

Dixon Doll on the venture capital math problem

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As part of The Deal's ongoing series exploring the challenges facing the venture capital industry, we spoke with Dixon Doll, former chairman of the NVCA and co-founder of DCM, a VC firm with offices in Menlo Park, Calif., Beijing and Tokyo. (Links to the other stories in the series are below.)

Doll began his career as a venture capitalist in 1984. Among the investments he has led at DCM is in communications service provider Neutral Tandem Inc. (NASDAQ:NTDM), which went public in November of 2007, just before the IPO market shut down. (The first quarter of 2008 marked the first period in 30 years with no IPOs.) Neutral Tandem's stock price has since doubled, making it the most successful venture-backed IPO in three years.

We asked Doll to put the latest numbers from the NVCA in context. According to a report released Monday, VC fundraising continued its decline during the second quarter, with only 25 funds raising \$1.7 billion compared to the 49 funds that raised \$4.6 billion in the first three months of the year. The second-quarter data represents the smallest number of funds since the third quarter of 1996, when 21 firms raised money, and the lowest level of dollars since the first quarter of 2003, when \$938.1 million was raised.

"This is a continuation of a trend that started late last year when new commitments to venture, both in terms of aggregate dollars and new funds raising money, have been declining fairly significantly," says Doll, citing several factors underlying the trend, including declining returns for venture capital as an asset class, the lack of liquidity in an era of few initial public offerings and the toll the recession has taken on limited partners.

"There's a definite problem of liquidity with a lot of the LPs that have traditionally funded venture," Dixon says. "That has affected firms across the board that a given LP has been investing in. If they don't have the liquidity, it generally results in them shrinking down their aggregate set of funds, and that is showing up in spades in smaller absolute dollars."

The upshot is that LPs are scrutinizing VC firms very carefully now.

"The LPs that are continuing to make new commitments to venture capital are looking at the managers under a very intense focus," Doll says. "If they don't get a good feeling about a particular manager, if they don't think the manager is addressing globalization and other trends affecting the industry, they're reducing the number of firms and the number of dollars they'll invest."

Firms with solid reputations are bucking the trend, however, he says.

Firms that have closed funds recently include Trinity Ventures, with a \$300 million fund, and Charles River Ventures, with a \$320 million one.

"Some successful entrepreneurs certainly think it's a good time to make new bets and to start new firms," says Doll, referring to Netscape founder Marc Andreessen's new Andreessen Horowitz VC firm, which quickly closed a \$300 million fund. "There's a lot of great management talent out there, and there's time to do your homework and due diligence."

Doll says he is encouraged by the six venture-backed IPOs that have occurred this year and points out that the number is already higher than it was for all of last year.

"OpenTable, for example, is in the restaurant booking business," he says. "That's not necessarily the most exotic sector people have ever heard of, but they're doing a nice job with a nice business model that's recurring, and they're performing well in the after-market."

"But one data point that has not improved is the number of new filings with the SEC," points out Doll. "We can't expect to see the volume of IPO activity heat up significantly until the filings start to pick up."

When asked if he agrees with Union Square Ventures co-founder Fred Wilson and others that the venture capital asset class is shrinking, Doll says, "We are going through a period of contraction right now, but based on my years of experience in the industry, I don't expect this current trend to become a permanent phenomenon. Venture capital has grown with the U.S. economy, and I think it will continue to do so."

For an overview of the challenges facing venture capitalists, see *The Deal's* magazine piece, *Honey, I shrunk the VCs*. For a Q&A with Union Square Ventures' Fred Wilson on what he calls *The Venture Capital Math Problem*, [click here](#). For comments on how the current VC challenges are affecting capital-intensive startups, see our interview with David Hornik, a partner with August Capital Management LLC, which has raised the largest VC fund this year. For comments on how investing in digital media startups is like baseball's small-ball strategy, see our interview with Drew Lipsher, a partner at Greycroft Partners LLC, which is currently raising its second fund. For more on the new Andreessen Horowitz fund, [click here](#). - *Mary Kathleen Flynn*