

**CAPITAL SOLUTIONS NEWSLETTER...**

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When times are tight, one's instinct is often to squirrel away opportunities -- new data shows that many venture firms are engaging a similar strategy. And while many venture-backed firms are still searching for the EXIT sign, consolidation and innovation in the secondary market may offer both entrepreneurs and investors new opportunities to cash out. Lastly, one VC offers a lucid argument to provide company founders partial liquidity well before any substantial investor exit, while another narrowly avoids a night in jail.

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**First, gather nuts...**

What is the first response to scarcity? *Hoard*. The mantra of every preschool playground holds true for venture investors (as it does for most everyone else). New data (summarized [here](#)) shows that initial company financings are increasingly undertaken by a single VC firm (rather than syndicated across several venture firms). This is consistent with other trends, particularly since the lack of viable exits has resulted in venture firms holding their ownership stakes longer, while their portfolio companies often require additional capital. An early stake is thus more likely to get crammed down.

A larger initial ownership percentage can mitigate this dilution. Interestingly, the data shows that once the initial investment is made, venture firms once again look to spread risk, consistently syndicating out later rounds. And, also unsurprisingly, capital-intensive industries were more likely to see deals syndicated, even in early rounds.

In fairness, the article notes that the percentage of single-firm financings in an initial round has been rising since 2003, so scarcity is likely one of several factors. However, the past 18 months are roughly 50% higher than the average for the first half of the decade. Among the other indications of a consolidating market is the increased proclivity of self-interest. As my five-year-old is often told (and also totally ignores), *sharing is caring*.

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**Sloppy Secondaries**

The demise of the IPO market has left many venture-backed companies in their own version of [existential purgatory](#). The scarcity of realized exits is particularly hard on company founders, who often regard their illiquid equity as more albatross than eagle. This lack of liquidity, in turn, leads to an environment where capital raising is increasingly difficult, as many venture firms are reluctant to make new investments when unable to navigate an exit for their existing portfolio companies.

Someone will almost always try to see if two great tastes might also taste great together; so the subsequent coupling of a firm providing liquidity with a firm providing capital was perhaps inevitable (see [article](#)). Sure enough, earlier this month, [SecondMarket](#) (which runs an online marketplace where investors and managers can sell shares of private companies) reached an agreement to acquire [InsideVenture](#) (which helps late-stage private companies find institutional

investors). Both firms have venture investors themselves (FirstMark and NEA, respectively). Last June, a company called [SharesPost](#) launched a similar service to sell private company shares. And according to Dow Jones, through June, there were 18 secondary funds that raised \$13.9 billion in capital - an annual category record set in the first six months of the year.

The emergence of a robust secondary market is, in my mind, one of the most important new developments to arise from the rubble of the fiscal crises. Without viable exits, private investment will stagnate. There is clearly a lot that needs to happen before secondaries become a recognized solution to the liquidity problems facing both investors and companies. But these may be the important first steps.

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## Founder Liquidity

And further on the topic of increased liquidity, the always-observant Mark Suster has a [terrific piece](#) on why company founders should be able to take some equity off the table once their firm has reached reasonable milestones. His point is simple, but often overlooked: the alignment between investors and founders breaks down at some midway point between investment and exit. Why? Entrepreneurs are concentrated; VC firms are diversified.

Company founders have steep liquidity cliffs: they generally only realize a significant payday in the event of a sale or IPO, yet they almost always take salaries at below market value to preserve their equity. In contrast, venture firms receive a 2% carry off their fund (for expenses, including salaries) and have a portfolio of investments that pay out at different times. These separate paths, once diverged, do not easily rejoin.

Critical here is that the founders receiving liquidity are still key to the company's success, and there must be considerable upside remaining in the company. This is also not "buy a plane" money -- but it might be "buy a house" money. After all, a recent Kaufman Foundation [study](#) found the average age of technology company founder is 39. Um, take that, Marc Zuckerberg.

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## Digestif

Lastly, in my first nod to venture celebrity gossip, read about the night Brad Feld [almost went to jail](#). And it wasn't even for his self-regretful investment in [Interliant](#).

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