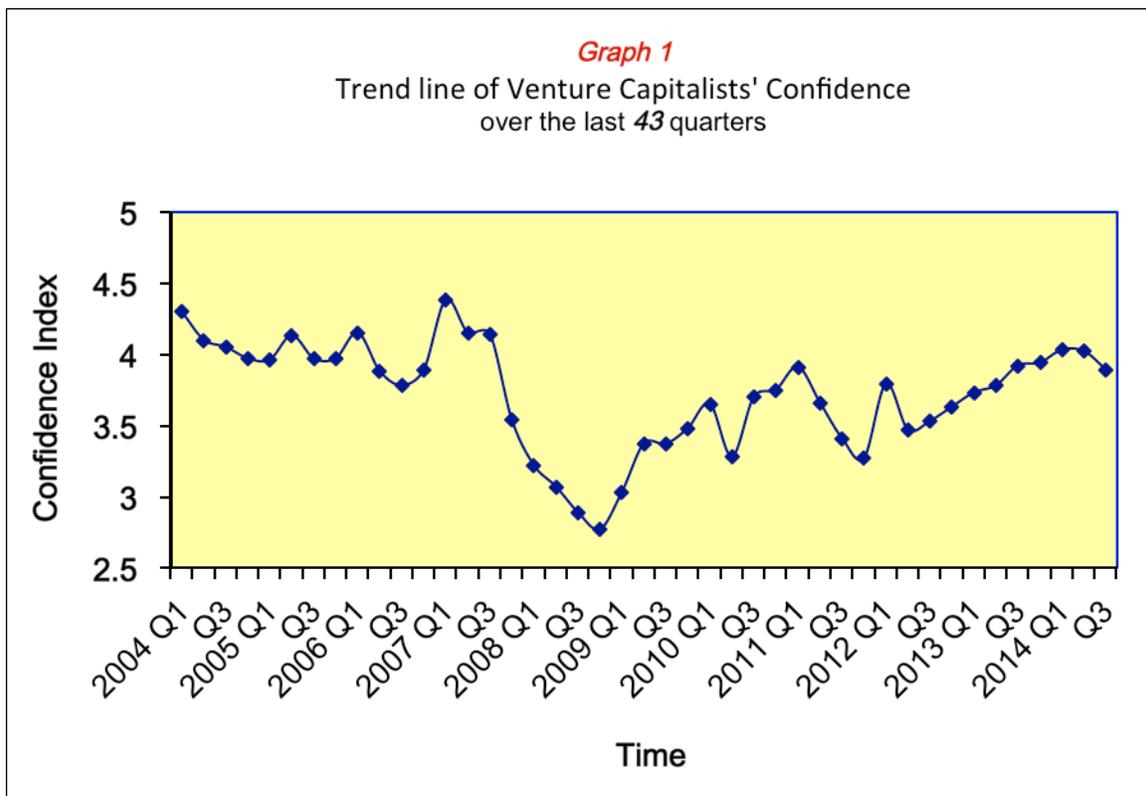


Silicon Valley Venture Capitalist Confidence Index® (Bloomberg ticker symbol: SVVCCI)

Third Quarter – 2014
(Release date: October 23, 2014)

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The *Silicon Valley Venture Capitalist Confidence Index®* (Bloomberg ticker symbol: *SVVCCI*) is based on a recurring quarterly survey of San Francisco Bay Area/Silicon Valley venture capitalists. The *Index* measures and reports the opinions of professional venture capitalists on their estimations 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 third quarter of 2014, based on a September 2014 survey of 33 San Francisco Bay Area venture capitalists, registered **3.89 on a 5 point scale** (with 5 indicating high confidence and 1 indicating low confidence). This quarter's index measurement fell from the previous quarter's index reading of 4.02. Please see Graph 1 for trend data.



¹Questions about this ongoing research study or related topics should be sent to Professor Mark Cannice at Cannice@usfca.edu.

Silicon Valley venture capitalists' confidence declined in the third quarter of 2014, marking the end of a 2-year upward trend. The lower Q3 index reading raises some concern for the near to medium term outlook for the high-growth venture environment. The decline in sentiment comes amid high but declining levels of venture-backed IPOs, fundraising, and investment in the third quarter. For example, Thomson Reuters and the National Venture Capital Association reported 23 venture-backed IPOs valued at \$2.6 billion in the third quarter of 2014, strong but declining levels from the previous and year-earlier quarters.² In fact, a number of responding VCs in this Q3 research report attributed their positive sentiment to the healthy investment and exit environment along with rising innovation. For example, Dixon Doll of DCM pointed to an “ample supply of capital at most stages of the VC spectrum, strong confidence in the health of the VC industry, especially in the U.S., Canada, and Israel, and a vibrant M&A market and strong IPO environment.”

