

The Canarie is Dead

Something is Wrong in Venture Capital

-Q3 2008-

The Lofty Goals of Venture Capital

- Economic Development
 - “fund growing companies”
- Technology Development
 - “in innovative technology sectors”
- Shareholder Returns
 - “that generate significant shareholder returns”

These are all positive goals, but are they being achieved?

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Face the Gritty Reality of Operations

Theory

- Successful business people raise or join a VC firm
- Leverage regional and experience networks
- Fund top companies within their networks
- Support the companies with their experience

Flaw

- Successful business people often tire of the VC model
- The relevancy of networks diminishes over time
- Top companies often come from “outsiders”
- Relevant experience is highly situational

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In a Model of “One Hit Wonders”



Investing billions
over 20 years boils
down to getting one
hit?

“The story told by Bon French, CEO of Adams Street [a fund of funds], is that a full 5-points of the 20-points of return over that 20-year period is attributable to a single company exit within a single VC firm portfolio: Benchmark Capital's investment in eBay.”

SOURCE: Startup Conversations VC Blog, April 2008

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The Presentation Thesis

1. Venture Capital is Broken
2. True Innovation is Undercapitalized
3. The Inflection Point has Arrived
4. It's Time for Change

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1. Venture Capital is Broken

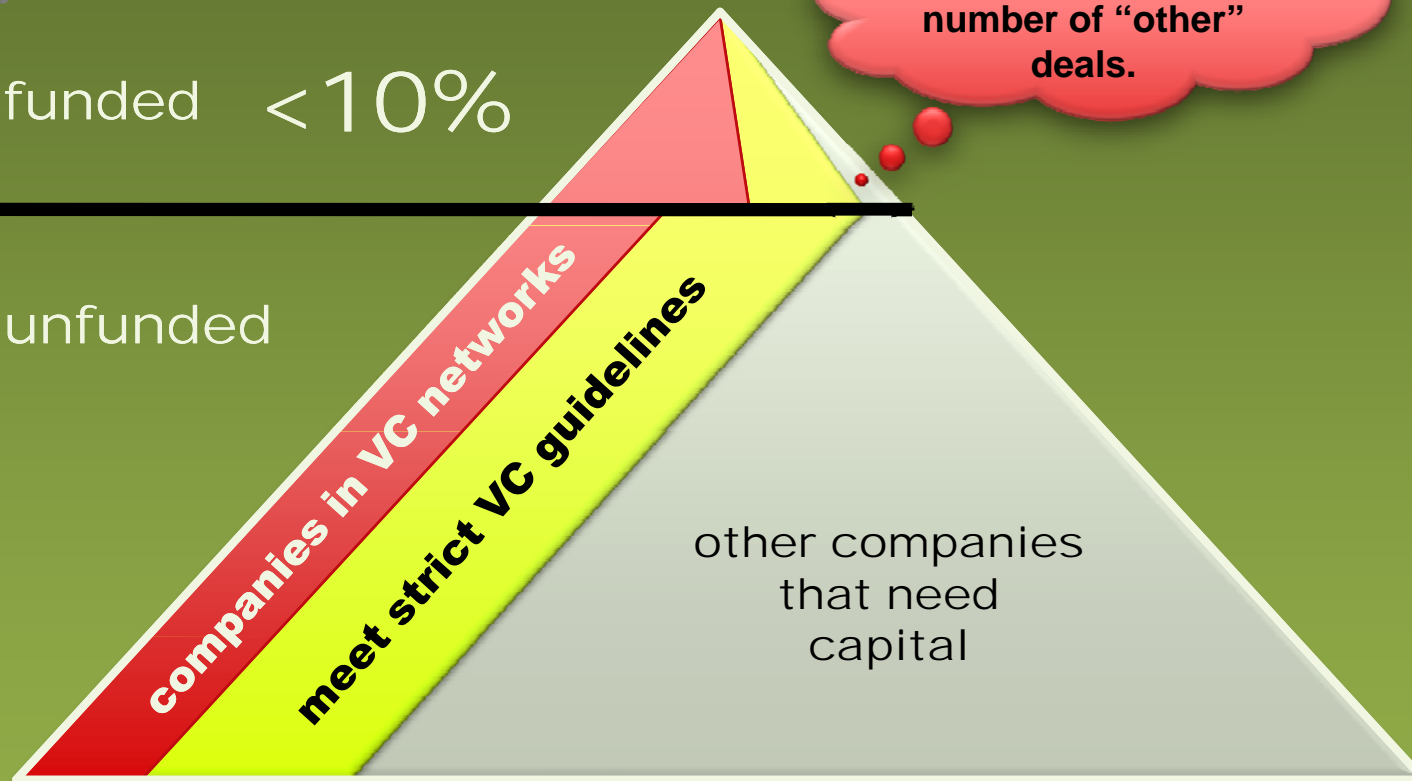
- Money does not flow where needed
 - <10% of companies that require capital get funded
- The fundraising process hurts momentum
 - Complicated, time consuming, distracting
- The VC industry does not generate returns
 - Just 13% of VC companies exit in recent NVCA data
 - Hundreds of VC firms have funds that return nothing

