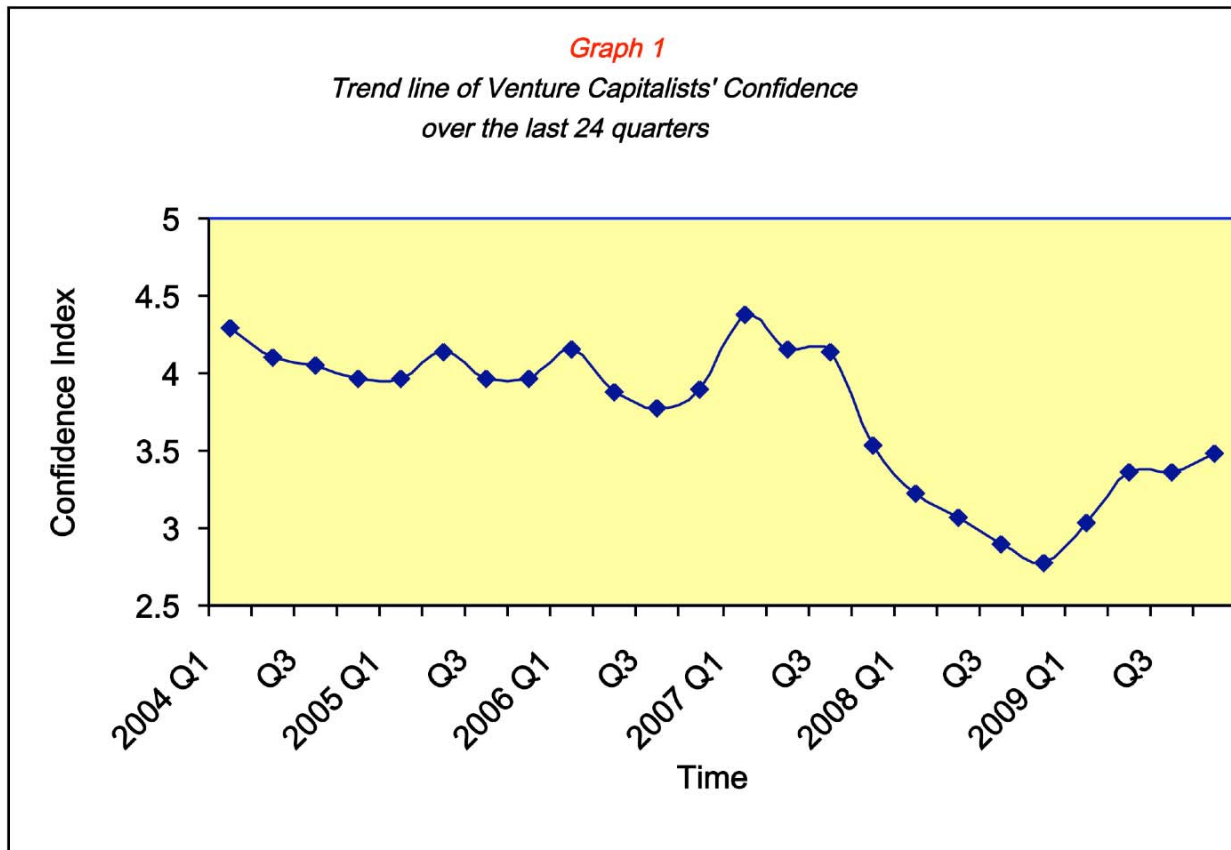


Silicon Valley Venture Capitalist Confidence Index™ (Bloomberg ticker symbol: USFSVVICI)

Fourth Quarter – 2009
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The quarterly *Silicon Valley Venture Capitalist Confidence Index™* (Bloomberg ticker symbol: *USFSVVICI*) is based on an on-going survey of San Francisco Bay Area/Silicon Valley venture capitalists. The Index measures and reports the opinions of professional venture capitalists in their estimation of the high-growth venture entrepreneurial environment in the San Francisco Bay Area over the next 6 - 18 months.¹ *The Silicon Valley Venture Capitalist Confidence Index™* for the fourth quarter of 2009, based on a January 2010 survey of 33 San Francisco Bay Area venture capitalists, registered **3.48** on a **5 point scale** (with 5 indicating high confidence and 1 indicating low confidence.) This quarter's index reading rose from the previous quarter's reading of 3.37 and indicates a modest uptick of confidence and continues an upward trend in VC confidence in 2009 following a five-year low in confidence in Q4 2008. Please see Graph 1.



