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 fourth quarter of 2014, based on a December 2014 survey of 28 San Francisco Bay Area venture capitalists, registered 3.93 on a 5 point scale (with 5 indicating high confidence and 1 indicating low confidence). This quarter’s index measurement is slightly higher than the previous quarter’s index reading of 3.89. Please see Graph 1 for trend data.

Questions about this ongoing research study or related topics should be sent to Professor Mark Cannice at Cannice@usfca.edu.

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Silicon Valley venture capitalists’ confidence in the forth quarter of 2014 moved slightly higher from the third quarter as a continuing strong exit, investment, and fundraising environment tempered concerns over inflated valuations in some sectors. In fact, Thomson Reuters and the National Venture Capital Association reported that the number of venture-backed IPOs in Q4 exceeded the number in the previous and year-earlier quarters. Furthermore, total venture capital invested and the number of new and follow on venture funds established in Q4 also exceeded the previous and year-earlier quarters. With the financial model of the venture industry appearing to be operating at full steam in Q4, VC confidence predictably followed suit higher, but its rise may have been tempered somewhat by concerns over the rapid rise in valuations in some sectors along with some macro risks. For example, one venture capital respondent to the Q4 survey indicated “The environment is very good with enough capital for both early- and late-stage deals. The problem is that the valuations are unrealistic and the number of companies in each segment is way too many without much to differentiate them.”

Still, VC confidence did edge higher in Q4 and was relatively high historically (well above the 11 year average of 3.72). 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 strong exit market supported VC confidence. Sandy Miller of Institutional Venture Partners stated “The IPO market for venture-backed tech companies is coming to a solid finish for 2014. It has been the best year since 2007. That said, it is still far below the pre-bubble years in the 1995-1996 timeframe. I think 2015 is poised to be an even stronger year than 2014. Institutional buyers have a strong appetite for IPOs given their success this year and there are a large number of strong private tech companies with sales and growth.” Additionally, Paul Holland of Foundation Capital shared “We have had six IPOs in the last five quarters and as long as public markets remain open, the pipeline for liquidity is very robust. In addition, strategic buyers are wading into the market with force and mass and we expect the M&A environment to continue to be robust. The biggest risk is not in the early or very late stages but in the highly priced mid-staged companies where their access to liquidity may be delayed significantly (a la many late stage 2006-7 investments) depending on the macro environment.”

Dixon Doll of DCM observed that the “new investment pace has slowed down a little from last time (which I think is healthy) but the exit environment remains quite strong by all recent historical measures.” A venture capitalist respondent who requested anonymity also reported “a healthy set of exit opportunities in M&A and IPO markets.”

The healthy exit market is bolstering fundraising and investment among venture capital firms. Bruce Cleveland with InterWest Partners maintained “With strong liquidity from venture sectors over the past 2 years and the Fed and other global banking entities signaling continued support for low-interest rates, we believe the public markets will continue to seek higher returns associated with traditional high growth venture-backed entities across IT and HC (biotech, specifically). As a result, capital is flowing – and should continue to flow - into the venture community to finance private, start-ups.” To this point, Roy Thiele-Sardina of HighBar Partners relayed “We are seeing an increasing number of later stage deals which indicates that companies are moving beyond the ‘Angel & Start-up’ stage of growth.”

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2 Thomson Reuters and NVCA press release dated January 7, 2015
4 Thomson Reuters and NVCA press release dated January 12, 2015
The level of innovation and entrepreneurial activity among Silicon Valley ventures remains vibrant and transformative. Jeb Miller of Jafco Ventures affirmed “The Bay Area remains the center of gravity for the startup ecosystem as we continue to experience the massive transfer in market cap from legacy vendors to emerging winners that are capitalizing on major platform shifts to cloud, mobile and data-driven businesses.” Likewise, Mohanjit Jolly of DFJ contended “The sheer quality of startups still continues to be very robust. They are solving real problems and disrupting massive industries.” For example, John Malloy of BlueRun Ventures reported “The early stage innovation environment remains strong in Silicon Valley. Mobile technology and scale continues to open new vertical market opportunities in massive traditional markets such as health, transportation and education.”

Eric Buatois of Benhamous Global Ventures argued “The overall digitalization of any large business is demanding the enterprise to transform their infrastructure and application environment. This is creating very large opportunities for emerging new companies. Large established enterprise companies are caught by surprise by the speed and magnitude of the transformation. They will have to buy companies to refresh their product portfolio. They will also leave some white space widely open for young companies.”

