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State of the Venture Capital Industry
Analysis of data shows that who you know is top driver of VC returns

PALO ALTO, Calif. July 11, 2005 — An overview of the current state of the venture capital industry shows that some of the common perceptions about the factors that drive profit for the top firms are outdated.

Steve Bird, a general partner at leading Silicon Valley-based venture capital firm Focus Ventures today published a white paper titled “Private Equity or Personal Equity: Why Who You Know Still Drives Venture Capital Returns.” Focus Ventures provides expansion-stage capital for leading software, communications and semiconductor companies.

By combining the data of industry watchers, such as VentureOne and Thomson Venture Economics, with Focus Ventures’ analysis of returns from more than 8,000 venture financings from 1980-2003, the new white paper debunks, confirms, and forces caveats on some of the prevailing myths about the venture industry.

There were three major findings from Focus’ research:

- Despite the proliferation of VC firms, only 40-50 VC firms still create the bulk of industry value. The same small group of firms has consistently created the majority of value in the VC industry over the last 20 years, and their share of total industry profits has increased, not decreased, over time.
- Stage doesn’t matter... much. Perhaps the biggest myth in venture capital is that only early stage investors earn high returns. Focus Ventures found that if you take out the aberrant “bubble” year of 1999, when a substantial disparity in returns for early versus late stage skews the comparison, late-stage firms’ internal rate of return (IRR) matched that of early-stage firms over the last 20 years. The report also found that, while late stage investors pay about twice as much for their equity, they also nearly double the odds of a pay-out, hold their investments half as long as early stage investors and enjoy more predictable returns.
- Who you know is everything. The quality of the relationships that general partners build over years in the business influences VC fund returns the most, more so than sector, stage and geography. High returns and long-standing relationships with the financial community, entrepreneurs, customers, suppliers and scientists earn a firm access to the best deals, and ultimately to better performance.

“Together, these findings reinforce a notion that is intuitive, but bears repeating: that it is the quality of the startups that drives VC returns,” said Bird. “And since only a handful of firms and

general partners get to invest in the best startups, success in venture capital still boils down to one thing: relationships.”

The findings show that only a handful of initial public offerings (usually 30 or fewer) account for the bulk (70%) of industry profits in most years. The grip of the top 50 or so venture capital firms that have invested in those IPOs is tightening, not loosening.

That research presents a quandary for limited partners: if they can't directly access the best deals through top-tier early-stage funds, should they go to other avenues such as seed and angel investments (highly risky), late-stage funds (the best of which invest later in the life of the highest quality startups), or even funds of funds to get into the most desirable investments?

“If none of these options are possible, or palatable, limited partners should avoid compromise,” said Bird. “History has shown that, unless you can capture a piece of the very best deals in venture capital, your money may be better off in the public markets,” Bird concluded.

To view a copy of Focus Ventures' white paper, go to:

http://www.focusventures.com/whitepaper_who_you_know.pdf

About Focus Ventures

Focus Ventures is the leading expansion stage venture capital firm that invests in emerging market leaders in the software, semiconductor and communications industries. Focus Ventures currently manages \$570 million, having closed its first fund in October 1997 and Focus Ventures II in December 1999. Focus Ventures offers its portfolio companies access to high quality partners in Asia and an extensive network of resources focused specifically on driving top line revenue growth through customer introductions and by establishing distribution channels, joint ventures and licensing arrangements. Since the firm's inception, Focus Ventures has invested in 85 companies and has had 20 IPOs and seven acquisitions by public companies. A select number of portfolio companies that have gone public include: Active Software, Agile Software, Alteon WebSystems, BroadBase Software, Chordiant Software, Commerce One, Copper Mountain Networks, Corio, CoSine Communications, Interwoven, Loudcloud, Niku, Pixelworks, and Verisity. For more information on Focus Ventures or to read Steve Bird's full white paper, visit www.focusventures.com.