¹ Publishing a recurring confidence index of professional venture capital investors is intended to provide an on-going leading indicator of the overall health of the high-growth new venture environment. Questions about this study or related issues should be addressed to the author at Cannice@usfca.edu.

Confidence edged upward in the fourth quarter of 2009 with most responding venture capitalists satisfied that the macro economy has stabilized enough to allow for the resumption of a nearer to normal venture environment. While concern remains over potential economic landmines in the future (e.g. withdrawal of government stimulus, increasing interest rates, harsher tax treatment, etc.) the notable return of exit opportunities – especially headline acquisitions - is breathing life into the venture business model and likely presages an increasing quantity and quality of exits in 2010. A steady flow of attractive investment opportunities continues. And the difficult economic climate of the last two years has selected out many of the weaker ventures from the mix, thus allowing the survivors to operate in a less cluttered field where they are better able to sell into corporate and retail markets that have pent up demand for the best solutions. Still, concern persists over decreased capital commitments from institutions and the resulting lack of funds for promising investment opportunities. In the following, I provide many of the comments of the participating venture capitalist respondents along with my analysis. Further, all of the Index respondents' names and firms are listed in Table 1 save those who wished to remain anonymous.

Deal flow appears strong. Bruce MacNaughton of Crosslink Capital confirmed “We’re seeing more promising startups than we’ve seen in quite awhile.” And Debra Beresini of InvenCor added “Momentum is beginning to build as valuations are coming to equilibrium and more investments are made. We have heard ‘talk’ that many firms are looking at seed and early stage investments again, and others are focused on those companies closer to revenue. In either case, it means investment into new companies which fuels the economy...” In fact, confidence in the resilience and innovative capacity of entrepreneurs has remained robust through the broader economic decline.

The stabilizing economy will allow venture-backed firms to increase sales to enterprise customers. Savinay Barry of Granite Ventures observed “Planning and budgeting visibility for enterprises is much better than it was last year, when the future looked opaque. Hence, they are more willing to loosen their purse strings and one of the beneficiaries for this outflow would be startups.” And Steve Harrick of Institutional Venture Partners also finds that “We are seeing an increase in confidence on the customer front. Businesses are beginning to spend again and cost cutting is giving way to strategic IT initiatives.” Similarly, Richard Yen of Saban Ventures noted “There is healthy optimism in the entrepreneurial community as the economy appears to be recovering and revenue streams will start to flow again.” Finally, Victor Hwang of T2 Venture Capital expects that “Macroeconomic situation has stabilized, and big companies will be tight on cash in coming years, creating more space for entrepreneurs to innovate.”

More exit opportunities are supporting the venture business model. Deepak Kamra of Canaan Partners observes “Exuberant public markets and expected increases in tech spending by enterprises and consumers.” Chester Wang of Acorn Campus also sees a “limited IPO window opening.” And Dan Lankford of Wavepoint Ventures noted “We are seeing some increase in M&A activity, which is always a good sign!”

Venky Ganesan of Globespan Capital elaborated “Nothing succeeds like success. The impending IPO’s of Facebook, LinkedIn, Solyndra, Silver Spring Networks, etc.; the consummated acquisitions of Admob (acquired by Google), Playfish (acquired by EA) and Jajah (acquired by O2) all show that high growth venture backed startups are back. Like moths to the flame when the exits start happening in 2010, the venture money and the entrepreneurs are going to be back (and I am afraid so will the tourists). I am bullish on 2010.” And Shomit Ghose of Onset Ventures agreed “The tech IPO market will begin to return in 2010...” Finally, Jeb Miller of JAFCO Ventures indicated “We’re seeing the availability of quality entrepreneurs and an improving exit environment combine to help reignite interest in building new companies around emerging opportunities in digital media, cloud computing, health IT and green IT.”

