

As Cash Stops Flowing, Venture Capitalists Get Creative

By [PUI-WING TAM](#)

As venture-capital funds face a cash crunch driven by the financial downturn, they are taking extreme measures to ensure they can fund their investments.

Some venture capitalists are selling their equity stakes in start-up companies at fire-sale valuations so they don't have to keep funding those businesses, allowing them to husband their remaining cash for other investments.



Terry Opendyk

Others are considering so-called annex funds, which are side funds that can provide an extra pool of money. And some are scaling back on new investments to increase the cash reserves in their funds.

"It's all about cash flow right now," says Terry Opendyk, a general partner at venture-capital firm Onset Ventures in Menlo Park, Calif. "If you don't have cash, companies die and we can't resurrect them for our investors."

Venture capitalists typically raise money from institutional investors to form a 10-year fund, using it to invest in private companies with the hopes of profiting later when the start-ups go public or are sold. The funds collect the capital their investors have promised over time, providing a steady stream of cash to nurture start-up companies.

In normal times, the funds can stop spending on the start-up when it has an initial public offering or is sold, allowing them to put remaining cash toward other investments.

Now, few venture capitalists can sell their companies or take them public amid frozen deal markets. Many older venture funds that have collected most of their capital now have to continue spending on multiple companies, spreading their cash thin.

Funds that haven't gathered all their capital also face cash difficulties, since some cash-strapped institutions are reluctant to honor their commitments. It is also difficult for venture investors to borrow money, as many banks are currently disinclined to lend.

At Onset Ventures, Mr. Opdendyk says his firm's \$280 million fund raised in 2000 has collected most of its commitments from institutional investors and doesn't have much cash left. At the same time, the fund has to keep spending to nurture numerous companies because there have been so few IPOs and sales. "We're squeezing every dime" and may consider selling some company stakes, he says.

Onset's \$200 million venture fund that was raised in 2005 and a new fund raised this year are in better shape because they haven't invested all their capital and still have money in hand. Mr. Opdendyk says those funds are getting an offer a week from other cash-strapped venture investors who want to sell out of their companies at a discount, often "for 10 cents to 60 cents on the dollar." He says Onset is considering purchasing one or two such stakes.

Tom Crotty, a venture capitalist at Battery Ventures in Waltham, Mass., says the situation is reminiscent of the technology bust earlier this decade, when many venture funds faced a similar cash crunch. With few sales and IPOs at the time, venture investors were left spending money on too many companies. Ultimately, venture capitalists had to cut many start-ups loose.

This time, Mr. Crotty says, Battery is closely monitoring its \$850 million fund that was raised in 2000 and which already has collected on all the capital pledged by institutional investors. If Battery uses the fund's remaining cash too quickly, "we could end up having a shortage in the fund in mid- to late-2009," he says. To prevent a crunch, he says the firm is now pruning the fund's portfolio, a process that will leave more cash for the start-ups that make the cut.

For some venture investors, the cash crunch is an opportunity to buy into start-ups at a big discount. Bryan Roberts, a managing general partner at venture-capital firm Venrock in Palo Alto, Calif., says he recently purchased a stake in a health-care-related start-up for just 40 cents on the dollar, based on the company's last round of financing, from a cash-strapped investor he declined to name.

"The dislocations in the markets have created such losses and constraints in liquidity that investors lacking sufficient cash are being forced into uneconomic decisions to satisfy short-term problems," Mr. Roberts says.

Other venture investors are considering raising annex funds, which also happened during the tech bust. Bryon Sheets, a general partner in the San Francisco office of private-equity firm [Paul Capital](#), says several venture capitalists have recently approached him about providing capital to establish such funds.

The venture capitalists didn't set aside enough money to keep funding their start-ups and now need new capital to do follow-on financings for their companies, Mr. Sheets says. He adds that his firm hasn't yet decided whether to participate in any annex funds.

John Steuart, a venture capitalist at Claremont Creek Ventures in Oakland, Calif., says his firm is trying to avoid a cash crunch by increasing cash reserves for existing investments. In its \$130 million fund that was raised in 2005, Claremont Creek originally planned to invest in about 20 start-ups, meaning the firm would have about \$6 million to put into each company over time.

But, since the downturn hit, Mr. Steuart says Claremont Creek has decided to make just 16 to 17 investments, leaving more cash to put toward each company. "Our portfolio will be smaller and more concentrated," he says. "It's all about cash economics."

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