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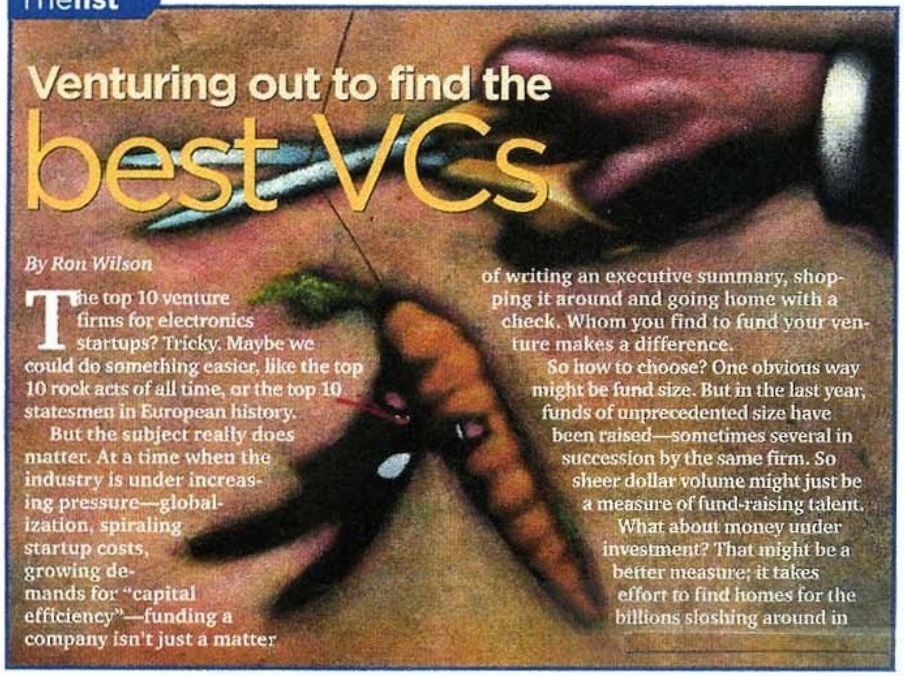
Thelist



Venturing out to find the best VCs

By Ron Wilson

The top 10 venture firms for electronics startups? Tricky. Maybe we could do something easier, like the top 10 rock acts of all time, or the top 10 statesmen in European history.

But the subject really does matter. At a time when the industry is under increasing pressure—globalization, spiraling startup costs, growing demands for "capital efficiency"—funding a company isn't just a matter of writing an executive summary, shopping it around and going home with a check. Whom you find to fund your venture makes a difference.

So how to choose? One obvious way might be fund size. But in the last year, funds of unprecedented size have been raised—sometimes several in succession by the same firm. So sheer dollar volume might just be a measure of fund-raising talent.

What about money under investment? That might be a better measure; it takes effort to find homes for the billions sloshing around in the funds. But determining who has how much invested where would be a daunting challenge—and the preference among some firms for the later funding rounds, when the dollar amounts are usually larger, might skew the findings.

How about returns? That's certainly the metric that investors care about the most. But there are two problems with it from the entrepreneur's point of view. First, a great rate of return doesn't necessarily indicate a firm you'd want on your board. The great numbers could have come from one or two home runs scored in 1999 amid an otherwise dismal portfolio. And gains can be, from the entrepreneur's point of view, ill-gotten.

Not only that, returns are notoriously hard to measure. Funds aren't public, so there's no annual statement. And if you ask a fund manager, you may not get an entirely straight answer. "I've never met a general partner whose returns weren't in the top quartile for the industry," quipped Steve Bengston, who follows VC activity for the moneyTree tracking service at PriceWaterhouseCoopers.

Maybe the answer lies in the pitch the venture capitalists make for themselves. Their claim is that you want a firm on your team not just for the money, but also for the expertise the general partner will bring to the table.

"The best VC can help in a variety of ways," said Bengston. "The help is most important for a first-time startup, but even seasoned entrepreneurs may be willing to take a lower valuation in order to get one of the top VCs into the deal."

"There are lots of ways a good firm can help—operating assistance, finding strategic partners, offering influence in international markets, even recruiting," said Jim Lussier, general partner in Norwest Venture Partners. "We have partners scouring India now for the best locations and the best people for our companies."

But don't expect that level of service from every VC partner. "At one company I was involved in, we had 10 venture investors," related Allan May, CEO of Vascular Architects Inc. "One of those 10 was really helpful. All firms pitch how much help they are going to be to you. Nine times out of 10, it's just air."

"It's not just the firm; it's the individual partner," noted Ed Lambert, senior vice president of Bridge Bank.

May agreed, adding, "You want to look for someone who has actually run a company, not some snot-nosed MBA."