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Let's Fund our Friends

funded <10%

unfunded



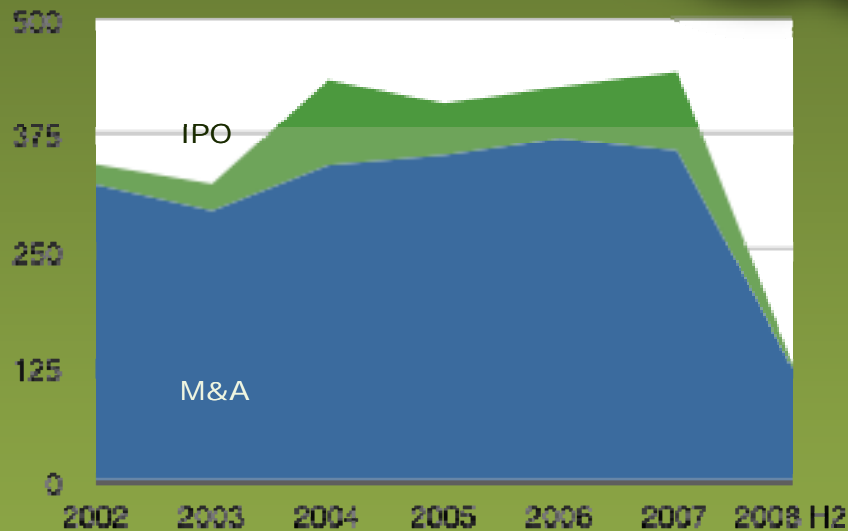
SOURCE: TheFunded.com Membership Applications

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So our Friends can save Us

Similar number of M&A deals, yet the prices skyrocketed.

VC Exit Events



VC Exit Values (\$ MM's est)

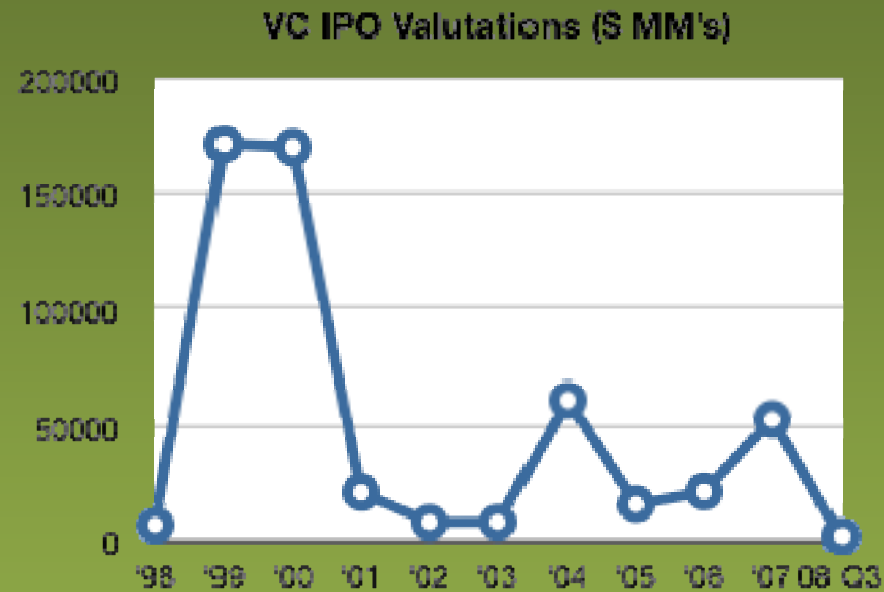


How many of these M&A buyers were also VC backed?
"Will you buy my other company, please... at a premium?"

