Silicon Valley Venture Capitalist Confidence Index®

(Bloomberg ticker symbol: SVVCCI)

Second Quarter – 2013

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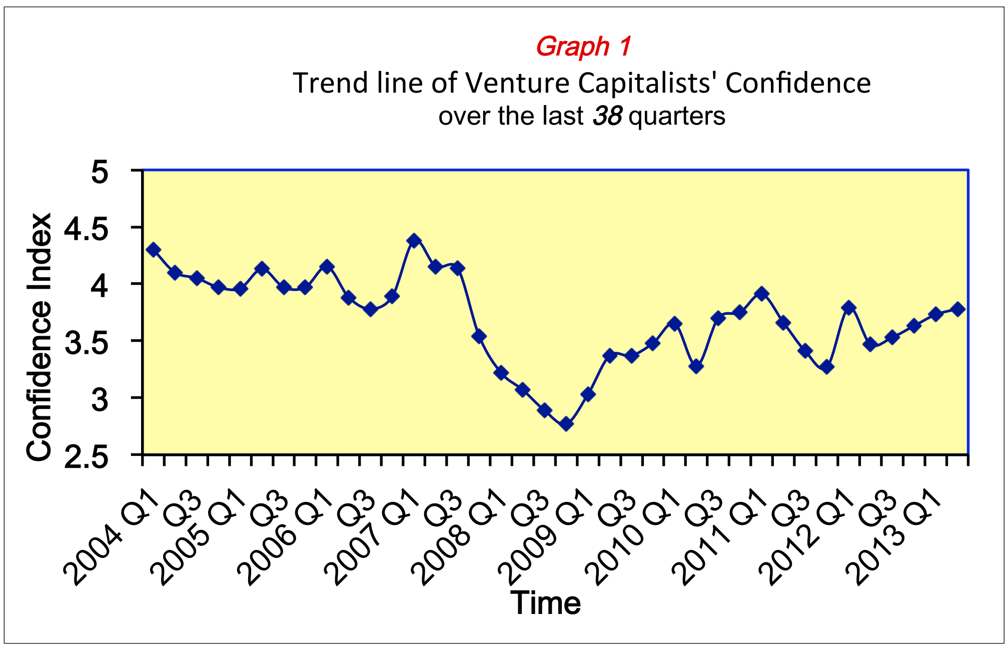
The quarterly *Silicon Valley Venture Capitalist Confidence Index® (Bloomberg ticker symbol: SVVCCI)* is based on an on-going survey of San Francisco Bay Area/Silicon Valley venture capitalists. The *Index* measures and reports the opinions of professional venture capitalists in their estimation of the 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 second quarter of 2013, based on a June 2013 survey of 29 San Francisco Bay Area venture capitalists, registered* ***3.78 on a 5 point scale*** (with 5 indicating high confidence and 1 indicating low confidence). This quarter's index rose slightly from the previous quarter's confidence reading of 3.73. Please see Graph 1 for trend data.



[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 entrepreneurial environment. Questions about this on-going research study or related topics should be addressed to its author at **Cannice@usfca.edu**.

An improving exit market and enthusiasm for opportunities in emerging technology sectors helped sustain optimism among venture capitalists in the second quarter. The Index of Silicon Valley Venture Capitalists' confidence in the future high-growth entrepreneurial environment in the San Francisco Bay Area edged higher in the second quarter of 2013. The slight increase in Q2 confidence made for four consecutive quarters of increasing sentiment among the responding venture capitalists to this quarterly survey and research report. In Q2 venture capitalists credited an improved IPO market along with high expectations for new venture opportunities in disruptive technology sectors (e.g. cloud, mobile, social, energy efficiency).

Additionally, the life sciences sector perked up somewhat with much improved exit performance in Q2. And declining uncertainty in the macro environment made business investment decisions easier and, thus, also supported confidence. Still, concern over a challenging funding environment with LP funding falling tempered the increase in confidence somewhat. In the following, I provide many of the comments of the participating venture capitalist respondents along with my analysis. Additionally, all of the Index respondents' names and firms are listed in Table 1, save those who provided their comments confidentially.

Optimism about opportunities in rapidly growing technology sectors and the venture capital process of supporting entrepreneurs in these areas appears strong. Venky Ganesan of Menlo Ventures stated that "We are in the midst of a long term bull trend for high growth venture backed companies. One of the fundamental drivers of returns in an asset class is the supply demand balance and right now the supply demand balance is very much in favor of investors. Cloud, mobile and social are fundamental, once in a generation trends, that will drive returns for a long long time." Similarly, Jeb Miller of Jafco Ventures sees "massive opportunity for startups to emerge as category leaders in the cloud, mobile and big data markets, with the Bay Area remaining the epicenter of activity." John Malloy of BlueRun Ventures concurred, noting that "Mobile and cloud continue to be disruption drivers." And Alain Harrus of Crosslink Capital indicated that "The software ecosystem continues to grow at breakneck speed."

