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. The Silicon Valley Venture Capitalist Confidence Index® for the fourth quarter of 2015, based on a December 2015 survey of 30 San Francisco Bay Area venture capitalists, registered 3.59 on a 5 point scale (with 5 indicating high confidence and 1 indicating low confidence). This quarter’s index measurement rose from the previous quarter’s index reading of 3.39, bringing a pause to the three-quarter downturn. 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.
Confidence among venture capitalists in the future high-growth venture environment in the Bay Area recovered somewhat in the fourth quarter of 2015, stemming a three-quarter decline. However, Q4 confidence is still below the 12-year average of 3.72 as concerns over high valuations of many venture-backed businesses and the ability of public markets to welcome them remain. Still, general caution on the overall venture environment from the previous quarter appeared to ease somewhat in Q4 as a focus on the fundamentals of venture investing in disruptive firms began to unseat concern over new sources of capital that have inflated valuations in recent quarters. Still, as valuations across some sectors and stages begin to decline, investments may decline accordingly, leading to a potential slowdown in the entrepreneurial environment. In fact, the total number of venture investments and the aggregate amount invested were down in Q4 from the previous and year-earlier quarters, although 2015 in total was a very strong year for venture investments. Additionally, the number of new venture funds in Q4 2015 decreased from the previous and year-earlier quarters, although total committed funds for the year were strong.

In all the Silicon Valley Venture Capitalist Confidence Index rose in Q4 and suggests the beginnings of a possible shift in recent unsustainable trends in the entrepreneurial environment. 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.

With regard to valuations, a return to the mean appears to be in process. Venky Ganesan of Menlo Ventures predicted “The late stage venture market is due for a correction. The heady cocktail of easy money due to the fed, high burn rates, and questionable gross margins is going to give a massive hangover to a bunch of companies. We will see a pullback in late stage financings and even some layoffs, but the long-term value proposition of technology driven change remains intact. Caution ahead!” And Dan Lankford of Wavepoint Ventures also indicated “High valuations, public market volatility and general ‘frothiness’ are concerns.” Similarly, Bill Reichert of Garage Technology Ventures reminded “As I said last quarter, the public markets cannot possibly absorb the current batch of unicorns at their current valuations, not to mention the thundering herd of unicorn wannabes. There will be more disappointment than celebration over the next 18 months. Still, there is plenty of room for creating real value and building great companies. We just need to adjust expectations.” In fact, the number of venture backed IPOs in Q4 2015, while up slightly from the previous quarter, was down significantly from the year-earlier quarter.

What goes up must come down. Dag Syrrist of Vision Capital explained “It’s hard to outrun gravity. The cumulative effect of macroeconomic headwinds and softening in M&A pricing, pull back from non-VC late stage investments from hedge and mutual funds, and less than stellar IPOs across multiple tech sectors, may just finally curtail the more exuberant speculation. While that’s all healthy and good, suspect it will have a far-reaching downward pressure on pricing and more importantly reduce the pace of investments. It’s become increasingly difficult for earlier stage companies to raise capital, especially once some level of commercialization has started as the unrealistic comparison to some fantastically inflated valuations of some has become the norm. It’s as if the industry forgot that starting and growing companies of lasting value both takes time and is actually quite hard. The big question will be if the highest value companies can, in fact, reduce spending in pursuit of growth and reach some level of survivable margin. So net-net, suspect capital will become much harder to raise; recently invented metrics will be re-evaluated, and we may even see some renewed interest in GM or

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God-forbid even profitability.” Tom Baruch of Formation 8 also took note of the “unicorn demise” while several VC respondents confidentially shared concerns over “some sectors overheating”, “high valuations across all rounds in VC financing”, and “looming risk of mass Unicorn devaluations” and “medical device concerns”.

**Declining valuations have made follow-on financings more challenging.** Igor Sill of Geneva Venture Management relayed “The pace of venture investments has clearly slowed. There’s been a downward trend to valuation expectations in the last few months with successful fund raising going to exceptional young businesses, not marginal ones. Financing rounds have become harder to raise with valuation multiples at lower levels. Follow-on financing rounds are no longer perpetual valuation increases, but are based on metrics that support the projected and promised goals of earlier rounds. An upward trend in customer acquisition along with profitable sales margins has become a critical element of valuation assessment for subsequent up rounds.”

**Differentiating venture opportunity from venture risk.** Bob Ackerman of Allegis Capital wrote “All that Glitters is not Gold and, the hens of excess are coming homing to roost. The massive influx of outside capital into the venture ecosystem, which has inflated a broad spectrum of valuations, has once again validated the ‘Greater Fool Theory’. The venture community is actively pulling in its investment horns which will reinforce the inevitability of the correction. The good news – with the reset come excellent opportunities for those that know the difference between FeS2 and Au.” And a respondent who requested anonymity pointed to “Economic uncertainty and geopolitical issues” for causes of concern.

**However, more sanguine views emerged as well.** Dixon Doll, DCM founder emeritus, stated “In this frothy environment with way too many Unicorns and public markets receding, I’m long-term optimistic...short term pessimistic because of contracting liquidity alternatives.” And Gerard van Hamel Platerink of Redmile Group observed “Some helpful differentiation is beginning to take place in the marketplace after a period of frothiness in some areas.” And Eric Buatois of Benhamou Global Ventures noted “Whilst there will be a major correction of the inflated valuations of Unicorns, a lot of solid companies are created and funded every week based on solid fundamentals such as customers, revenues and profits. The digitalization of the enterprise, first Internet Of Things business applications, the widespread adoption of Saas, and the increasing adoption of robots and drones continue to attract entrepreneurs from all over the world to the SF Bay Area.”

