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Venture-Capital Firms Draw a Rush of New Money

Endowments and pensions help raise $13 billion this year, the most since 2000

Peter Thiel, the Silicon Valley investor who co-founded PayPal, talks to students in Paris on Feb. 24, 2016. *PHOTO: REUTERS*

By **ROLFE WINKLER** March 29, 2016

Venture-capital firms are raising money at the highest rate in more than 15 years, even as the values of some once-hot startups have begun to cool. With the quarter nearly over, U.S. venture funds have collected about $13 billion, which would be the largest total since the dot-com boom in 2000, according to preliminary data from Dow Jones VentureSource. Many prestigious venture firms have raised new billion-dollar funds in recent weeks, including Accel Partners and Founders Fund. Other big-name firms like Kleiner Perkins Caufield & Byers and Andreessen Horowitz are also looking to raise funds in the coming months, according to people familiar with the matter. Andreessen Horowitz declined to comment. Kleiner didn't return a request for comment. The influx of capital comes as many venture firms have reined in investing in recent months and pushed back on rich valuations. The vote of confidence from limited partners—the endowments, pension funds and other institutions that back venture funds—could extend the life of some struggling startups but also prevent a shakeout that some say is necessary after valuations inflated to unsustainable levels in recent years.

Venture-backed private companies valued at $1 billion or more

Investors have stayed excited about venture capital because it offers higher growth in a low-return environment. The 10-year return by venture funds for the period ended Sept. 30 was 11% versus 6.8% for the S&P 500 index, according to investment adviser Cambridge Associates.

"From October to a couple weeks ago, there was a huge swell of funds coming through," said Mike Kelly, managing director at Hamilton Lane, a Philadelphia investment firm that has backed venture firms such as Accel and Spark Capital. Mr. Kelly says his firm has become more selective, looking for managers that have been through a downturn.

Venture-capital firms typically raise new funds every three to four years, collecting 2% to 3% annual management fees as they make investments in startups. The funds usually stay open for 10 years until they distribute profits to investors, keeping 20% to 30% of the gains.

In recent years venture firms have written bigger checks and encouraged companies to spend to battle for market supremacy. That left some venture firms short of cash, requiring them to raise money sooner than in years past to continue reaping fees and making new investments.

Some venture capitalists say the fundraising spike is timed to ensure that paper gains on startup investments still look attractive. Valuations are already shrinking for some startups with money-losing business models including food delivery company DoorDash Inc. and software firm Couchbase Inc., according to corporate documents. The lack of a single tech IPO so far this year shows that Silicon Valley's paper winners could fall further before investors can cash out through public listings.

"Better to get out in front of these trends," said Charles Moldow, general partner at venture firm Foundation Capital, which closed a $325 million fund in September to target earlier stage startups with valuations that haven't grown as frothy. He said firms are also looking to add reserves to take advantage of falling valuations.

The venture-capital market tends to lag behind a public-market downturn. The Nasdaq Composite Index is down about 9% since its high in July. Similarly, venture fundraising peaked in the fourth quarter of 2000 at $25 billion even though the dot-com bubble began bursting in March of that year.

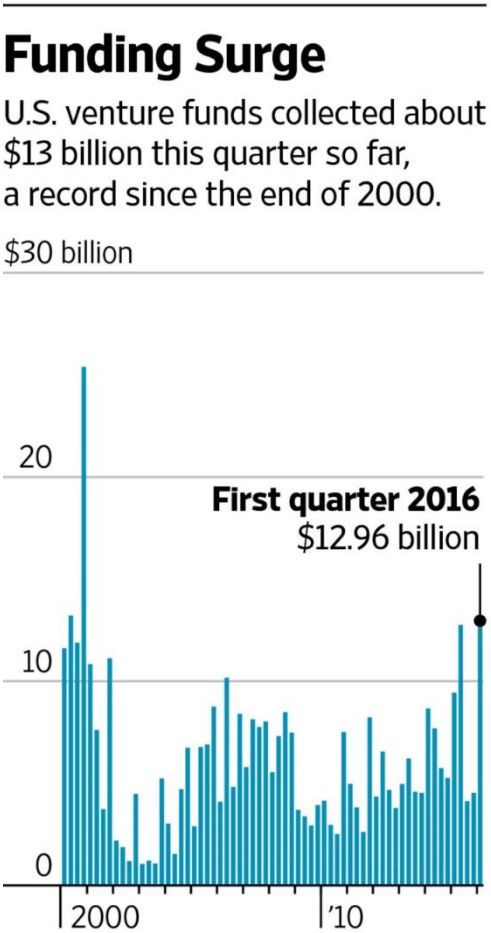
Limited partners say only a small group of venture firms can reel in the best entrepreneurs and therefore generate the lion's share of returns. So investors hand over cash when these top firms come calling, lest they lose access to future funds. So far in the first quarter, just 6.6% of firms have raised half of the venture-capital money, compared with a 16-year average of 11.6%, according to VentureSource.

Accel Partners this month collected $2 billion for three funds. That is a record amount for the Palo Alto, Calif., firm and the fastest it has raised money for its main funds since 2000. Accel was an early backer of Facebook Inc. and is an investor in at least 20 startups currently valued at $1 billion or more, according to VentureSource. Accel declined to comment.

Other firms are out raising money at a faster pace than in years past. Shasta Ventures is in the market for new capital after raising a $300 million fund two years ago, according to people familiar with the matter. The Menlo Park, Calif., firm's last two funds were raised after three and four-year intervals, respectively. A Shasta spokeswoman declined to comment.

As valuations have risen swiftly over the years, many performance reports for venture funds look great on paper.

Founders Fund, which last week said it raised a fresh $1.3 billion fund, is sitting on strong gains in the $227 million fund raised in 2007. Yet like other funds, it has struggled to turn paper profits into cash returns. The fund's net asset value climbed above $1.5 billion as of September, according to people familiar with the matter. An investment in rocket maker Space Exploration Technologies Inc. had risen by 16 times, while bets on music-streaming site Spotify Ltd., home-rental marketplace Airbnb Inc. and data-mining company Palantir Technologies Inc. were each up eight to nine times.



Note: As of March 29
Source: Dow Jones VentureSource
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All four companies remain private, so the gains are mostly unrealized. Some of the fund's investors say they have grown impatient that they aren't receiving bigger cash distributions. In December, Founders sold some of its Spotify stake in a private sale, according to people familiar with the matter, and it had previously cashed in other winning investments like Facebook Inc. A Founders Fund spokeswoman declined to comment.

Chris Douvos, managing director at Venture Investment Associates, which invests in venture firms, said the lack of IPOs and acquisitions of startups is leading to "capital constipation." Money is going out the door faster to startups than is coming back to limited partners, forcing some investors to make choices about which funds to back.

"We are feeling like a one-armed juggler," Mr. Douvos said. Smaller funds with limited track records could get squeezed out, he said.

Seed-stage venture firm SoftTech VC moved forward its plans to raise a fresh $145 million starting later this year to the first half in order to beat the crunch, according to people familiar with the matter. The Palo Alto, Calif., firm is in a better position than some newer early stage funds because it cashed in on at least one big winner when fitness tracking Company Fitbit Inc. went public last June.

Cash distributions are what matter at the end of the day, but big paper gains still make for good fundraising pitches.

"What better time to talk to institutional investors than when your numbers look awesome?" said Bryce Roberts, managing director of venture firm O'Reilly AlphaTech Ventures. "There's never been a moment when so many venture firms have pieces of highly valued companies with no liquidity. So the returns on paper look great. The question is, are these real businesses or not?"

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