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Subprime Fallout Could Help Venture Capitalists

By [MATT RICHTEL](#)

THE sky is falling. The sky is falling. The ground is rising.

Could the subprime problems that have fouled the public market be a mixed blessing for Silicon Valley's high-technology investors?

Highly out of favor in recent years, public offerings of technology start-ups are enjoying a mild resurgence. And some venture capitalists are arguing that the fragile momentum could be bolstered by the problems that mortgage-related securities have caused in the stock and credit markets.

The rationale is that technology investments, because they are far removed from credit-centric securities, could look relatively enticing.

"People are being scared away from other investment strategies," said Keith Benjamin, a partner at Levensohn Venture Partners, a San Francisco firm that focuses on technology investments.

"The credit crunch can help venture," he wrote on his blog. "One man's ceiling is another man's floor."

The logic is being echoed in Silicon Valley, albeit somewhat sheepishly given the self-interest involved and the fact that there is but one major data point. That point is the initial offering of [VMware](#), a company that makes software for servers. It went public on Aug. 14 at \$29, and its shares surged 76 percent. VMware shares closed yesterday at \$70.20, up \$3.35.

The sharp rise of VMware, while the markets have been so volatile, punctuates what appears to be the end of the technology drought for initial public offerings. In the second quarter, 26 venture-backed offerings raised \$4.3 billion, compared with 19 such companies raising \$2 billion in the period last year.

Venture capitalists now hope that the disfavor technology companies engendered during the dot-com collapse is being more quickly erased — or put into perspective — by the risks evident in the struggling hedge-fund investment strategy.

But, that said, venture capitalists said the subprime-spawned troubles could be a mixed blessing — given that those troubles could take a negative toll, though an indirect one, on the seeding and growing of high-tech companies.

On the downside, venture investors said, they could have a tougher time raising investment funds from big financial institutions and other limited partners. The concern among some venture investors is that those institutions have less money because of recent declines in the market and also that they are distracted by all the fallout.

In addition, limited partners tend to some extent to lump together venture firms and hedge funds as alternative investment options. That means that as hedge funds come under scrutiny, some venture firms may get less money, said Paul Kedrosky, a venture capitalist in San Diego and author of the blog Infectious Greed.

Another concern is that tighter credit, by making it harder to borrow debt, could sap the ability of some larger companies to pay for and acquire start-ups. While technology investors would rather take their investments public than have them acquired, a potential dip in the mergers sector could hurt one of venture capital's primary strategies for selling investments.

More indirect still could be the impact the credit crunch has on the ability of venture-backed technology companies to attract and retain talent. Yogen Dalal, a managing partner at Mayfield Fund, said his biggest concern was the inflated housing market in Silicon Valley.

The credit crunch “may not affect the engineers and others who are well paid, but it may affect the labor and service people who keep the machinery of the valley humming,” Mr. Dalal said, noting that the added new pressure could create an exodus of people who do essential jobs in the valley.

One venture capitalist who is experiencing the mixed blessing of the market shake-up is Sunil Dhaliwal, a partner with Battery Ventures, which is in Waltham, Mass., and Menlo Park, Calif.

On July 25, a company backed by Battery, Blade Logic, which makes software to automate data centers, went public. It was initially priced at \$17, rose to \$27, and has settled in around \$25 — a healthy run that Mr. Dhaliwal said reflected in part the renewed embrace of technology investments.

But the broader market dip has brought challenges for a different company that Battery has supported.

That company, which operates landline telephone businesses but which Mr. Dhaliwal declined to name, needs \$50 million to \$100 million to make acquisitions. The trouble is that banks are not in a lending mood, and so Battery and the other backers are dipping into their own coffers to finance the acquisitions.

“I’m having to put more equity at risk,” Mr. Dhaliwal said. “With a normal debt market, that’s one more risk I wouldn’t have to take.”

But Mr. Benjamin, the venture capitalist with Levensohn, and a former technology industry analyst with Robertson Stephens, is bullish about the overall impact on the venture business of that latest market dynamics.

He said he was hearing from investment bankers who focus on the technology sector that they were finding themselves not just coming back into favor, but freed of comparison to and pressure from hedge funds, which have held sway in the market in recent years.

“When the credit crunch happened, it almost immediately led to a better mood for tech bankers,” Mr. Benjamin argued. He added that the latest events will create critical momentum for the investors tempted to return to technology start-ups. “The credit crunch pushes these people over the edge.”