Mark Platshon of Birchmere Ventures reported that "Entrepreneurial activity is very high in several categories where companies can be built efficiently and relatively quickly - like big data, the Internet of things, mobility services (Uber, Lyft), commerce (Glam, Hauz, Conscious Box), edtech (Bloomboard, Udacity), media (TVPlus, Umano), enterprise SAAS (Resumator), and payment innovations. And several cleantech/cleanweb sectors that appeared to be "out of favor" are actually very healthy and growing now that costs have decreased dramatically - Tesla, Solar City, First Solar, Mosaic, Makerbot, and View are a few examples. Meanwhile the availability of corporates, angels, and crowd sourced funding adds meaningfully to the supply of capital from traditional VC sources." And a venture capitalist respondent who provided comment in confidence confirmed "continued interest in everything related to Cloud infrastructure deployment, adoption of analytics in the enterprise, the changing face of retail, and location becoming more important in the mobile eco-system."

The macro environment appears to be improving, encouraging business investment in technologies developed by venture-backed firms. Jon Soberg of Blumberg Capital commented "I continue to see positive macro-economic trends, and the technology trends that are supporting new innovation are continuing to be extremely strong and positive." And Dag Syrrist of Vision Capital indicated that "More of the systemic risks to the economy seems to be fading (European debt crises, Cypress, QE3 [or 4] – what happened to all those?) such that there's a perception of slow but steady economic growth which bodes well for deploying capital." Bill Reichert of Garage Technology Ventures indicated that "…the macroeconomic environment feels healthy once again, and revenue growth is actually accelerating across our portfolio. We're no longer worried about falling off a cliff. Maybe that's naïve, or just temporary, but perception is everything when it comes to markets." With less macro uncertainty, new opportunities are being considered. For example, Bryant Tong of Nth Power shared “With the improving economy, we are seeing greater interest from our portfolio company's customers in trying new efficiency technology.”

Sandy Miller of Institutional Venture Partners expects that “The next 12 to 18 months should be good for liquidity in venture portfolios. The IPO market has picked up a bit. Most importantly, there is a surge of acquisition interest by the bigger tech companies in the successful private venture-backed tech companies. We are seeing more inquiries and unsolicited acquisition offers for our private companies than any time in some years. This should translate into a higher level of quality M&A exits.” John Malloy of BlueRun Ventures also emphasized the “strong performance of recent enterprise focused IPOs.” Bill Reichert of Garage Technology Ventures observed that “The liquidity environment has improved somewhat, although it's still distressingly lumpy.” In fact, the number venture-backed IPOs in Q2 nearly doubled from the year ago quarter and more than doubled the previous quarter’s IPOs.[2]

Igor Sill of Geneva Venture Management summarized these positive trends in terms of the data, explaining “Clearly, the venture industry is experiencing something of a major comeback. Numbers are clearly up, with estimates of $20.6 billion of venture capital raised in 2012, and $28.5 billion invested in some 3,700 venture deals according to the National Venture Capital Association (NVCA). Approximately 49% of all job creation in the U.S. since the year 2000 has come in the areas of early and expansion stage businesses with early stage investments experiencing a rise of 47% and expansion stage venture capital of $10 billion representing a 37% increase. We can all see the effects of a robust, recovering economy. Feels like 1998 without a bubble looming!” The new PWC NVCA MoneyTree Report of Thomson Reuters data indicate a meaningful increase in venture investment in Q2 in terms of total investment dollars and the number of deals over the previous quarter, but a decline on both measures from the year earlier quarter.

However, the funding and fund-raising aspects of the venture business model are lagging. Debra Guerin Beresini of invencor stated “We are headed for the summer doldrums. Although several VC-backed companies went public in the first half of the year, new venture fundings declined a bit. With this and the fact that most investors take vacation in July and August, the market should be slow over the summer. This is to be expected, though, and does not erode my confidence of the market gaining speed in the Fall.” And Bob Bozeman of EastLake Ventures reported “good quality in opportunities seen (generally less fluff) offset against slowness in fundings for new enterprises (an alarming 4 percent of total investment capital).” Meanwhile, Dag Syrrist of Vision Capital reasoned that “the inexplicable enthusiasm for gadget and app investments is concerning in that the valuations and froth seen there are likely to make it hard for new companies who actually seek to build or develop something of value past Thanksgiving will find it hard to raise capital...”

