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Shhhh Listen, That's the Market Ready for Innovation

By [Sujata Srinivasan](#) | 11 March 2009



There's good news tucked away inside the bad news.

First, the bad news: According to the latest MoneyTree Report by PricewaterhouseCoopers and the National Venture Capital Association (NVCA), based on data from Thomson Reuters, venture capitalists invested \$28.3 billion in 3,808 deals in 2008, marking the first yearly decline of total investments since 2003. Venture investments in 2008 represented an eight percent decrease in dollar terms and a four percent decrease in deal volume from 2007. Investments in the fourth quarter of 2008 totaled \$5.4 billion in 818 deals, a 26 percent drop from the \$7.3 billion invested in the third quarter of 2008.

Now, the good stuff: Market discipline is alive and kicking in the venture capital world. VCs are on the prowl for under-valued firms, and wealthy investors are demanding more from their investments, thereby shoring up quality levels across the spectrum. Funds continue to flow into future technologies, the bedrock of sustained economic recovery. Despite a decline in VC investments last year compared to 2007, investments in the Clean Technology sector grew more than 50 percent in 2008, according to the report. Clearly, the industry is gearing up to meet customer demand for clean technologies in the

future.

“We are encouraged by the strength of the Clean Technology sector which continues to grow at a considerable rate. The stability of seed and early stage deals as a percentage of total deal volume suggests that venture capitalists are continuing to fund very young companies, giving credence to the philosophy that an economic downturn is a time ripe with opportunity,” said Mark Heesen, president of the NVCA, in a press release.

Of course, raising funds is a Herculean task.

“As we emerge from an extremely difficult year, the venture capital industry is holding its own and taking steps to adjust to the new reality,” Heesen said. “Venture capitalists are being cautious with their dollars which, in this environment, is the right strategy.”

Tighter funding brings into effect the Darwinian law.

Kanwal Rekhi of Inventus Capital in the Silicon Valley, who I spoke to on this trend, believes that when the economic climate gets tough, the weaklings start packing and the strongest remain, raising the chances of survival.

Sometime back, I interviewed Neeraj Agrawal, general partner of Boston-based Battery Ventures, for a newspaper article. He said that in the past, even an “okay idea” would receive funding. But now, you had to be the cream of the crop with a really brilliant idea to be able to raise funds. Agrawal said his firm was pursuing an aggressive acquisition strategy this year, and is on the prowl for firms that are undervalued due to the recession.

So contrary to popular belief, the market is functioning quite splendidly in this recession and the basic economic laws of demand and supply is driving VC investments. Yes, investors are more risk averse. But it's what the market needs now, after being battered by highly risky financial instruments that went kaput.

While the recession has wiped out the wealth of individuals and corporations, the process of creative destruction will usher higher returns on investments, smarter innovations, better execution of ideas to the final product stage, and lower failure rates in an industry, which has had traditionally very high failure figures. Additionally, a small and growing group of highly experienced senior executives who were laid off from large corporations are getting on the entrepreneur bandwagon.

Tracy Lefteroff, global managing partner of the venture capital practice at PricewaterhouseCoopers LLP said in a press release, “Even though we saw a significant drop in funding during the fourth quarter, we still note that the \$28 billion invested in 2008 is the fifth highest annual investment total in the 14 years the MoneyTree Report has been tracking venture capital. At this point, venture capitalists are doing what everyone else is doing - assessing and reassessing their capital outlays and each and every investment carefully in order to make prudent decisions on what companies have the brightest outlook for the long-term. The silver lining is that history has proven that true innovation can surface under very challenging

circumstances.”

While government bailouts are almost always palliative, providing critical care to prolong the life of a dying business deemed too big to fail, innovation in the private sector is the cornerstone of continued economic growth long after the bailout funds are used up.

In the latest newsletter from the Connecticut Technology Council, Liddy Karter, program director of Innovation Pipeline Accelerator, asks if we can innovate ourselves out of this economic mess.

Karter wrote that President Barack Obama's economic stimulus package contained almost no support for innovation that will create the next generation of productivity drivers.

Indeed the federal government can and must reduce entry barriers and promote innovation in the private sector.

Here are some suggestions directly from the horse's mouth.

According to a preliminary report dated Nov. 28, 2008, the President's Council of Advisors on Science and Technology advised the federal government to adopt the following measures to spur innovation in the industry:

- *Update and enhance R&D tax credit to make it a more stable and effective incentive for industry to perform and support R&D*
- *Develop guidance and educational tools on intellectual property and technology transfer practices for university and private sector partners*
- *Modify, or clarify through additional guidance, tax-exempt policies that may have an unintended negative impact on industry-supported research on university campuses*
- *Develop a task force to assess other tax policies impacting innovation*

Wrote Karter:

“Supporting our most promising entrepreneurs, the ones with ideas to change the world, is our best hope for getting us out of our current predicament. With so much focus on fixing the old economy we will leave ourselves even more unprepared for the new one. Entrepreneurs have the ideas, the ambition and the ability to find the path back to prosperity in a rapidly changing, technology-driven global economy.”

All that's needed is for the government to give a free rein to the American industry to do what it does best – innovate. No handouts, no protectionism, no mollicoddling. Just innovation tax credits and well-


defined intellectual property rights for collaborative research between the private and public sectors.

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1.  [J. Nick Puglia](#) Says:
[March 11th, 2009 at 8:37 pm](#)

Good stuff. Well-researched and very well done.

Imagine how much better things would be if government was completely out of the way, however. I always have 2 or 3 irons in the fire, so to speak, and many of my ideas never really ever get developed because there is so much regulation and red tape in the way.