

Credit crunch gives some VCs a lift

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Three months before Wall Street started gagging on its own cooking and Washington got hung up on a financial Heimlich maneuver, the chairman of the National Venture Capital Association declared there was a "crisis in capital markets."

Prophetic? Not really. As NVCA Chairman Dixon Doll made clear at a recent gathering, VCs were simply trying to call attention to the disappearing market for venture-backed initial public offerings. The VCs didn't foresee the convulsions to come -- bankruptcy of Lehman Brothers; the bailouts of AIG, Fannie Mae and Freddie Mac; the fire-sale mergers of Merrill Lynch, WaMu and Wachovia. And so on.

None of this, VCs agree, is a good thing. Then again, Wall Street's epic troubles have the Sand Hill Road crowd looking on the bright side. At least we traffic in investment capital, not loans, they explain, so the impact of the credit crunch is indirect. At least we deal in long-term investments, they add, so this too will pass.

One low-profile sector of the Silicon Valley economy figures to directly benefit from the crisis at hand: the secondary venture capital funds. These firms don't fund start-ups, but rather provide financial flexibility for the primary VCs and their limited partners (LPs), such as pension funds, university endowments and wealthy families and individuals. (Those LPs also fund the secondary venture firms.)

"It's good in the sense that the number of new opportunities we're looking at has ballooned," said Hans Swildens, principal and founder of Industry Ventures, which competes with Paul Capital, Pantheon Ventures and about 40 other secondary firms nationwide. "The bad news is that liquidity for the investments has stopped."

But the secondary venture firms figure they have time on their side -- and those deals will eventually pay off.

You might call secondary VCs bailout funds, although Swildens didn't phrase it that way. As credit markets tighten, and as "liquidity events" like IPOs and merger and acquisitions dry up, primary VCs and their portfolio companies often turn to the secondary venture funds to sell off positions to cash in on their original investments.

When founders and boards of private companies decide to hold off on an IPO or M&A, they strike a deal with secondary funds to "take some money off the table," as Swildens put it.

For the secondary firms, business has been growing since the collapse of Bear Stearns in the spring. "That was a good catalyst," said Swildens. "Every month for the last six months, the market's been growing."

The weak IPO and M&A market isn't the only reason such firms are doing well. Many venture funds were raised in the boom times of the late 1990s -- and with their 10-year contractual lifespan approaching, those funds need to find the so-called "exits" to return earnings to LPs.

Swildens said the real estate troubles are also showing up in the venture industry. In some cases, he said, wealthy individuals find themselves over-extended, with investments in real estate, stocks and a

position in a venture fund. Faced with a choice of abandoning their dream home or depressed stocks or their stake on Sand Hill Road, they decide to sell off the latter.

Without investing in a single start-up, Industry Ventures now has investments in 75 companies. And like other VCs, Swildens is finding solace in the long view.

"What we own and what we're buying, we're going to have to hold for a long time," he said. "There's no quick buck. It's a longer hold -- and there's more risk."