



Web IPO Boom Splits VC Haves From Have-Nots

By Ari Levy - Jun 14, 2011

LinkedIn Corp. and Groupon Inc. are leading a surge in Web-company initial share sales that underscores a deepening chasm between the venture-capital industry's haves and have-nots.

Sequoia Capital, Greylock Partners, Accel Partners and Andreessen Horowitz are among the few firms that own stakes in the most valuable startups, giving them access to promising entrepreneurs and plenty of money for new funds. The majority of the industry, meanwhile, is struggling to raise capital.

LinkedIn's IPO has produced more than \$2 billion in paper profits for backers, including Sequoia and Greylock, while Groupon's two top outside investors, New Enterprise Associates and Accel, may own a \$5 billion stake when the daily-deal site goes public. Funds not in those companies or their highly valued peers are being shut out in the hunt for new Internet deals, meaning fewer firms are poised to reap the expected returns.

"The rich are getting richer, and they're finding the better products and better companies at better valuations," said David Schwartz, co-chair of the emerging companies and venture-capital practice at law firm Michelman & Robinson LLP in New York. "It's making it very complicated for second-tier funds."

Success in venture capital opens the door to better deals because entrepreneurs seek out connections to a firm's existing portfolio companies, and view the partners as having a better understanding of emerging trends.

Venture Capital Swings

The venture industry has been shrinking in the past decade. The dot-com bust and global financial crisis put scores of startups out of business, and made it harder for the survivors to go public. Venture firms raised \$12.5 billion for funds in 2010, down 52 percent from 2008 and the lowest in seven years, according to the National Venture Capital Association.

The drought in IPOs helped push the number of active venture capital firms down by 47 percent in the first half of 2010, according to Ernst & Young LLP. In October, the accounting firm said the number of U.S. venture firms making at least one investment a quarter sank to 167 through June 2010, compared with 313 for all of 2009. The decline created a class of "walking dead"

firms -- those that are only working with their existing portfolio companies and don't have cash to make new investments, Ernst & Young said.

An IPO resurgence is bringing some money back. Fundraising jumped 76 percent in the first quarter from a year earlier to \$7.1 billion, NVCA said. At least 294 companies have announced plans for U.S. IPOs this year, more than in the same period for any other year since 2000, data compiled by Bloomberg show. Venture capitalists make money when companies they invest in go public or get acquired.

LinkedIn, Groupon, Pandora

LinkedIn became the first major U.S. social media company to sell shares to the public. The professional-networking site, which held its initial sale last month, is now valued at \$7.2 billion. Pandora Media Inc. is expected to price its shares later today and begin trading tomorrow. Groupon has also filed for an initial sale this year, and online game developer Zynga Inc. is expected to register for an IPO by the end of June.

Facebook Inc., the biggest social network, said it plans to start reporting financial results by April 2012, and is valued at \$52.8 billion on secondary exchange SharesPost Inc. Twitter Inc., which hasn't announced plans to go public, is valued at \$6.6 billion on the exchange.

Biggest Winners

A handful of venture-capital firms are likely to be the biggest winners in all of these deals.

Greylock was an early backer of LinkedIn, Facebook and Pandora and a later investor in Groupon, whose IPO may value the company at as much as \$25 billion, people familiar with the matter said in March. Accel has big stakes in Facebook and Groupon, and Union Square Ventures in New York was among the first investors in Twitter, Zynga and mobile-application developer Foursquare Labs Inc.

Andreessen Horowitz, started by Internet pioneer Marc Andreessen, owns shares in Facebook, Zynga, Groupon, Twitter and Foursquare.

"We've been attractive to entrepreneurs, repeat and first-time, because we're a firm that's made up of former entrepreneurs and operating executives," said Scott Weiss, who joined Andreessen Horowitz as a general partner in March and previously co-founded security company IronPort Systems Inc. "We're certainly seeing our fair share of great deals."

Bloomberg LP, the parent company of Bloomberg News, is an investor in Andreessen Horowitz.

Kleiner Perkins Caufield & Byers was late to social media, buying shares in Facebook, Groupon and Twitter in the past year at multibillion-dollar valuations. The exception was the firm's 2008 investment in Zynga.

Andreessen Horowitz

Menlo Park, California-based Andreessen Horowitz is the top firm based on probability of success in the next decade, according to Chris Farmer, a venture partner at General Catalyst Partners in Palo Alto, California. He has spent 15 years researching venture capital.

The rest of the top five are Sequoia, Accel, Benchmark Capital and Union Square, Farmer said, using a method he developed called InvestorRank that predicts success based on current investments and relationships.

Farmer estimates that two-thirds of the industry's returns over the next 10 years will come from 15 firms, down from 50 during and after the dot-com boom. He presented his analysis at the TechCrunch Disrupt Conference in New York last month.

“The strong have, if anything, increased their franchises, and a lot of the other ones have become pawns,” Farmer said in an interview. “There are countless firms that have raised a fraction of what they had a decade ago.”

Funds' Size

Draper Fisher Jurvetson, Menlo Ventures and Highland Capital Partners LLC have cut the size of their newest funds, while Greylock, Accel, Sequoia and Bessemer Venture Partners have reeled in at least \$1 billion each for theirs.

“Very large funds are good for leading very large rounds in late-stage companies that distanced themselves from competitors and are well on their way to stardom,” said Shawn Carolan, a managing director at Menlo Ventures. “Having the bandwidth to spend with great founders building great companies is where we can best deliver value to the entrepreneurial community and our investors. We're very proud of our results.”

Peter Bell, a general partner at Highland Capital, said the latest fund, at \$400 million, met the firm's goals.

“For what we're doing in terms of venture, that feels like a really good size,” he said. “Our returns continue to be very strong.”

Marta Bulaich, a representative of Draper Fisher Jurvetson, declined to comment.

Newcomers

Some of the money coming into venture capital is going to funds that weren't even around during the dot-com boom. Andreessen Horowitz was founded in 2009, and Fred Wilson opened Union Square in 2003. Twitter backer Mike Maples started his firm, now called Floodgate Fund LP, in 2006, and Foundry Group, the first venture investor in Zynga, opened in 2007.

These younger firms have stood out by catching trends in social networking, online games and mobile apps and getting in at the earliest stages, said Eric Ries, an entrepreneur and author of “The Lean Startup,” being published this year.

“They have a new prominence, especially in Web circles,” said Ries, who is based in San Francisco. Still, for firms like Sequoia and Kleiner Perkins, “the brand is so strong that entrepreneurs have faith that things will happen.”

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