However, caution was raised on valuations, an overheated market and related factors in the venture environment. Still, the overall level of confidence in the third quarter was relatively high historically (above the 10 year average of 3.72). But the break in the upward trend could indicate slowing momentum going forward as the VC confidence reading is future oriented. 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.

Innovation, both disruptive and incremental, continues to create opportunities in the entrepreneurial environment. For instance, Venky Ganesan of Menlo Ventures maintained that “The major trends driving entrepreneurial growth remain intact – mobile and social for consumers; cloud and big data for enterprises. The world we live in is being refashioned by these trends and we are in the 2nd inning of the game. There will be some short term perturbations and some of the excesses we see in certain sectors will get curtailed, but the long term secular trend remains intact.” Reinforcing this perspective, Mark Platshon of Birchmere Ventures stated “I am confident and optimistic because so many sectors are simultaneously undergoing disruptive innovation at scale. From enterprise to mobile, from ed-tech to fintech, from automotive to retail - even if one area takes a breather, another absorbs the venture money, and the talent to support growth and excitement. And this is happening at all stages: At the late stage and public end of the market, we see companies ranging from Mobileye's B2B business to GoPro's consumer business to Uber's services business demonstrating they can scale and create whole new ecosystems for many companies to build. At the earlier stages, we find increasing prices and competition for deals - with more angels, more corporates as well as new funds from established players.”

Delineating specific sectors of growth, John Malloy of BlueRun Ventures suggested “The Valley will continue to produce major innovations in Mobile Transformation, Cloud Computing, IoT, Digital Security and Crypto Currency over the next 18 months and beyond.” Furthermore, Bill Reichert of Garage Technology Ventures reported “We are seeing good diversification in target sectors and good depth of technology. Although there are still lots of startups focused on the next big social local mobile gamified app, that is no longer the overwhelming focus of the community. (Actually, it never really was, but it sure felt that way.)”

Determined entrepreneurs continue to provide the vision to make these innovations transformational. Shomit Ghose of Onset Ventures contended “The Silicon Valley start-up machine would give the Eveready Bunny a coronary. We continue to see a spate of really innovative business models being driven by really good entrepreneurs.” Mohanjit Jolly of DFJ emphasized the “Sheer quality of deals, the size of their vision, with a focus on fundamental business models, is giving me confidence in the new crop of entrepreneurs, driven by the confluence of significant tech trends.” Furthermore, Jeb

² Thomson Reuters and NVCA press release dated October 1, 2014.

Miller of Jafco Ventures concluded “With over 10,000 startups in San Francisco alone, the Bay Area continues to attract the highest quality entrepreneurs to launch disruptive companies in the cloud, mobile and big data ecosystems. Capital is abundant and the IPO and M&A exit markets remain robust, continuing to fuel the ecosystem.” And a VC respondent who requested anonymity shared his optimism noting “strong interest from individuals to start companies;” he continued, saying “This is partly driven by the valuations of companies they are tracking and the plethora of funding sources, especially from individual investors who as a syndicate are not shying away from seed-rounds that are \$2M-\$3M in size.” To this point, the National Venture Capital Association and PWC reported an overall high but declining level of VC investment activity.³

The exit environment has continued to provide the impetus for the venture business model. Sandy Miller of Institutional Venture Partners predicted “The outlook for exits this year looks very strong. With the Alibaba IPO both highly successful and, even more importantly, now out of the way, the deck has cleared for a number of new IPOs. I think we will see strong reception and a good environment for IPOs the remainder of the year into early next year. This tends to help bolster the whole venture ecosystem.”

Similarly, Igor Sill of Geneva Venture Management explained “With Alibaba’s massive NYSE IPO behind us, the public markets for tech IPOs take us into new bullish heights. There are now 14 new companies set to go public. Alibaba’s IPO added significant momentum to the public market’s receptivity for venture-backed tech IPOs, making venture investments more valuable. We’ve seen 195 IPOs thus far this year, raising \$62.4 billion in proceeds. That’s up 39% from the same period last year. The prospects are looking up indeed.” Additionally, Paul Holland of Foundation Capital shared “For the moment, exit environments remain positive and the pipeline of exiting companies also remains strong so I expect the short term environment to be positive; however, valuations of earlier stage projects have surpassed 2007 levels and the 2014 vintage of new investments may be negatively affected by these valuations by the time they exit in 3-8 years.” Another VC respondent asserted “Stock market and large company (e.g. Google, Apple, Facebook) acquisition sprees are driving venture capital. Unlike the bubble timeframe, cash in tech companies bank will provide a flow for robust returns.” And another VC respondent also pointed to “successful IPOs and M&As” for his positive outlook.

