

Venture Capital's Growing Aspirations

VC funds are getting bigger and targeting more established companies. And some firms are placing their bets outside the U.S.

by [Aaron Ricadela](#)

Silicon Valley's archetype for drawing venture funding has long been two guys in a garage—from Hewlett-Packard ([HPQ](#)) founders Bill Hewlett and David Packard to the brains behind Google ([GOOG](#)), Larry Page and Sergey Brin. But judging from recent trends, that template may be subject to revision.

Some of the biggest venture capital firms are raising large funds, targeting more established companies, and increasingly setting their sights abroad. That's the finding of recent research by Dow Jones ([DJ](#)) VentureOne.

Bigger Funds Seek Fast Growth

Oak Investment Partners and New Enterprise Associates raised the two largest venture funds ever last year—at \$2.56 billion and \$2.5 billion, respectively, according to VentureOne. Overall, the percentage of funds that closed last year worth \$500 million to \$1 billion doubled from 2005, to 12.1%. And 4.4% of funds raised last year topped \$1 billion, up from just 1.6% the preceding year.

"These funds are just getting larger and larger, and the small funds are getting squeezed out," says Josh Grove, an analyst at VentureOne. "There is the thought that this is going to leave a vacuum for smaller funds that would traditionally fund early-stage companies." Consider the percentage of new funds under \$100 million: It dropped to 34% last year from 71% in 2002. The median fund size was \$200.5 million last year, compared with \$153 million in 2004.

The upshot? Some venture capitalists are starting to resemble private equity investors, looking for fast growth from their more established portfolio companies instead of doing the spade work of assembling a management team, evangelizing a product, and building a market—tasks often associated with nurturing the fledgling companies that VCs typically target. "Some funds have come out of the bubble and said, 'We're going to go even bigger,'" says Bryan Roberts, a managing general partner at Venrock Associates. "Their

business model has evolved to more growth equity than venture capital." The concern for some is that innovation will be undermined as investors shun risk in favor of surer bets.

Crowding Out Smaller Funds

The evolution is partly a response to the tepid market for initial public offerings and lower tech stock prices that hamper the ability to merge and acquire. It also reflects the boom in private equity investments, which reached a record \$660 billion last year. At a time when private equity firms are cleaning up, some VCs want a bit of the luster.

Rounding out the top five funds raised last year were Polaris Venture Partners, which closed a \$1 billion fund; VantagePoint Venture Partners, which closed one for \$1 billion; and Sequoia Capital, at \$861.5 million.

At the same time, other VCs have scaled back. Charles River Ventures' latest fund, closed in 2004, is worth \$250 million, down from \$450 million in 2001. North Bridge Venture Partners raised a \$500 million fund in 2005, but four years earlier cobbled one together worth \$825 million. And U.S. Venture Partners downsized to \$600 million for its last fund, raised in 2004, vs. one for \$1 billion in 2001.

Bigger funds also can mean larger investments. The sweet spot for stakes taken by firms with the largest funds is now between \$20 million and \$50 million, compared with the \$1 million to \$10 million investments VCs traditionally take in startups, says Venrock's Roberts.

Looking Abroad

None of this is to say seedling companies aren't luring cash. Investments in companies in VentureOne's "information services" category—laden with firms focused on the emerging user-generated Web—jumped 27% last year, to \$2.4 billion.

But picking winners among startups is harder than ever, and some firms are increasingly looking abroad. Even funds that target early-stage tech companies are looking far beyond the Valley for home runs. Draper Fisher Jurvetson manages a little more than \$4 billion, but it's spread across 19 funds and run out of 33 offices from Boston to Beijing. Regional managers can often spot opportunities more quickly than those in charge of "monolithic funds" based on Sand Hill Road, says Ravi Belani, an associate at DFJ.

Three of Draper's four home runs of the past two years—Baidu.com ([BIDU](#)), eBay's([EBAY](#)) Skype unit, and Focus Media Holding ([FMCN](#))—have come from outside the U.S. The fourth, Divx ([DIVX](#)), is based in San Diego. "Most of the amazing innovations we're seeing actually aren't in Silicon Valley," says Belani.

Squeezing the Middle

The hunt for more capital-intensive, later-stage investments and promising startups in the booming markets of India and China is causing fund managers to make tough choices. Venture funds between \$400 million and \$700 million are often too polyglot to compete with smaller, sector-focused funds, but not quite big enough to cover the plane-hopping and branch offices required to forage for opportunities in Asia. So the pension funds and university endowments that put up the money during fund-raising are looking at the ends of the spectrum, not the middle. "A limited partner looking at this might say, 'I already have an international fund, a life-science fund, and a mega-fund. What do you bring to the table to differentiate?,'" says Mark Heesen, president of the National Venture Capital Assn. "That fund that's trying to be all things to all people—it might be hard for them to respond to that."

Oak Investment Partners scored last June when Gmarket ([GMKT](#)), an online marketplace in Korea it had funded, went public. Gmarket is worth more than \$1 billion on the Nasdaq now; Oak sold a 10% stake in the company to Yahoo! ([YHOO](#)) a week before the IPO.

To be sure, investment in U.S. startups is still rising. Venture capital investments in U.S. companies rose 8%, to \$25.75 billion in 2006, according to Ernst & Young and VentureOne. Among the year's bigger Web deals, cell-phone service provider Amp'd Mobile raised \$150 million in April from investors that included Intel ([INTC](#)) and Qualcomm ([QCOM](#)). Spot Runner, an online ad agency that creates and places ads for small businesses and has former AOL executive Robert Pittman on its board, announced \$40 million in funding on Oct. 30 from CBS ([CBS](#)), Interpublic Group ([IPG](#)), and others.

Keith Rabois, vice-president for corporate and business development at social-networking site LinkedIn, which Jan. 29 closed a \$12.8 million round of funding, sees a winnowing on the horizon (see BusinessWeek.com, 1/29/07, "[LinkedIn Reaches Out](#)"). "In 2005 and 2006, even with mediocre A-round results, you could get a B round," he says. This year, "people are going to be very critical."

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