

## **RED HERRING**

### **Too much VC? An old hand says it's a good sign**

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Hardly a liability, the overhang is proof that the venture capital business has grown up, and is no longer a cottage industry.

The amount of uninvested capital committed to VC firms doesn't worry Bob Pavay, a general partner at Morgenthaler Ventures who entered the business in 1969. Mr. Pavay believes that the VC business has reached a new level of maturity.

About \$50 billion lies uninvested, says Mr. Pavay. But the industry currently invests roughly \$5 billion per quarter, meaning that the surplus funds only extend two and a half years.

The amount of money required for a startup to succeed these days explains the jump in the sums VCs invest, says Mr. Pavay. A typical startup now takes \$20 million, while it used to absorb just \$3 or \$4 million in the early 1980s.

Meanwhile, the number of companies receiving VC backing is now back to below 1,000 per year, after soaring to 3,000 during the bubble. With the number of companies funded back to a reasonable level, "the only difference is how much it takes for a company to make it," says Mr. Pavay. "I can't fund a communications IC company for a couple of million bucks," he says. Venture capital transitioned from a small cottage industry to a mature business at the end of the 1990s, he says. "Some guys long for the good old days of venture, when the industry was investing \$5 billion a year," says Mr. Pavay. But those days are long gone.

Mr. Pavay remembers previous leaps in funding. "The advantage of age is that you get to see things repeat themselves," says Mr. Pavay. Though the end of the 1990s are often perceived as an unparalleled anomaly, Mr. Pavay says there are plenty of similarities to what the VC industry experienced three decades ago.

The 1960s saw a tremendous bull market in tech stocks, and "everything we touched in 1969 doubled in value," says Mr. Pavay. "We thought we were geniuses." Then came a crash in 1970 – much like the tech sell-off in 2000. And somewhat akin to the terror attacks of 9/11, the oil embargo "gave us a double whammy, and it was miserable for five years."

The boom and bust cycle seems to be part of VC history, points out Mr. Pavay, but the industry rockets in magnitude through each phase.

Mr. Pavay says that while the amount of capital committed to VC funds may continue to grow, the number of VCs actually investing in successful businesses remains comparatively constant. Out of 8,000 VCs in the industry, "only 3,000 will do productive work in the next 12 months," he says. He expects idle VC partners to stick around longer than expected because "institutions have a lot of money to put to work," meaning that marginal VC firms will be able to raise funding.

Mr. Pavay concedes that a crowded industry with plenty of cash means that late-stage valuations can skyrocket. But he says that early-stage valuations remain stable. "Valuations are too high for later-stage deals because that is an easy place to put money if you don't know how to start companies," says Mr. Pavay. "Our firm isn't seeing crazy valuations."