Optimism is returning. Kurt Keilhacker of TechFund Capital stated “While there is some caution with macro employment problems and worrisome tax policies, there is guarded optimism in Silicon Valley. Indeed, we are witnessing some tectonic technological shifts that are just in their infancy.” And Sandy Miller of Institutional Venture Partners declared “We have returned to a healthy normalcy in the technology venture environment. It feels like the pre-bubble 1990s. The exit market has peeked open with an active IPO calendar and greatly enhanced acquisition interest by the big cash-rich technology company acquirers. This in turn is spurring new entrepreneurial start-ups as liquidity comes into the venture business. 2010 should be an active year for both new investments and exits. There is indeed light at the end of the tunnel!”

Looking to the past as prologue, Graham Burnette of Red Planet Capital recollected that “Silicon Valley has historically produced the most value in the years following a crash. In the words of one of my partners, many generations of Silicon Valley companies have been built on the rubble of the previous generation. We now have a situation in which many weak firms have been cleared away and talented people are available to help a new generation of exciting companies to grow. Entrepreneurs with great ideas never went away, and money is again flowing to fund those great ideas. I believe that we are in the midst of a very exciting time.”

However, the supply of venture financing is limited. Robert Ackerman of Allegis Capital commented “I expect to continue to see more demand for capital for start-up ventures than there will be available capital. The consolidation of the venture industry and difficulties for many managers in new fund formation will only complicate this supply/demand in balance. That said, there is no shortage of quality start-up investment opportunities.” And Joe Mandato of De Novo Ventures explained “there is still much uncertainty in the venture industry; the bar for investments is higher, the timelines for exits is longer and the exit options are fewer. Compounding this is the increased challenge to raising new funds.” One VC respondent who wished to remain anonymous observed “continued challenges in raising money,” while another confirmed that “financing environment for small entrepreneurial companies continues to be treacherous.” In fact, Thomson Reuters and the National Venture Capital Association reported that 2009 was the slowest fund raising year (by number of new or follow-on funds established) since 1993.²

Natural selection still rules. Tom Rodgers of Advanced Technology Ventures detailed “The environment is going through a natural Darwinian contraction. There is already less money going towards fewer companies. We will see the stronger companies surviving and thriving and the more disruptive and resilient approaches will continue to be funded. This is good for the long-term health of the environment. Venture firms with active funds are looking to put money to work but are taking a very disciplined and opportunistic approach. However, many well run companies will continue to focus on rational strategic growth during this climate as opposed to high growth that may come to involve a risky price tag.”

And caution remains. Bill Byun of Samsung Ventures indicated “Q1’10 is viewed very cautiously since 2009 was a very challenging year. We will know additional forecast and confidence level of our venture community in Q2’10.” Kirk Westbrook of invencor explained “Overall, the fundamentals that have challenged business growth during the last 24 months in the US appear to have been addressed to a sufficient extent to support expansion. The second half of 2009 showed the improving health of the US and global markets, albeit with some hiccups along the way. However, one major X factor remains, consumption. As with previous significant recessionary periods, debt, both consumer and business, create an anxiety level that impairs spending. Due to the nascent nature of the recovery, the ability to overcome

² “Despite Fourth Quarter Increase, Venture Capital Industry Experiences Slowest Annual Period for Dollars Committed Since 2003,” Thomson Reuters and National Venture Capital Association, January 11, 2010.

the emotionally driven anxiety will need to be monitored closely as it will have a material impact on the ultimate rate of growth.”