SOURCE: NVCA / Thompson Reuters Exit Poll

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When the Going gets Tough...



2008 YTD IPO valuations are one third less than in 1998.

SOURCE: NVCA / PwC MoneyTree Reports

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2. True Innovation is Undercapitalized

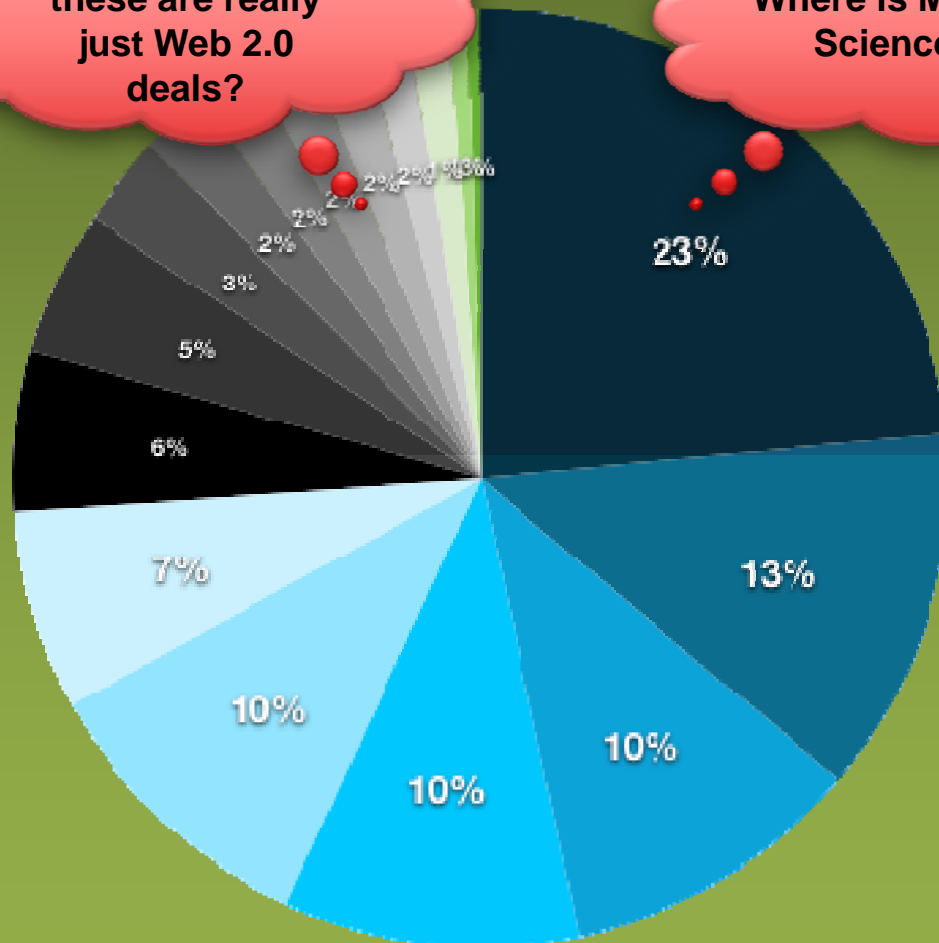
- VC investments are highly concentrated
 - 6 of 17 industries receive >73% of investment
 - “Me too” company investments are common
- Sectors are selected with inexperience
 - Example: \$ Billions invested into biofuels
- Investments have unrealistic expectations
 - > \$100 MM in annual revenue targets
 - Ignoring advances and “foundation technologies”

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Not a lot of Portfolio Diversity

How many of these are really just Web 2.0 deals?

Where is Material Sciences?