While confidence in the Valley’s entrepreneurs, innovation engine, and exit roadmap remained strong, some VC respondents raised caution related to valuations and overall environment dynamics. Robert Ackerman of Allegis Capital wrote “While the engine of innovation is running at full speed, there is considerable risk of overheating, particularly in consumer sectors. The excess of capital available to these companies is inflating both valuations and their wage costs. The laws of gravity remain universal and, at some point, we can expect to see a reconciliation between hype and hope.” Jon Soberg of Expansive Ventures noted “The ‘bubble’ talk has grown louder, especially discussion about high valuations and burn rates. I expect VCs will be more conservative in the coming months and will fulfill the predictions of things slowing down. I still see great innovation and opportunities, and I expect that we will continue to see great companies being built and scaled, but possibly with a little lower valuations.”

Gerard van Hamel Platerink of Redmile Group added “There is a general and widely appreciated sense of frothiness in some parts of the market and many people are wondering how it will turn out.” And Debra Beresini of invencor observed “While valuations are growing, and because the M&A market is strong, gains on investments are also growing. We have been in this position in the past and have not managed it well. My concern is that as valuations continue to increase, the economy may pull back again. Investors should ‘charge’ forward, but do so farsightedly.”

Steve Harrick of Institutional Venture Partners also observed “high private valuations”, while two other

³ NVCA and PWC press release dated October 17, 2014.

VC respondents indicated “Valuations have been high for a long time. Money is largely made through timing,” and “bubble symptoms on the rise,” respectively.

Commenting on the macro environment, Kurt Keilhacker of Techfund Capital indicated “With market demand lagging in China and in most of Europe, many companies are finding it difficult to forecast 2015 international sales. As a result, many U.S. companies are forecasting modest growth with the headwinds of softening demand internationally and an appreciating U.S. Dollar.” Another VC respondent also raised concern over “macro market risks.”

Finally, Dag Syrrist of Vision Capital candidly penned “It's unclear to me how long VCs will subsidize experiments to see what else 24 year olds can do with their iPhone that has close to zero intrinsic value and does not solve even a perceived problem. At some point, and, I actually hope sooner rather than later, funding will flow to ideas and opportunities that have, at minimum, the appearance to address actual needs and opportunities. Easy money at high valuations works for a while and then it stops, and rather suddenly.” Coincidentally, Thomson Reuters and the NVCA reported a strong but declining level of fundraising in Q3.⁴

In summary, confidence declined in the third quarter of 2014, ending an upward trend in sentiment over the previous two years. Worries over inflated valuations and their eventual impact on the venture business model, along with concern on the macro environment, drove the decline in confidence. However, a still strong if moderating exit market for venture-backed businesses, healthy levels of investment and fundraising, rampant disruptive innovation, and the ever present belief in the determination of Silicon Valley entrepreneurs kept sentiment at a relatively high level. Recent public market volatility, though, may slow the exit environment in the near term, with a resulting drag on other aspects of the venture business model. Whether the deceleration in public and private markets acts as a moderating force against over exuberance or is a signal of a longer-term slowdown in the entrepreneurial and broader economic environment remains to be seen.

Table 1
Participating Venture Capitalists in the 2014 3rd Quarter Confidence Index Survey

Participant	Company
Bill Byun	7 Capital
Bill Reichert	Garage Technology Ventures
Dag Syrrist	Vision Capital
Dan Lankford	Wavepoint Ventures
Debra Beresini	invencor
Deepak Kamra	Canaan Partners
Dixon Doll	DCM
Gerard van Hamel Platerink	Redmile Group
Igor M. Sill	Geneva Venture Management
Jack Young	Qualcomm Ventures
Jeb Miller	Jafco Ventures
Jeremy Liew	Lightspeed Venture Partners
John Malloy	BlueRun Ventures

⁴ Thomson Reuters and NVCA press release dated October 9, 2014

Jon Soberg	Expansive Ventures
Karan Mehandru	Trinity Ventures
Kurt Keilhacker	Techfund Capital
Mark Platshon	Birchmere Ventures
Mohanjit Jolly	DFJ
Paul Holland	Foundation Capital
Robert R. Ackerman, Jr.	Allegis Capital
Sandy Miller	Institutional Venture Partners
Shomit Ghose	Onset Ventures
Standish O'Grady	Granite Ventures
Stephen J. Harrick	Institutional Venture Partners
Venky Ganesan	Menlo Ventures
IDG Ventures	IDG Ventures
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 Jack Cannice and James Cannice for their 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.

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