

Cash pours into startups, but investors are turning cautious

May 5 2015, by Paresh Dave, Los Angeles Times

Vadim Tarasov is getting pickier. The managing director of Silicon Valley venture capital firm Altpoint Ventures, Tarasov has begun rejecting startup deals he would have jumped on earlier. Prices are just too high.

"Everything has stepped up," he said. "You need to pick your battles much more carefully."

The total amount of cash pouring into startup companies continues to rise as later-stage startups remain popular with [investors](#). But smaller early stage startups are finding fewer investors ready to pay the high prices they're asking for company shares. If that trend continues, it could indicate that the current cycle of [venture capital funding](#) has hit a peak.

It's "way more tough to invest in good companies," Tarasov said.

Investors and startup founders dicker on deal terms, like any buyers and sellers who try to arrive at a price. Entrepreneurs want top dollar while surrendering as few shares as possible in their young companies; [venture capitalists](#) and other financiers, naturally, want a bigger slice at the lowest cost.

For several years, the startups held the upper hand. They still do. But investors are beginning to balk.

"Seed funding rounds used to be somewhere around \$500,000 and Series

A around \$3 million," Tarasov said, referring to the earliest stages of startup investing. But now "you are up to \$2 million seed and \$5 million to \$10 million A rounds."

Over the last two years, the estimated worth of early stage startups worldwide - practically speaking, the price to investors - doubled to \$16.3 million, according to deal tracking service PitchBook.

The number of investments has fallen for three straight quarters, with early-stage deals in particular taking a hit, according to data released this month by Dow Jones VentureSource. At the same time, just 61 venture capital funds raised investment money during the first quarter of 2015, the lowest number in about two years, according Thomson Reuters and the National Venture Capital Association.

Yet the money invested in startups continues to climb, reaching \$15.72 million in the first quarter, up 27 percent from a year earlier, Dow Jones data said. In part, that's because new investors have jumped into the market for "mature" startups, which are a few years old and producing revenues and even profits. They're attracting big money from private equity firms such as TPG Capital and Bain Capital that are in search of higher yield.

Mature startups are also attracting mutual funds, including Fidelity Investments and T. Rowe Price, who are new to making bets on private technology companies before their [initial public offerings](#). The funds are seeking an edge as retail investors spurn traditional mutual funds for low-fee exchange traded funds. Sovereign wealth funds from the Middle East and Asia are also jumping into startup finance.

In the first three months of 2015, only 64 percent of the capital flowing to startups came from venture capital firms - a lower proportion than the 80 percent or higher in preceding quarters, according to data from CB

Insights.

"The message is the private market has never been so generous," said Jeremy Abelson, founder of investment fund Irving Investors.

The current venture capital cycle was already building steam when Uber, the quasi-taxi ride-hailing phenomenon, received its first big venture-capital check for \$11 million in early 2011. Its stupendous growth since then made it a household word throughout the industrialized world. In each financing round, investors bid Uber's value higher. Uber's fundraising in December set its nominal valuation at more than \$40 billion, or higher than about 70 percent of the publicly traded companies in the Fortune 500.

Startups have also attracted notable investors - including pop stars such as singer Will.i.am, who backed restaurant reservation payment app Reserve in February, and boxer Floyd Mayweather, who's among early investors in image-sharing app Shots.

The wealth of investors has enabled startups to demand, and get, far more money than they'd ever dreamed.

Last month, even Tarasov's cautious Altpoint Ventures led a \$12 million investment into Honk Technologies Inc., a Santa Monica, Calif., [startup](#) that has developed a smartphone app for motorists to hail a tow truck. The funding amount was on par with previous deals completed by Altpoint, but the transaction valued Honk on the high end of what the firm would prefer, Tarasov said.

"We're not too sensitive as long as you're within range," he said. "A few other companies, though, we won't be making deals because we don't agree on the valuation. It doesn't make sense what they want."

The haul for Honk - remember, this is an Uber-like app for tow trucks - was set with an eye toward what Uber received in 2011, when raising that much capital would have been rare. PitchBook estimates Honk's latest funding pushed its valuation, including the new money, to \$62 million from \$9 million. Honk declined to comment.

With such high prices, the major worry for financiers is not that startups will implode as they did during the dot-com crash of 2000, but rather that they are being overvalued to the point that investors might not get the return they had expected.

"Some of these terms, when the market has a hiccup, could be painful for investors," said Byron Deeter of Bessemer Venture Partners. That's why he said he's pushing for "clean deals at fair valuations" rather than deals "at the highest valuations possible" that are pocked with conditions to protect certain shareholders.

Another problem: Smaller [venture capital firms](#), with thinner pocketbooks, are being priced out.

Deeter's firm is able to engage in strong-arming because its global network enables it to shift to earlier, lower-priced deals in the U.S. while continuing to focus on older companies abroad. Bessemer Venture Partners raised \$1.6 billion in the first quarter to invest in startups, more than any other [venture capital](#) firm.

"We can remain very active in all markets," Deeter said. "That's why larger funds are having more success fundraising."

Meanwhile, the "have-nots of the venture community are being whipsawed," said Dave Berkus, a prominent angel investor in Southern California.

Berkus said he now receives two to four calls a week from private equity firms looking to invest in the 10 companies for which he's a board member. Deals provide cash to company founders and angels such as Berkus, but they are also "negatively affecting smaller venture capitalists" and "reinforcing the bigger venture capitalists with more firepower," Berkus said. "It's totally topsy-turvy."

He's well aware of the concerns that investors will "correct" the hot market in the months to come by refusing to give in to high valuations. The public market is already showing a limited appetite: 44 of 165 initial public offerings in 2014 valued companies at less than their previous funding round, a 57 percent increase over 2013, according to Abelson's research with TriplePoint Ventures.

As Honk Chief Executive Corey Brundage searches for a larger office, he is seeing another sign that people are concerned about a potential correction: Landlords are trying to require longer lease terms to mitigate their risk should a downturn strike.

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Citation: Cash pours into startups, but investors are turning cautious (2015, May 5) retrieved 11 May 2024 from <https://phys.org/news/2015-05-cash-startups-investors-cautious.html>

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