Q3 2008 Investment by Sector

1. Software
2. Biotechnology
3. Industrial/Energy
4. Medical Devices and Equipment
5. Media and Entertainment
6. IT Services
7. Semiconductors
8. Telecommunications
9. Business Products and Services
10. Networking and Equipment
11. Consumer Products and Services
12. Financial Services
13. Electronics/Instrumentation
14. Computers and Peripherals
15. Healthcare Services
16. Retailing/Distribution
17. Other

SOURCE: NVCA / PwC MoneyTree Reports

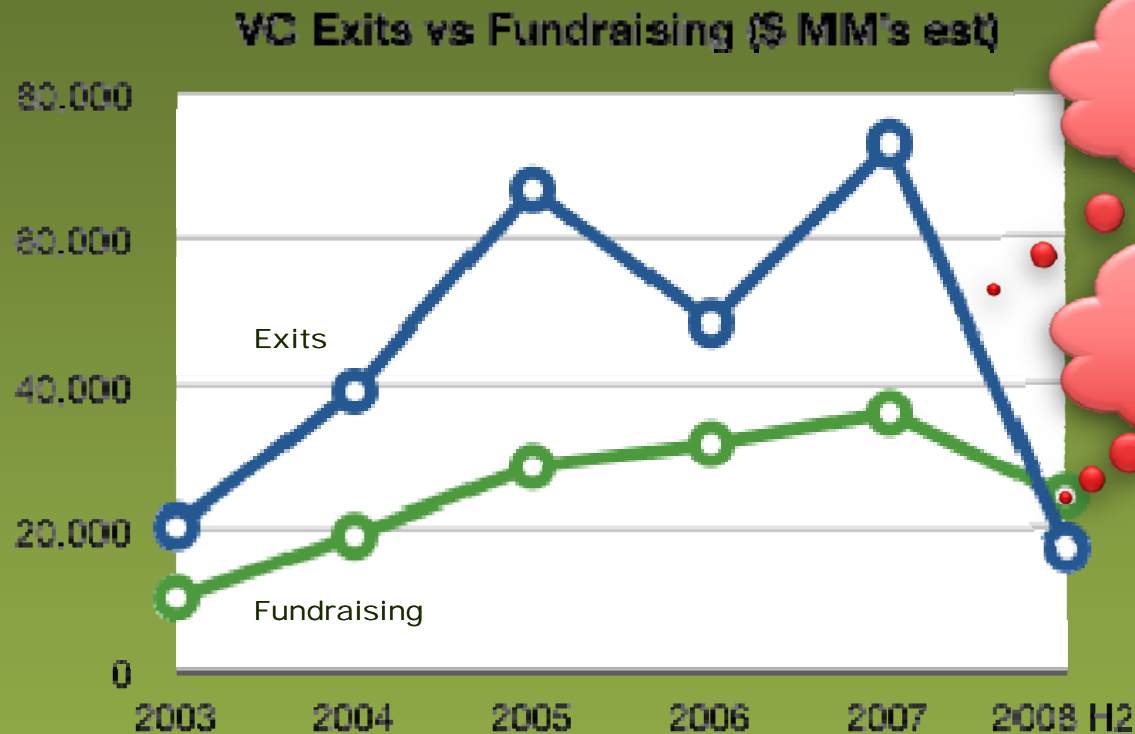
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3. The Inflection Point is Here

- Second downturn in eight years
 - Returns never recovered from peak highs
- The same VC firms are getting funded
 - < 50 new VC firms get funded per year
- The outlook for VC returns is worsening

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A Line has been Crossed



Blue is the total economic value created by VCs.

