

Silicon Valley Startup Economy Shifts into Higher Gear

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Just when it seemed America was emerging from the recession, Wall Street swooned again as January segued into February. But Silicon Valley's startup economy shifted into a higher gear.

Within a two-week period, a diverse group of startups raised a whopping \$600 million in investments, topped by \$350 million for Better Place, a Palo Alto company with a global vision for a 21st-century electric car battery-charging network. And Tesla Motors, widely seen as the poster child for the infant electric car industry, filed for an initial public stock offering.

So is Silicon Valley, after two sputtering years, finding its way to a new normal? And what will the valley's new normal look like anyway?

The portrait may have a lean, cautious look. Venture capital funding, hammered by recent financial turmoil, figures to remain relatively low for the next few years, according to current investment trends, venture industry surveys and interviews with several venture capitalists.

Venture investments nationwide rebounded modestly in the second half of 2009, according to the latest MoneyTree Report, which tracks the industry. But the yearly total of \$17.7 billion was a steep drop from \$28 billion in venture investments in 2008 and \$30.5 billion in 2009.

Although startup founders still find creative ways to grow their companies, the decline in venture dollars and consolidation within the venture industry create a greater challenge in raising early rounds of funding. An even larger share of total funding will go to more established startups that show strong revenues or a proven customer base.

Venture firms themselves face a similar squeeze. Some already have gone out of business and others appear headed in that direction. "There will be a difficult fundraising environment for all but the absolute rock stars of venture capital," said Nat Goldhaber of Claremont Creek Ventures, which has raised two funds since 2005.

Still, the valley's current roster of six IPO candidates, including makers of semiconductors and biocatalysts, is encouraging given the IPO drought of the past two years.

QuinStreet, an Internet marketing firm based in Foster City, earlier this month became the valley's first Wall Street debut of the year, raising \$140 million despite a lukewarm response from investors. QuinStreet followed November's debut of Sunnyvale Internet security company Fortinet. Cleantech investors have high hopes for the expected debuts of Tesla, the Palo Alto-based maker of high-performance electric cars, and Solyndra, a Fremont-based maker of thin-film solar panels.

Companies that file for IPOs often withdraw from the process. But waiting in the wings, venture capitalists say, are dozens of other valley companies considering such filings.

"We might have 10 IPO candidates in our portfolio," said Norm Fogelson of Institutional Venture Partners, a firm that specializes in late-stage investments. He declined to identify any, but IVP's portfolio includes hot Internet properties Twitter and social game maker Zynga.

Dixon Doll, founder of Doll Capital Management, said his "back of the envelope" estimate is that valley venture capitalists may have stakes in as many as 100 companies strong enough to consider IPOs. He said he is doubtful, however, that 2010 will come remotely close to the performance of 2007, when 86 venture-backed companies nationwide went public.

Still, the landscape looks much better than it did in July 2008, when Doll, then chairman of the National Venture Capital Association, warned of a "crisis in capital markets" amid a drought of new Wall Street offerings of venture-backed companies. Conditions grew much worse after Lehman Brothers went bankrupt and turmoil paralyzed the financial industry and triggered the subsequent government bailout.

Nationwide, there were only six venture-backed IPOs in 2008 and 13 in 2009. Of those 19, only three were Bay Area companies.

IPOs are coveted by the venture industry because they deliver the greatest potential return on investment for entrepreneurs, venture capitalists and their limited partner investors. A healthy IPO market also drives up prices for mergers and acquisitions, another important "exit" for venture capitalists. And greater return on the investment will eventually encourage pension funds, university endowments and other deep-pocket investors to put more money into venture funds.

A successful debut by Tesla, some observers say, could ignite the emerging cleantech sector in public markets much as Netscape's rocketing IPO in 1995 triggered the great Internet wave that carried such companies as Yahoo and eBay.

Claremont's Goldhaber predicted a modest "flurry" of IPOs this year. "Some conspicuous ones will give a warm and fuzzy feeling about cleantech. Tesla may be the poster child of that," he said.

Speculation also centers on Internet brands like Facebook and Twitter. But a better barometer of the valley's economy, according to Naren Gupta of Nexus Venture Partners, might be the IPO of

a more obscure company, such as Meru Networks, a Sunnyvale company that provides wireless networks for business applications.

"For every Facebook," he explained, "there are 50 Merus."

Although some see a contraction of the venture capital industry as a threat to the valley's startup culture, IVP's Fogelsong sees it as a positive development.

"Those of us who are varsity players are glad to see the venture industry getting back to a state of equilibrium," he said, adding that too much money had been chasing too few good ideas.

The new normal, many say, will likely include a steady revival of IPOs, but hardly a rush, and many more mergers and acquisitions. There are a lot of good deals available for tech giants such as Cisco Systems, Google, Microsoft, EMC, Oracle and HP, which have a history of growing through acquisition.

All of which helps explain why surveys of venture capitalists show that optimism is on the rise — and not only because the mood has been down so long.

Unemployment is at 11.5 percent in the valley. Yet in board rooms, "we're having lively discussions about what companies can do to keep good people and fight off the poaching," Doll said.

In his long experience, such talks are as sure a sign of recovery as the traffic delays he's encountered on Palo Alto's Page Mill Road.

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