The New York Times

Some venture capitalists are rooting for a market dip to calm Silicon Valley's overheated start-up scene.

By Erin Griffith

Jan. 6, 2019

SAN FRANCISCO — Vini Letteri, a managing director at KKR who invests in tech companies, had a slow 2018.

Mr. Letteri, a venture capitalist who manages a $714 million fund, tried to put some of that money into 12 tech start-ups last year — but failed when they demanded too rich a price. In some cases, he said, his offers to invest were outbid by as much as 40 percent. The only investment he led in 2018 was a $360 million deal in OutSystems, a software company in Atlanta.

So here's what Mr. Letteri is not-so-secretly hoping for in 2019: a downturn in the private start-up market.

"When the market turns, we're prepared to be more aggressive," he said. He added that he had sketched out a "downturn list" of 150 targets — including financial tech, cybersecurity, and consumer internet companies — in case they become cheaper.

MR. LETTERI IS ONE OF A GROWING NUMBER OF VENTURE CAPITALISTS ROOTING FOR A MARKET DIP TO CALM THE OVERHEATED START-UP SCENE. FOR THE PAST FEW YEARS, SILICON VALLEY TECH START-UPS HAVE BEEN AWASH IN A STREAM OF CASH THAT HAS ALLOWED THEM TO EXPAND QUICKLY AND SELL OR GO PUBLIC AT HIGH VALUATIONS. YET THAT DROVE UP THE COSTS OF DEAL MAKING FOR VENTURE CAPITALISTS, WHO OFTEN PREFER TO INVEST IN YOUNG COMPANIES AT LOWER PRICES IN THE HOPES OF MAKING A BIGGER RETURN LATER.

NOW SOME OF THESE INVESTORS MAY GET THEIR WISH FOR A MARKET DECLINE. STOCKS TUMBLED LATE LAST YEAR, LED BY TECH GIANTS SUCH AS FACEBOOK AND APPLE, AMID FEARS OF SLOWING ECONOMIC GROWTH AND A TRADE WAR WITH CHINA. AND SO FAR THIS YEAR, THE STOCK MARKET HAS SWUNG WILDLY, WHIPSAWED BY CONFUSING SIGNALS INCLUDING APPLE'S DISAPPOINTING IPHONE SALES IN CHINA AND AMERICAN EMPLOYERS ADDING MORE JOBS THAN EXPECTED LAST MONTH.

WHILE IT TAKES TIME FOR CHOPPINESS IN THE STOCK MARKET TO RIPPLE OUT INTO THE START-UP MARKET, MANY VENTURE INVESTORS ARE ALREADY PREPARING FOR A DOWNTURN. SOME ARE SETTING ASIDE MONEY TO POUNCE ON INVESTMENTS AND ARE PREPARING TO WRITE BIGGER CHECKS WITH THE EXPECTATION THAT NEW INVESTORS WHO

FLOODED IN IN RECENT YEARS WILL FLEE. AND THEY ARE KEEPING CLOSER TABS ON COMPANIES THAT WERE TOO EXPENSIVE TO INVEST IN LAST YEAR.

“WE DEFINITELY WANT TO TAKE ADVANTAGE OF A MARKET DOWNTURN,” SAID SANDY MILLER, A VENTURE CAPITALIST AT IVP WHO PROJECTS THAT START-UP VALUATIONS WILL FALL BY 10 PERCENT TO 40 PERCENT THIS YEAR. HE SAID HIS SILICON VALLEY VENTURE FIRM HAS SET ASIDE “MEANINGFUL RESERVES” TO DO MORE DEALS AND TO PUT MORE MONEY INTO COMPANIES IT HAS ALREADY INVESTED IN, THOUGH HE DECLINED TO SPECIFY AN AMOUNT.

Silicon Valley investors have long complained that start-up valuations have gotten too expensive, given that the start-up ecosystem has been on a bull run since at least 2015. That has minted an unprecedented number of “unicorn” start-ups, which are valued at more than $1 billion, including now-giant companies such as Uber and Airbnb.

But the rising valuations have only continued to climb in the last year. In 2018, the median company valuation for one category of mature start-ups more than doubled to $420 million, up from $183 million in 2017, according to Carta, a provider of valuation software and services. And in a 2017 National Bureau of Economic Research study of 135 unicorn start-ups, researchers concluded the companies were overvalued by an average of 50 percent.

“There’s too much heat around good, not necessarily great, companies” that are older, said Mamoon Hamid, a partner at the venture firm Kleiner Perkins. Even one “good, not great” company he recently met with had 13 investment offers, he said. The upshot: Kleiner did not invest.

Greg Sands, a managing partner at Costanoa Ventures, said his venture firm walked away from three investments in 2018 where the price was 30 percent higher than he was willing to pay, an increase from past years. He also screened out numerous companies that were asking for more money than seemed reasonable — yet some of those companies then went on to raise triple that amount from other investors.

“What’s happening right now isn’t sustainable and it won’t go on forever. It can’t,” he said. Costanoa raised a $75 million “opportunity fund,”, which Mr. Sands said would give it the ability to do more deals when the market cools down.

Many other venture capital firms are also in a position to become more aggressive in case of a market downturn. Venture funds raised $30.2 billion in the first three quarters of last year, on track to surpass 2017’s total of $35.3 billion, according to PitchBook, a data provider.

Start-up founders also appear to be preparing for a potential shift in fortunes. In a survey conducted late last year by First Round Capital, a venture capital firm, just under half of 529 entrepreneurs said they expected fund-raising to become more difficult in 2019. A third said they believed the tech bubble was close to popping, a 10-point increase over 2017.

Some start-ups are raising more money to weather the uncertainty, according to Kirsten Green, a managing partner at Forerunner Ventures. Others are creating backup plans to cut costs so their survival won't depend on new funding.

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A version of this article appears in print on Jan. 7, 2019, on Page B1 of the New York edition with the headline: Hoping To Outlast Bull Market For Start-Ups