Dag Syrrist of Vision Capital identified other impediments to the entrepreneurial economy, explaining “Spending, housing, expanding employment and investments – are all lagging the stock market rally and until there is sustained progress on these fronts, the venture community is going to hesitate and seek to hedge on deploying new capital. Only a handful of funds are investing with a forward market perspective, and while they are active and deploying capital, the majority are reacting slow to deploy new capital in absence of more robust economic data. Compounding this, is the uncertainty of institutions committing capital to funds, which makes funds with capital to deploy recognize they may have to be much more cautious with rate of new commitments.” Pointing to a possible future hazard to the venture business model, a respondent who remained anonymous voiced concern over potential new tax treatment, stating “Congress’ proposed increase in tax rates for venture capital carried interest is a threat to the venture economy.”

And Igor Sill of Geneva Venture Management reasoned “I don't believe we'll experience another 90s bull market cycle for some 24 - 36 months from now given the current economic and political uncertainties affecting the broader markets. Venture valuations are just now returning to their early 2008 levels and should begin to grow in absolute terms throughout 2010. I believe those valuations will be sustained in 2011 and beyond barring any further US or global crises. Risks include the premature withdrawal of our trillion plus dollar economic stimulus since it directly impacts the return of an IPO market (critical for venture investment exits/realizations) and the possible raising of Fed interest rates. I believe we'll see venture investors seeking value-based investments (later stage startups with real revenues) while funding value creation in current, strong portfolio holdings.”

In conclusion, the prevailing sentiment is that of guarded but increasing optimism. Concern over possible future hits to the macro economy and the limited supply of institutional finance available for venture funds has constrained the flow of investment capital to promising start-ups. However, the slow return of the exit market is bringing a sense of normalcy back to the venture business model with major acquisitions occurring alongside a growing IPO calendar. Thomson Reuters and the National Venture Capital Association reported five venture-backed IPOs and 67 venture-backed M&As in the fourth quarter of 2009. Another 29 venture-backed firms have filed with the SEC for an IPO.³

Major corporate acquisitions ultimately drive further acquisitions out of competitive necessity. This strategic acquisition mandate accompanied by a pent-up supply of efficient, innovative, and private ventures, higher value stock currencies, and low interest rates will spawn more acquisitions and drive up valuations. This long awaited return of liquidity will be a balm to the venture industry and will bring into balance its business model. A tepid consumer, uncertain regulatory policies, and limited inbound capital notwithstanding, a rational sense that we are on the verge of something much better is emerging. The first half of 2010 should confirm this stabilizing trend in the venture environment, and when that base is formed, a powerful spring back to vibrant entrepreneurial growth and investing later in 2010 may be in the cards.

³ “Venture backed exit market improves marginally at year end”, Thomson Reuters and National Venture Capital Association, January 4, 2010.

Table 1

Participating Venture Capitalists in the 2009 4th Quarter Confidence Index Survey

Participant	Company
Alain Harrus	Crosslink Capital
Bill Byun	Samsung Ventures
Bruce MacNaughton	Crosslink Capital
Dag Syrrist	Vision Capital
Dan Lankford	Wavepoint Ventures
Debra Beresini	invencor
Deepak Kamra	Canaan Partners
Eric Buatois	Sofinnova Ventures
Graham Burnette	Red Planet Capital
Igor Sill	Geneva Venture Management
Jay Watkins	De Novo Ventures
Jeb Miller	JAFCO Ventures
Jim Marshall	Selby Ventures
Joe Mandato	De Novo Ventures
Kirk Westbrook	invencor
Kurt Keilhacker	TechFund Capital
Mudit Jain	Synergy Life Science Partners
Prashant Shah	Hummer Winblad Venture Partners
Richard Yen	Saban Ventures
Robert Ackerman	Allegis Capital
Sandy Miller	Institutional Venture Partners
Savinay Berry	Granite Ventures
Shomit Ghose	Onset Ventures
Stephen Harrick	Institutional Venture Partners
T. Chester Wang	Acorn Campus Ventures
Tim Wilson	Partech International
Tom Baruch	CMEA Capital
Tom Rogers	Advanced Technology Ventures
Venky Ganesan	Globespan Capital Partners
Victor Hwang	T2 Venture Capital
IDG Ventures	IDG Ventures
Skyline Ventures	Skyline Ventures
Anonymous	Anonymous

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