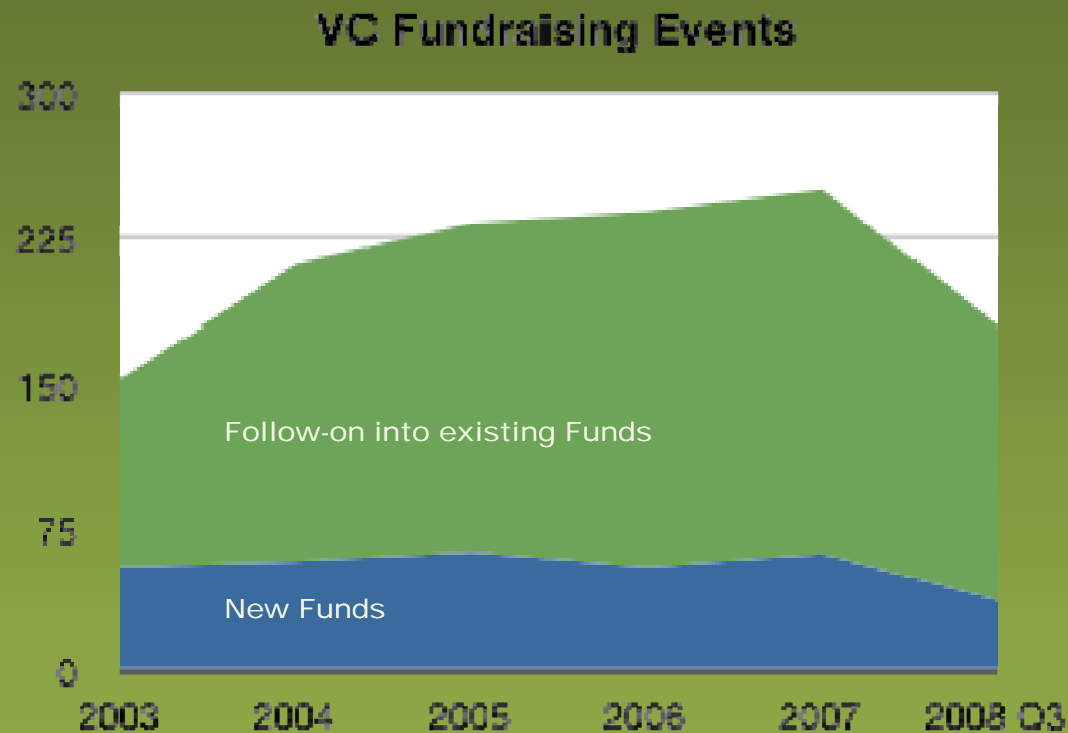
Green is the total amount of money raised by VCs.

Is more money going into the VC model than coming out?

SOURCE: NVCA / Thompson Reuters Exit Poll
SOURCE: NVCA / Thompson Reuters VC Fundraising Q3

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and Nothing Changed...



1 new VC firm is funded for every 4 existing firms funded.
How many "new" firms are started by existing VCs?

SOURCE: NVCA / Thompson Reuters VC Fundraising Q3

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4. It's Time for Change

- Less Funds + Better Funds
 - LPs scrutinize VC investments
 - LPs invest more money into better VC firms
 - *Target: 1,000 great VC firms versus >4,800 today*
- More Deals + Equal Treatment
 - Structured and published investment process
 - Stage-specific investors
 - *Target: Fund 25% of companies versus 10% today*

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in the Deal Terms, too...

- Simplified Terms + Standard Structures
 - Correlate ownership to exit values
 - Close the “Preferred Equity” tax loopholes
 - *Target: 1 Page Term Sheet*
 - *Target: Boilerplate Investment Agreements*
 - *Target: Closing costs below \$10,000*
(especially in the early stages)

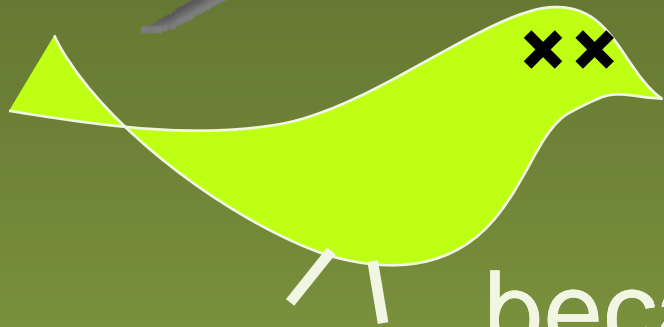
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and, while you're at it...

- Introduce Fund Governance + Oversight
 - VC Firm Board of Directors
 - Formal Performance Feedback Solicitation
- Restructure the Fund Incentives
 - Introduce “Contingent” Management fees

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Why change?



because VC firms
have little to lose,
and a lot to gain
by doing things better...

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