More VCs passing on startups in favor of growing companies

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If you just launched a company from your apartment last week and are looking for some cash, don't go to knocking on a venture capitalist's door.

Venture capital is giving less money to startup companies and putting whopping sums into businesses with a solid customer base and steady revenue, according to venture capital data from the first quarter this year.

Companies that launched two to five years ago are raising $200 million and $300 million - sums that a few years ago would be unfathomable to put into an apartment sharing website or messaging app. But these days, analysts say, firms are investing to grow - not help start - companies that have the potential to be the next Facebook or Twitter.

"There is a lot of money being thrown into companies to scale," said Jeff Grabow, a venture capital expert at San Jose-based financial services Ernst & Young. "It's turning into a war, and you had better be well-funded and well-armed."

The latest MoneyTree Report, prepared by the National Venture Capital Association and professional services firm PricewaterhouseCoopers using data from Thomson Reuters, shows just nine seed-stage investments in the Bay Area for the first quarter of 2014, a 67 percent drop from the same quarter a year ago. Even at the height of the recession, firms were doing between 30 and 46 seed-stage deals a quarter.

Nationally, seed-stage funding dropped 24 percent to 41 deals in the first quarter.

Meanwhile, expansion-stage deals in the Bay Area were up 17 percent over the first quarter of 2014. Those investments made up more than a quarter of all deals in the Bay Area, and firms gave $2.3 billion to these growing companies - about half of the total $4.7 billion invested last quarter. Nationally, expansion deals were up about 15 percent, and companies in this category got the largest chunk of change - $3.9 billion, or 41 percent of total investments.

Experts say firms are directing large sums of money to companies that are less risky, and have the ability to expand and ultimately dominate a sector.

"I think that there is a lot more focus on trying to make existing companies that have weathered the storm viable through scale ... and that requires more money," said Glenn Luinenburg, a lawyer with firm WilmerHale who works with tech startups.

In 2012 there were 21 deals that were $100 million or more; in 2013 there were 28 such deals, according to a study from WilmerHale. Today, it's not uncommon for a firm to replace six $50 million investments with a single $300 million deal, experts say.

Meanwhile, the median size of seed investments has declined from $800,000 in 2012 to $500,000 in 2013.

The trend has caused some to worry that venture is playing favorites, and that promising startups aren't getting a fair chance.

"These very large venture funds are anointing winners to chill any competition," said Michael Greeley, a partner with Foundation Medical Partners.

Dropbox is the darling among cloud-based file storage programs for consumers, raising about $350 million last quarter; Pinterest is winning the discovery-based social networking sector, raising $425 million last year; and Uber and Lyft are leading ridesharing companies with about $361 million and $250 million, respectively.

"In the rideshare industry, there are now only two companies," Greeley said. "It's making it virtually impossible for anyone else (to compete)."

Experts say venture firms have moved away from early-stage companies for at least two reasons: It's cheaper than it was 10 or 20 years ago to start a company, and there are new funding sources better suited for startups that are just getting their legs beneath them. Today, an entrepreneur can start a Web company using Amazon's cloud computing software, borrow a desk in a shared office and distribute and market products through Facebook and Twitter.

And startups today have other financial resources - crowdfunding sites and angel investors have in part replaced the role of venture firms for seed funding.

But for growing companies, the pressure is on to raise a few hundred million dollars - or fall behind.

Said Grabow: "Everyone wants to be No. 1, or worst-case, No. 2."

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