The Silicon Valley Venture Capitalist Confidence Index® (Bloomberg ticker symbol: SVVCCI) is based on a recurring quarterly survey of San Francisco Bay Area/Silicon Valley venture capitalists. The Index measures and reports the opinions of professional venture capitalists on their estimations of the high-growth venture entrepreneurial environment in the San Francisco Bay Area over the next 6 - 18 months.\(^1\)

The Silicon Valley Venture Capitalist Confidence Index® for the second quarter of 2014, based on a June 2014 survey of 29 San Francisco Bay Area venture capitalists, registered 4.02 on a 5 point scale (with 5 indicating high confidence and 1 indicating low confidence). This quarter’s index measurement was essentially unchanged from the previous quarter’s confidence reading of 4.03. Please see Graph 1 for trend data.

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\(^1\)Questions about this ongoing research study or related topics should be sent to Professor Cannice at Cannice@usfca.edu.

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Silicon Valley venture capitalists’ confidence held firm in the second quarter of 2014; however, it was essentially unchanged from the previous quarter’s sentiment level. The steady Q2 index reading provides a pause to the seven quarter upward trend in confidence among Silicon Valley venture capitalists. This leveling off of sentiment comes amid strength in venture backed exits, fundraising, and investment in the quarter. For example, PricewaterhouseCoopers and the National Venture Capital Association reported in their MoneyTree™ Report that venture investments reached their largest amount ($13 billion) since Q1 2001. Reflecting these strong metrics, comments by the venture capitalists who responded to the Q2 2014 survey highlighted the good exit market, a broad array of disruptive ventures to invest in, and an improving fundraising environment.

Some concern was raised regarding the medium to long term prospects for the current robust environment. Still, the overall level of confidence was high, if not increasing in Q2. In the following, I provide many of the comments of the participating venture capitalist respondents along with my analysis. Additionally, all of the Index respondents’ names and firms are listed in Table 1, save those who provided their comments confidentially.

The continuing strong exit environment coupled with reasonable valuations supported a high level of confidence among the responding venture capitalists in Q2. Dixon Doll of DCM reported that an “exceptional liquidity environment, both for M&A and IPO’s, is providing the best returns to LP’s since 2000. And valuations by almost any measure are well below the ‘bubble’ territory of 1999-2000.” Sandy Miller of Institutional Venture Partners stated “Private valuations in the venture market have begun to reflect the significant multiple decline in the public market in some of the high growth tech sectors.” Mr. Miller added “The IPO market is working well for well-priced issues. I think we will see a strong IPO market for the second half. So overall I think it is a healthy venture environment.” To their points, Q2 was another solid quarter for venture-backed IPOs, with both the number of IPOs and the capital raised exceeding the totals for the year earlier quarter.

Providing a further analysis of the current exit environment, Igor Sill of Geneva Venture Management explained “I see public market traded technology stock valuations at an attractive level right now, based on historical levels. Despite the recent run-up, valuations remain below their 15-year average of 23X NTM (next twelve months). Thus, later stage venture backed startups are commanding much higher valuations in the pre-IPO stage, especially for those benefiting from the major structural shift from PC platform to mobile, wireless and cloud-based solutions. Secondly, the private equity and corporate sector will continue to drive M&A activity in these sectors. Venture investments in enterprise software, fintech and security solutions continue to be the strongest.” Additionally, a respondent who provided comment confidentially also pointed to the “rebound of the IPO market, strength of the M&A market, and stability of the economy in the US” for his confidence.

The quality and disruptive nature of the companies being developed in Silicon Valley continue to bolster the outlook of venture capitalists. Tim Draper of DFJ indicated “There are a lot of good companies out there and change is happening faster than ever before, and venture capital thrives in a changing environment.” Meanwhile, Deepak Kamra of Canaan Partners observed “disruption caused by new platforms such as cloud and mobile coupled with an abundance of large private companies with strong revenue traction.”

Eric Buatois of Benhamous Global Ventures detailed “The overall enterprise sector is very healthy with solid companies coming for VC funding already with first version product and several customer validation. The R&D costs are well under control as a lot of these companies either have grown outside

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3 Thomson Reuters and NVCA press release dated July 1, 2014.
the high salary environment of Silicon Valley with very stable and loyal engineers (Israel, Western Europe, Russia, Czech Republic, etc.) They are usually addressing a strong customer pain point at the departmental level avoiding large enterprise wide sales cycles. Sophisticated tools leveraging mobility and cloud are creating a very efficient process for sales, marketing and customer access, reducing capital needed to achieve breakeven.”

Supporting these disruptive new companies, investments in venture-backed firms in Q2 reached their highest level since 2001 signaling broad investor confidence in the businesses being developed. Mohanit Jolly of DFJ emphasized “The pace of innovation itself is accelerating. That, combined with the confluence of trends around Cloud, social everything, mobile-first, IoT (home, automotive, quantified self) are giving rise to unprecedented disruption, and therefore opportunities for startups. The quality and intensity of deals coming through has never been better, which bodes well going forward.”

