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Venture capitalists reflect a market where there's no more easy money

By *GARY HABER*
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Marc Olson is convinced he has a million-dollar product on his hands.

Olson's two-year-old company, Nayatek, has developed a computer software system to archive and retrieve e-mail.

At a time when corporations are sued regularly and may have to turn over thousands of e-mails as part of the discovery process, Olson's software allows them to sort through e-mail and attachments on their computers at the click of a button.

All he needs is some venture capitalist willing to make the seven-figure investment in his Newark-based computer software company to help him bring his product to the world.

The 43-year-old Glasgow native was one of about two dozen entrepreneurs pitching their companies to venture capitalists this week at the Early Stage East conference at Wilmington's Hotel du Pont.

It was the 11th annual session for the conference which brings together entrepreneurs looking for dollars and venture capitalists looking for the next Google.

Olson is a software industry veteran. Before starting his company he was a sales executive at McAfee and at Sybari Software, a company acquired by Microsoft.

But even for a veteran like Olson, it seems that venture capitalists have a tighter grasp on their checkbooks than they once did.

"It's difficult to get early stage money, very difficult," he said.

Olson says venture capital firms in the region seem less willing to take a chance on early stage companies, focusing their efforts on more mature businesses with a product already on the market and a proven revenue stream.

"I think a lot of them were burnt by the last bubble that burst," he said.

Venture capital funds, and the companies looking for funding, say there is money available for Delaware companies. But entrepreneurs say funding is harder to come by than in the past and they have to jump through more hoops to get it.

Gone are the days when venture capital firms threw "wild amounts of money" at companies before they even had any revenue, says Bill Freeborn, executive vice president of Information Assurance Corp. in Wilmington.

Freeborn, who was at Early Stage East looking to raise \$3 million, said venture capitalists are also more demanding in evaluating a company for funding. They're taking a tougher look at business strategies and revenue projections, among other things, he says.

"You have to be a lot smarter with your business plan," Freeborn says.

Tougher to cash out

Last year was a banner year for companies seeking venture capital, with investors pouring more than \$30.5 billion into 3,912 deals, according to the MoneyTree Report from PricewaterhouseCoopers and the National Venture Capital Association, based on data provided by Thomson Reuters.

That was the biggest year since 2000, the height of the dot.com era, when venture capitalists couldn't write checks fast enough for promising Internet companies.

Things started to turn in the first quarter of this year. During the period from January to March, \$7.4 billion was invested in 958 deals, about \$428 million and 87 fewer deals than in the previous three months.

The market was particularly tough on seed-stage and early stage companies, the two earliest periods in a company's lifespan. Investment in those companies fell by 17 percent, the MoneyTree Report said.

Experts say that one reason for the decline is that venture capital firms have had to hold on to their investments longer than they used to because of tighter credit markets.

Venture capital firms invest in promising companies in exchange for a stake and a voice in running the company. They don't want to hold on to their investment forever.

The home run they're looking for comes if the business is sold, or goes public, because then the venture capital firm can cash out and make a big return.

But these days, investment banks and commercial lenders are backing far fewer mergers or initial public stock offerings. That means venture capital funds must hold on to their stake in a company longer, leaving less money to fund other deals, said Mark Heesen, the National Venture Capital Association's president.

That doesn't mean funds aren't investing, Heesen said. They're just taking a longer view.

"The economy of today is not what they're looking at," he said. "They're looking at what the economy will be like five to seven years from now."

The hottest targets for venture capital firms these days are companies in biotechnology, medical devices, information technology and alternative energy, Heesen said.

Better-baked ideas

When it comes to Delaware's entrepreneurial community, it's hard to find a bigger cheerleader than David Freschman.

Freschman, the founder of Early Stage East and managing principal of Innovation Ventures L.P., a venture capital fund that has invested in many Delaware companies, says the state's entrepreneurial scene has "improved dramatically" in recent years.

"There's a lot of money on the sidelines waiting to be invested," Freschman said.

But even an optimist like Freschman admits that venture capital firms have become more demanding of late.

Companies seeking funding need to make sure their ideas are "much better-baked," he says.

Bruce Luehrs is a partner in Emerald Stage 2 Ventures, a Philadelphia-based venture capital fund that invests in later-stage companies.

Luehrs sounded an encouraging note at the Early Stage East conference, telling aspiring entrepreneurs, "Don't worry about the market conditions. There's always capital for exceptional companies."

The fund is plenty busy these days, but the size of its investments are smaller than what they used to be, he says.

"We're dishing out \$1 million at a clip, instead of \$2 million to \$4 million," Luehrs says.

Complicating things for startup Delaware companies is that fewer venture capital firms in the Pennsylvania-Delaware-New Jersey region are investing in early stage companies, Luehrs said.

To fill in the gap, state governments, including Delaware, have launched their own venture capital funds.

The Delaware Economic Development Office has three funds with a combined \$7.5 million in taxpayer dollars to invest in early-stage companies in Delaware, or those looking to move to Delaware.
