VENTURE FIRMS VS. INVESTORS

Yale and the Like Quietly Cite Pressure To Back Offbeat Funds

By REBECCA BUCKMAN
August 28, 2007; Page C1

Some top venture-capital firms eager to expand into new markets are twisting their investors' arms to get them to go along--or so say the investors.

Investors said big-name firms such as Sequoia Capital and North Bridge Venture Partners have been exerting not-so-subtle pressure on some of their limited partners, as these investors are called, to put money into unproven investment vehicles, including funds that invest in China, India and so-called later-stage U.S. companies.

OUR WAY OR THE ...

• The Situation: Investors in some venture-capital funds say they're being pressured to go along with racier investments.
• What's Behind It: The venture capitalists are trying to expand into investing in China, India and other newer markets. They need the big investors to go along.
• The Memo: Venture firm Sequoia told Yale University that it preferred investors that would give it a "blank check" to invest, according to a Yale memo. Sequoia says it doesn't pressure its investors.

These investors -- including big university endowments, foundations and pension funds -- worry that if they don't comply they could damage their relations with the venture-capital firms and possibly lose out on the chance to get into more typical funds, which invest in small start-ups.

One limited partner feeling the heat is Yale University and its $18 billion endowment fund. Yale declined...
funds launched in the past few years by Sequoia, including a 2005 fund focused on Chinese companies. Sequoia later decided to "oust Yale from its partner group" because the university passed on the new funds, which targeted "later stage deals, China and Israel," according to a September 2006 internal Yale review of the endowment's private-equity portfolio.

Sequoia told Yale it preferred investors that would give the Menlo Park, Calif., venture-capital firm a "blank check" to invest as it saw fit, according to the 39-page Yale memo, parts of which were reviewed by The Wall Street Journal. A Yale spokesman declined to comment.

Sequoia partner Doug Leone declined to comment on the Yale situation, citing privacy agreements with the firm's investors. He said Sequoia doesn't pressure its investors and has "multiple" investors who have declined to put money into the firm's many overseas funds "without repercussions of any kind.... We encourage our limited partners to invest only in the funds they believe in."

Some Sequoia investors said they felt no pressure to invest in the firm's overseas funds. One Sequoia investor, the Massachusetts Institute of Technology, provided a statement at Sequoia's request saying the university has "on more than one occasion declined to invest in name brand venture capital firms' affiliated products that did not match our portfolio requirements," and "we continue to maintain excellent relationships with those firms."

The discord offers a look inside the culture of the venture-capital world, highlighting the increasing power of top firms. With median industry returns lackluster lately, spots in venture funds that are performing well are prized than ever -- and new spots seldom open up, except when firms launch new investment vehicles.

So, even large investors like universities and foundations generally are loath to publicly criticize the firms they're getting kicked out of their funds. Many investors also pony up for new types of funds because they don't have a choice of not investing -- even though some venture firms tell them they won't be punished for passing. Some investors are skeptical about the ability of even the best-performing firms to succeed in such areas as investing overseas and in larger companies at home.

In some cases, investors "have really felt like there's been a gun held to their heads," says Josh Lerner, a Harvard Business School professor who has studied the venture-capital industry. Some venture-capital firms tell investors they can continue to be able to invest in the mother ship, you've got to play ball and invest" in the secondary funds.

Apart from Sequoia, investors said North Bridge pressured some existing investors to put money into a roughly $500 million the Waltham, Mass., firm raised last year. At least one institution said it was told that how much it put into the growth fund would help determine how much the institution could invest in a coming early-stage fund. The other criterion was how much money it had invested in North Bridge's previous early-stage fund, these investors said.

North Bridge declined to comment. Three investors with the firm who were asked by North Bridge to comment on the issue...
said they weren't pressured to put money into the growth fund.

Some investors said they don't mind any subtle arm-twisting over secondary funds because they are happy to put money into any product offered by such top-ranked firms as Sequoia and North Bridge.

Many investors said they don't begrudge the best venture-capital firms using their increasing influence to expand into new markets. Sequoia, which has funds targeting China, India and Israel, said in June regulatory filings that it was raising two additional China funds of about $225 million and $450 million.

Kleiner Perkins Caufield & Byers, which famously backed such companies as Amazon.com Inc. and Google Inc., this year launched a $360 million China-focused fund this year and last year launched a $200 million fund focusing on companies making drugs or disease-detection products used in health pandemics. And Silicon Valley's Accel Partners this summer teamed up with IDG Ventures to launch a $510 million fund focusing on China, two years after the firms raised their joint China fund.

"All the first-tier funds are sort of rolling into this new model of multisector venture funds, which is a way of having your finger in a lot of pies," said Paul Kedrosky, executive director of the William J. von Liebig Center for Entrepreneurism and Technology Advancement at the University of California at San Diego. It also means funds can collect more fees from investors, because fees generally are based on assets under management. Most venture-capital firms expanding overseas said they are simply responding to increasing globalization in the industries in which they invest.

Still, limited partners who don't want to go along worry they may get cut out of future funds if they don't invest in the new offerings. Sometimes the pressure is subtle, with firms saying that declining to participate in new funds is "fine" but may "change the relationship" between the firm and the investor, according to one university endowment official.

What makes Yale's falling out with Sequoia so unusual is that big investors known for their long-term outlooks, such as Ivy League endowments and well-known charitable foundations, often have more clout and receive better treatment from venture firms.

"With our relationships, we're close enough with the [fund] managers that we're part of the dialogue when they're thinking about doing something with a new fund" and are rarely "approached after all is said and done," says Dan Feder, who helps manage the endowment at Princeton University in New Jersey. "But I understand that our experience is probably not typical."

Write to Rebecca Buckman at rebecca.buckman@wsj.com

URL for this article:
http://online.wsj.com/article/SB118826096094510425.html

Hyperlinks in this Article:
(1) mailto:rebecca.buckman@wsj.com

Copyright 2007 Dow Jones & Company, Inc. All Rights Reserved
This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.

RELATED ARTICLES AND BLOGS