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End Game: Venture Firms Seek Overtime On Funds

By Russell Garland - Editor, **Dow Jones Newswires**
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Venture firms are facing ticking time bombs embedded in their fund documents.

These are end-of-fund-life deadlines for vehicles raised during the boom-and-bust cycle in the late 1990s. Funds typically have deadlines of 10 years to dispose of all their companies and wind down, but many VC funds from the late 1990s still have a substantial number of companies within their portfolios.

The typical path to dealing with such issues is to ask for extensions of investment period or fund life. But limited partners aren't in a forgiving mood these days. As such, venture professionals may find themselves in delicate negotiations, with the fate of their firms resting on the outcome.

"If you're a GP and you have to go back to the LPs for any type of request, it opens up a negotiation," said Michael Taylor, a managing director at fund-of-funds manager HarbourVest Partners LLC.

The venture industry is reaching the end game on the huge wave of funds it raised during the dot-com bubble. From 1999 to 2001, 1,203 venture funds closed on $178.7 billion, and many of these funds still hold companies that investors think have potential.

U.S.-based venture investors currently have 3,929 U.S.-based companies in their portfolios that received their initial equity investment seven or more years ago, according to Dow Jones VentureSource. That represents 28% of all U.S.-based portfolio companies of U.S. VCs.

VC funds can generally buy a year or two more beyond their 10-year life without LP approval, but they can't just keep managing the fund forever. The situation sparked some humor at the Dow Jones Private Equity Analyst Limited Partners Summit in June. "I don't think that there's a 10-year venture fund in existence," said Eric Fitzgerald, director of venture capital at MetLife.

Talks about extending fund life tend to center on management fees. Extensions beyond year 12 are often fee-less, but the issue can be tricky.

If the general partners have no chance of collecting carried interest on the remaining companies and no chance of raising another fund, they need some source of income to keep going. But if carry is within their grasp or the firm has newer funds, the management fee might not be an issue. "It's structurally really nettlesome," said Kenneth Sawyer, a managing partner at secondary firm Saints Capital.

There are a few examples of firms that have successfully extended their fund life beyond the routine extensions, including Allegis Capital, CMEA Capital and Worldview Technology Partners. But for the most part, LPs feel that after 12 years, VC managers can't do much more to extract value from their funds. Investors would rather just put the bad memory of investments made during the venture bubble behind them.

"LPs are not very tolerant of requests for extensions unless there is clear, demonstrable evidence that material value can be realized for the fund," said HarbourVest's Taylor.

"When I look at exits over the last nine months, 85% to 90% are in companies that were started in 2003 or more recently," Jason Andris, a managing director of fund-of-funds manager Venture Investment Associates, said at LP Summit. "The fresher companies built with a revised model for today are what's providing the liquidity for us, not the ‘99 [portfolio companies]."

GPs have some leverage because most LPs don't want to deal with private company stock, which is what they would get if a venture fund is liquidated before exiting all its investments. Furthermore, LPs are not always on the same page when it comes to winding down a fund.

Garage Technology Ventures, which began life as an accelerator, found a way to manage all these issues. It turned to secondary firm Industry Ventures to work out conflicting limited partner interests and enable it to close out a $6 million fund, which still held promising assets after 10 years. Industry Ventures engineered a deal to distribute company shares to LPs who wanted them and to buy the rest.

Hans Swildens, founder and principal of Industry Ventures, said well-established venture funds aren't receptive to his firm's pitch unless they're having trouble raising cash to support companies in an older fund. Less-established firms or those whose days are numbered are more open.

Still, even that is progress. "I don't think the marketplace has accepted them as much as you would think," Robert Fore, a partner at Goodwin Procter LLP said of the secondary players. But "the fact that they're not being ignored is progress in my mind."

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