A venture capitalist respondent who requested anonymity expressed low confidence “based on the difficulty VCs are having raising capital at this time, which will reduce VC-funded start-up activity over the next few years. VC returns will improve over the next 3-5 years, which will attract capital back to the sector over the longer term, but the next few years could be difficult.” Substantiating this view, Thomson Reuters and the NVCA reported that the total amount of capital raised in Q2 2013 was down about 1/3 from the previous quarter and down over half from the year earlier quarter.[3]

And uncertainty, macro and otherwise, is still present. Kurt Keilhacker of Techfund Capital suggested that the “global growth near term trajectory is still a great unknown. Uncertainity exists as to whether the U.S. is a modest growth anomaly or a leading indicator of global trends.” Another VC respondent also pointed to macro uncertainty. And Lisa Suennen of Psilos shared “Since I come from the healthcare sector

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[2] Thomson Reuters and NVCA press release dated July 1, 2013.
[3] Thomson Reuters and NVCA press release dated July 9, 2013.

it's a mixed bag. We probably have in front of us the single greatest opportunity to bring true systemic change through innovation to the healthcare system. It should be a fruitful time to profit from this innovation. Yet those who previously supported healthcare venture capital are negative on the sector because of perceived uncertainty. It is a shame because that uncertainty is exactly what opens the door for opportunity."[4]

While confidence edged up only slightly in Q2, a notable upward shift in sentiment was expressed by most of the responding venture capitalists based on an improving IPO market, enthusiasm for rapidly growing technology opportunities, and a less uncertain macro environment. In fact, Q2 marked the fourth consecutive increase in confidence in this quarterly survey. Confidence in core technology sectors such as enterprise software, mobility, and cloud, along with renewed interest in energy efficiency and emerging sectors (e.g. the Internet of things), provided a notable optimistic flare in the commentary for this quarter. Furthermore, an improved IPO environment in Q2 and expectations for its continuation suggest optimism will persist for the balance of the year.

Still, pressures on the overall venture capital business model continue with funding in some areas becoming more difficult to attain. However, an improved exit market will lead to improved performance for this asset class and, thus, should drive better fund-raising and investment trends in the medium term. This improved exit environment is, of course, predicated on a less uncertain macro economic and political environment. Thus, policy makers can support innovation, new venture creation, and economic growth by setting a more predictable path forward.[5] The recent trend in confidence provides some hope that this path is possible.

Table 1

Participating Venture Capitalists in the 2013 2nd Quarter Confidence Index Survey

Participant	**Company**
Alain Harrus	Crosslink Capital
Bill Byun	7 Capital
Bill Reichert	Garage Technology Ventures
Bob Bozeman	Eastlake Ventures
Bob Pavey	Morgenthaler Ventures
Bryant Tong	Nth Power
Dag Syrrist	Vision Capital
Dan Lankford	Wavepoint Ventures
Debra Guerin Beresini	invencor
Deepak Kamra	Canaan Partners
Igor M. Sill	Geneva Venture Management
Jeb Miller	Jafco Ventures
John Malloy	BlueRun Ventures
Jon Soberg	Blumberg Capital
Karan Mehandru	Trinity Ventures
Kurt Keilhacker	Techfund Capital
Lisa Suennen	Psilos

[4] Thomson Reuters and the National Venture Capital Association reported the highest number of biotechnology IPOs in Q2 2013 since Q3 2000 (press release dated July 1, 2013.)
[5] The recent MoneyTree Report Data (PWC, NVCA, Thomson Reuters) indicate that venture capital investment increased in Q2 over Q1; however, it declined slightly from the year earlier quarter.

Mark Platshon	Birchmere Ventures
Mudit Jain	Synergy Life Science Partners
Sandy Miller	Institutional Venture Partners
Shomit Ghose	Onset Ventures
Standish O'Grady	Granite Ventures
Steve Harrick	Institutional Venture Partners
Tom McKinley	Cardinal Partners
Venky Ganesan	Menlo Ventures
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous

Mark V. Cannice, Ph.D. is Department Chair and Professor of Entrepreneurship and Innovation with the University of San Francisco School of Management. The author wishes to thank the participating venture capitalists who generously provided their expert commentary. Thanks also to the attorneys of Greenberg Traurig for their on-going support of this research, as well as to Jack Cannice for his copy-edit assistance. When citing the index, please refer to it as: *The Silicon Valley Venture Capitalist Confidence Index*®, and include the associated Quarter/Year, as well as the name and title of the author.