Finally, Bruce Cleveland with InterWest Partners declared “The early stage investment climate is one of the most exciting we have ever seen. Traditionally, there is typically one ‘big thing’ that drives the technology sector – mainframe to mini computing in the late 70s, mini to PC computing in the early 80’s, client/server computing in the early 90’s, internet-based computing in the late 90’s/early 00’s. Today, there are multiple ‘big things’ – changes that affect markets larger than $1B - driving a complete overhaul of the entire technology industry: cloud computing, mobile computing, ‘Big Data’, Internet of Things (IoTS), data-driven enterprise applications, software-defined data centers, real-time advanced threat detection/protection security, gaming, drones, not to mention emerging ‘business models’ based upon variable usage (subscription/recurring revenue) which can be even more disruptive to incumbents than technology disruptions alone.”

Despite broad enthusiasm for the current macro and venture environment metrics, some respondents voiced caution when looking ahead. Igor Sill of Geneva Venture Management explained “By any measure, 2014 has been a huge success for venture capital investors focused on the tech sector. An improving US economy will no doubt lead to tech sector growth of 6.6% in 2015, that's up from 5.7% in 2014, according to Barron’s. I sense that consumer-facing technologies, cloud computing and cybersecurity oriented solutions will have the strongest growth rate. In these last 4 quarters we saw record breaking IPOs achieve values not seen since 2000 and, 2015 appears to be following suit. There are now some 120 companies targeting to raise $84 Billion (WSJ). My concern is the recent astronomically overvalued pre IPO prices awarded to Uber, a staggering 40 Billion valuation, according to Red Herring as well as SnapChat ($10B), Dropbox ($10B), Palantir ($10B), Airbnb ($10B), Xiaomi ($10B), Theranos, Square, Cloudera, Spotify, etc., etc.”

Mr. Sill continued, saying, “The recession and subsequent bear markets caused many aspiring IPO seeking startups to focus on billionaires and late stage venture capital financing, creating a surge in the budding venture segment of secondaries, which seeks hedge funds managers, super wealthy individuals and family offices as buyers of overvalued equities. Therein is the potential for risk because private investors need to cash out sometime. I sense that 2015 will see this trend become more widespread. Companies that become profitable growth businesses will succeed, those that operate purely on a growth model won't. The public markets do not tolerate companies that operate in a loss.” Similarly, Robert Ackerman of Allegis Capital contended “The innovation economy is at risk of overheating as investor expectations in certain market sectors, but not all, run ahead of pragmatic reality. Excess investment capital flowing into the sector from non-traditional investors, looking to capitalize on apparent momentum, is pushing valuations and operating costs for young companies past the point of
sustainability in many cases. At some point, the market will need to reset and re-establish a sustainable equilibrium.”

Gerard van Hamel Platerink of Redmile Group noted “There appears to be a high degree of optimism in the market in many of the subsectors (e.g. biotech and HCIT) and deals are getting done quickly at relatively aggressive valuations. This situation can, of course, change very quickly, and many expect it will.” Bob Pavey of Morgenthaler Ventures indicated “The pace of change is as fast as I have ever seen it over a 45 year venture career. My only concern is the possible impact of world events.”

Dag Syrrist of Vision Capital reasoned “The venture business is starting to have a bar-bell like distribution, with very large, large betting funds Ubering over each other to write bigger checks for (often tried before) consumer oriented services (Instacart, WeWork companies, etc), and small funds focused in emerging segments, markets and products which can’t accommodate significant capital and take work to be successful. Overall, however, the industry will face issues (for the 90% that is) when thus far in 2014, more companies raised capital at valuations above $1b then there were IPOs above $1b, in fact at a ratio of 3:1, which is not good, of course, and, ideally, should be reversed, of course.”

**In summary, venture capitalists’ confidence edged slightly higher in the fourth quarter of 2014, as the strong exit environment refreshed the venture business model with strong returns.** These enhanced returns are supporting the other aspects of the venture business model forming a virtuous circle of more fundraising and more investments in high potential new ventures. Furthermore, the exit market appears to have broadened out as more life science firms have achieved liquidity events in 20145. By any measure the strong IPO market combined with the still healthy M&A market for venture-backed firms has made for a robust venture capital business model in 2014.

While the venture runway appears clear at present, some concerns are rising over inflated valuations in some sectors. Successful exits are attracting traditional as well as, in some cases, nontraditional venture investors. This wealth of capital makes possible more investments in promising companies but also potentially unbalances the risk-return equilibrium somewhat. It remains to be seen if there will continue to be enough public market and corporate acquisitor demand to absorb the growing number of highly valued private ventures and sustain the currently robust venture environment.

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<td>Bill Byun</td>
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<td>Bob Pavey</td>
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<td>Bruce Cleveland</td>
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<td>Dan Lankford</td>
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