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VENTURE CAPITAL

Young companies could avoid economic pains, investors say.

Older startups that aren't yet profitable may have to tighten up on spending.

By Lori Hawkins
AMERICAN-STATESMAN STAFF
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Not every tech startup will feel the heat of the nation's credit crunch, but experts say some are vulnerable.

Young companies are less likely to get caught in the crossfire, but later-stage companies could run into trouble if their sales slow and venture capital investing tightens, several Austin venture investors said this week.

"Very-early-stage startups are focused on building their products, and outside market conditions don't really affect them as much," said Phil Siegel, a general partner with Austin Ventures. "They can spend the next couple of years on development and emerge when the economy is stronger. It's much easier to be developing a product right now than trying to sell one."

The tech companies in a more precarious position are several years old, have raised a couple of rounds of venture capital and have products but aren't yet profitable, said Bob Smith, a principal with Bridgepoint Consulting, which advises startup companies.

If their customers cut spending, they might be forced to try to raise more venture capital to stay alive.

"The question is, how long will investors decide to keep funding these companies? Are they willing to roll the dice on another $12 million? The VCs have to be very comfortable that they have a winning technology and that the technology will be in the right place when the market recovers," Smith said. "The ripple effect is that some of those companies are going to fold because the investors say it is not worth that much more."

It doesn't help that venture capital firms are experiencing the slowest market in a decade for cashing out on their investments. In the third quarter, only one venture-backed company, Rackspace Hosting of San Antonio, had an initial public offering, according to a quarterly report by Thomson Reuters and the National Venture Capital Association released this week.

During the first three quarters of 2008, just six venture-backed companies went public, the lowest volume since 1977. At this point last year, 55 had made public offerings.

Acquisitions, the other way that venture capitalists recoup their investments, also have slowed. Fifty-eight venture-backed companies were sold in the third quarter, compared with 102 in the same quarter last year. The average deal size fell to $146 million from $208 million a year earlier.

With the public markets virtually frozen and Wall Street in turmoil, Steve Coffey, managing director of the Austin office of Hunt Ventures, said his firm will be monitoring its later-stage companies closely.

"They're going to feel the fallout, and it's going to become more difficult to raise additional venture capital," Coffey said. "We'll be watching quarterly revenue as it comes in to make sure nothing is starting to slip. Then, you take the steps necessary. Maybe you're not as aggressive in hiring."

Scott Abel, CEO of 3-year-old Austin software maker Spiceworks, which has raised $8 million in venture capital, said startups are taking their investors' questions seriously.

"VCs are telling their companies, 'Look, it's going to be a hard year, so think very carefully about your expenses and ask if you need to spend that money.' They're saying, 'Be sure about the bets you make, because you're spending money that could be hard to get in the future.' "

Abel said even though Spiceworks, which offers free network-management software that is supported by advertising, expects to triple revenue next year, the company is being cautious with 2009 planning.

"We're taking another look at our plan; we'll squeeze it down a little tighter and ask people to be very sure they need what they're asking for," he said. "Even though we've exceeded our milestones, we're not immune to the laws of physics.