**Other responding venture capitalists focused on the opportunities surrounding new technology innovations and other promising aspects of the entrepreneurial environment.** Mark Platshon of Bircmere Ventures contended “The explosion of research, corporate investment, partnering and innovation relating to connected/autonomous vehicles (drones, cars, trucks, factory automation, etc.) will continue to stimulate and broaden venture investment in Silicon Valley. The enthusiasm that DJI, Tesla, Google, Apple, Samsung, nVidia, Cisco and all the legacy auto companies and Tier Is are showing for this space makes it attractive to invest in startups that will be acquired by all the corporates trying to catch up.”

**Emphasizing technology trends that are leading to new market opportunities,** Jeb Miller of Icon Ventures suggested “eplatforming of IT to cloud, mobile and big data solutions will continue to lead to a major shift in market cap from the legacy vendors to a new generation of platform leaders and creating tremendous opportunity for startups. The Bay Area remains the epicenter of this activity where the most talented engineers and executives around the world continue to gravitate. There is pressure on later stage valuations and capital excess which we believe will lead to a return to focus on more capital efficient models of funding startups which aligns interests and will lead to more positive exit alternatives.” Another respondent shared “While the valuation expectations may hit some headwind in 2016, the fundamental technology tsunami will continue around areas such as AI, healthcare, connected everything,
deep learning, security, autonomous vehicles and several more.”

**Silicon Valley remains the global epicenter for building disruptive companies.** John Malloy of BlueRun Ventures emphasized that “Silicon Valley continues to draw and inspire the best of entrepreneurs from around the globe. Innovation happens anywhere but it is still easier to grow an idea into a meaningful company here. Let’s hope this ends the year of the mythical beast chatter and we all focus more on building great companies.”

*Spotting supporting industry metrics for the venture environment,* Sandy Miller of Institutional Venture Partners reasoned “2016 will be a strong year for the venture industry. Recent trends are encouraging. Private valuations are less heady. Tech IPOs are working again though the numbers are small. The big tech companies have unprecedented cash hoards. So the exit environment looks favorable. There are more great private tech companies with scale and growth than ever and by a wide margin. So I think 2016 will be nicely balanced with a good environment for both entrepreneurs and investors.” Relatedly, Jon Soberg of Expansive Ventures offered “I think we are going to see a normalizing in the funding environment with smaller amounts of capital deployed very selectively. I think that the next couple of years have the potential to be very strong vintages for venture funds because financing will be tighter than it has been, and I expect some very strong companies will emerge.”

**In summary, average confidence among responding Silicon Valley Venture Capitalists rose in Q4 after a steep decline the previous quarter and a three-quarter downward trend in 2015.** Whether this bounce connotes a sustainable reversal in sentiment or is more temporal in nature is yet to be revealed. Still, a widening recognition of the unsustainability of many ‘unicorn’ valuations is providing a base from which to build new ventures that take advantage of the continuing opportunities flowing from innovation led disruptions of existing industries. A reduction of non-traditional capital and a return to the basics of enterprise building should maintain stable if not accelerating growth in the entrepreneurial environment for now. However, more recent high volatility in public financial markets will complicate the exit environment for venture-backed IPOs, at least in the short run. Potential longer-term volatility in the public markets could risk creating a domino effect that would, in time, impact fundraising and investments. While the macro environment (e.g. Oil, China, Europe, The Fed, political campaigns, etc.) and the ongoing recalibration of public and private valuations may make the coming months interesting, the underlying strength of the Silicon Valley entrepreneurial ecosystem will continue to foster disruptive innovation and venture creation over the long run.

**Table 1**

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<tr>
<th>Participant</th>
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<tr>
<td>Bill Reichert</td>
<td>Garage Technology Ventures</td>
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<td>Bob Bozeman</td>
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<td>Bob Pavey</td>
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<td>Dag Syrrist</td>
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<td>Dan Lankford</td>
<td>Wavepoint Ventures</td>
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<td>Deepak Kamra</td>
<td>Canaan Partners</td>
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<td>Dixon Doll</td>
<td>DCM Founder Emeritus</td>
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<td>Eric Buatois</td>
<td>Benhamou Global Ventures</td>
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<td>Gerard van Hamel Platerink</td>
<td>Redmile Group</td>
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<td>Igor M. Sill</td>
<td>Geneva Venture Management</td>
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Jeb Miller  Icon Ventures
Jeremy Liew  Lightspeed Venture Partners
John Malloy  BlueRun Ventures
Jon Soberg  Expansive Ventures
Karan Mehandru  Trinity Ventures
Mark Platshon  Birchmere Ventures
Richard Yen  Saban Ventures
Robert R. Ackerman, Jr.  Allegis Capital
Sandy Miller  Institutional Venture Partners
Shomit Ghose  Onset Ventures
Standish O’Grady  Granite Ventures
Stephen J. Harrick  Institutional Venture Partners
Tom Baruch  Formation 8
Tom McKinley  Cardinal Partners
Venky Ganesan  Menlo Ventures
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