**Capital is available to support the development of these new vision firms.** Jon Soberg of Expansive Ventures said “We are continuing to see very strong companies being built, and with 2014 trending to be one of the best years for VC fundraising in the past decade, there is ample capital to support these companies.” In fact, Thomson Reuters and the NVCA reported that the number of venture funds being raised in Q2 was the most since Q4 2007. This growth in the number of funds should make capital more accessible to more start-ups.

**Silicon Valley continues to provide the supportive entrepreneurial ecosystem that make it the hub for new venture creation and technology innovation.** For example, John Malloy of BlueRun Ventures suggested “The shift to real time computing caused by mobile technology & services is redefining markets. The epicenter for these disruptive opportunities is in Silicon Valley.” And Jeb Miller of Jafco Ventures elaborated “The Bay Area remains the epicenter of the three hottest startup sectors of cloud, mobile and big data with disruptive platform shifts creating opportunities to build the next generation of market leaders and deliver massive returns.”

A strong supply of talented and enthusiastic entrepreneurs provide ample human and intellectual capital. One VC respondent who commented confidentially argued “The enthusiasm for starting companies by new college grads, relatively easy access to seed-funding by newly minted millionaires, the buzz around big data, IoT, Wearables, etc. continues to create a favorable environment for startups.”

**With regard to the life sciences,** Gerard van Hamel Platerink of Redmile Group observed “in healthcare, an emerging flow of high quality service and HCIT companies that solve real market needs in a rapidly changing healthcare market.” However, a contributor who asked to remain anonymous was concerned that “LFS (life science) approval timings and capital requirements continue to rise significantly.” The same respondent also pointed to the “lack on the part of LPs to participate in LFS compared to tech which has a shorter capital requirement and timeline to exit.” Still, some good news came in the sector, as biotechnology ventures led the IPO calendar for Q2.

**Some caution on the venture environment was raised.** For example, Kurt Keilhacker of Techfund Capital noted that while “markets continue to strengthen. Some signs of sector bubbles are forming.” Debra Beresini of invencor pointed out that “Venture Capital firms are investing more dollars these days, but they are investing in fewer companies. While it is positive that the venture capital market seems to be actively investing again, the firms are still being very selective in which companies they invest. The downfall, of course, is that fewer companies are receiving money and a diverse economy needs money

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5 Thomson Reuters and NVCA press release dated July 9, 2014
6 Thomson Reuters and NVCA press release dated July 1, 2014.
invested in many diverse companies…Confidence is building, but slowly uphill along the railroad tracks.”

Dag Syrrist of Vision Capital shared “I’m bullish in near term (< 6 months) and rapidly less so in longer terms (>12 months). There’s a widening disconnect between valuations, and not just the Uber-phenomena, which is less and less supported by M&A pricing and certainly not by the post IPO market. Thus far the size of rounds have covered, which will, with valuations, be curtailed when the sentiment changes. Ironically I don’t think the economy or even the perception of the performance of the economy will drive the change; I think it will be good old fashion over indulgence by the venture business, which we’re good at.”

Bob Ackerman of Allegis Capital reasoned “While the level of innovation underway in Silicon Valley is unprecedented, the explosive demand for human capital and the associated costs, gives pause for concern regarding sustainability. In parallel, there is a level of entrepreneurial hubris creeping into the local ecosystem that is reminiscent of the late 1990s. Fortunately, outside of late stage ‘public brands’ attracting momentum capital, the early-stage segment of the market remains reasonably stable with a balance between opportunity and investible capital.”

In summary, confidence held steady in the second quarter of 2014, capping a steady increase in sentiment over the previous seven quarters. A strong exit environment buoyed by welcoming public markets for venture backed firms continues to enhance the returns of venture funds and attract ample capital to the industry. As available capital grows, investments in new enterprises predictably increase in step. This virtuous circle of capital flows and returns, is, of course, an outcome of the innovative solutions and disruptive industries being created by talented entrepreneurs and their venture backers in the supportive Silicon Valley environment. Concurrently, a somewhat more predictable public policy environment has allowed the natural forces of creativity to flourish for now.

Still, some caution as to the duration of the current growth cycle is prudent. This is particularly so, given the rapidly growing enthusiasm for entrepreneurial endeavors and, occasionally observed, inexperienced entrepreneurial expectations. While the historical outcomes of financial market exuberance seldom repeat exactly, they often provide a familiar rhyme. It remains to be seen if the leveling off of venture capitalist confidence in the second quarter is a healthy pause in growing entrepreneurial expectations or a signal for something else.

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<td>Alain Harrus</td>
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<td>Dan Lankford</td>
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<td>Deepak Kamra</td>
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