Yet the firm can make a difference. Many of the older, seasoned firms bring in only partners who have really run something. They create an environment that encourages partners to spend time with their CEOs, with support from shared resources.

But that can cut both ways. An early-stage startup may find it can't get attention from a famous partner in a prestigious firm.

Still other firms may be so returns-oriented that they will make it hard for even a dedicated partner to spend time working with a young company. They may be more inclined to pull the trigger on a CEO than roll up their sleeves and work on a problem.

Can you spot a lemon? One respected industry CEO says you often can. He suggests studying the liquidation preferences in an

The favorites

In a small and unscientific survey, we asked fund partners, entrepreneurs and others familiar with the funding process which VCs they'd most like to have in their corner, and why. These, in descending order, were the top picks:

1 **Kleiner Perkins Caufield and Byers (Menlo Park, Calif., and San Francisco):** In many ways, Kleiner has become the benchmark people use to rate everyone else. In part it's a matter of longevity and reputation, especially the near-legendary reputation of partner Vinod Khosla. However, this is a cohesive group that has set standards and maintained them over the years.

2 **US Venture Partners (Menlo Park):** This firm was hailed for its general partners' strong domain expertise. General partner Steve Krausz in particular was mentioned.

3 **Foundation Capital (Menlo Park):** Broad-ranging Foundation claims all of its principals have been operating executives at one time or another. It tends to engage early with a startup but lets angel investors take the early funding; then it likes to lead the first institutional round. One respondent singled out general partner Mike Schuh.

4 **Lanza techVentures (Palo Alto, Calif.):** Lucio Lanza is something of a legend in the EDA industry. His fund is quite small compared with the billion-dollar giants being raised today, but his influence carries considerable weight.

5 **Sequoia Capital (Menlo Park and Herzlia, Israel):** Another old-line company that has been behind some now-famous names in the industry, Sequoia remains a group of folks you'd like to have on your side of the table.

6 **Fremont Ventures (San Francisco):** Part of a much larger private investment group, Fremont was cited for the quality of its support to its companies.

7 **Greylock Partners (Waltham, Mass., and San Mateo, Calif.):** Dave Strohm in particular was cited by those who mentioned this old-line firm.

8 **New Enterprise Associates (Menlo Park; Reston, Va.; and Baltimore):** Better known simply as NEA, this firm includes some partners who have become household names in the industry.

9 **Sevin Rosen (Dallas; Palo Alto; Austin, Texas; and San Diego)** Steve Domenik's name came up frequently among those who mentioned this famous old-line fund.

10 **Telos Venture Partners (Palo Alto):** Strictly speaking, Telos is a corporate fund. Cadence Design Systems is its only limited partner, and Cadence executives review its funding decisions. But the fund insists it is not a strategic investor for Cadence. Adding credibility to that claim is the number of times general partner Jim Hogan's name came up among respondents who respect his experience and acknowledge his aid to small companies.

offer. These are the terms that control who gets what if the company should be liquidated or, in some cases, merged or acquired.

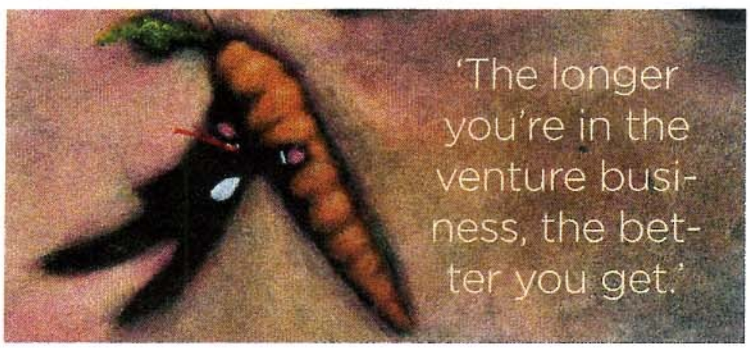
Read the fine print. Offers sometimes grant the fund a return of 300 or 400 percent on their investment before anyone else—including the founders—sees a penny. In many acquisition scenarios, this would mean that the founders and early employees of the company would almost surely be working for nothing but their salaries. And these days, acquisition is the most common exit.

Finding a partner

How do you find the right general partner at the right firm for your company? Chemistry makes a difference. You may find yourself working beside the partner during some of the hardest times of your professional life.

Experience counts as well. "The longer you're in the venture business, the better you get at it," said Raman Chitkara, partner and leader of the global semiconductor practice at PriceWaterhouseCoopers. "There are still a lot of firms around that opened during the madness in '99. But I think older is still better—both for institutions and individuals."

Bengston offered an even sterner warning about new funds. "Over the next 10 years, about a hundred general partners will go away. In the next five years, about half the existing firms will go away. Attrition will be highest among the newer firms and the corporate funds. Choose wisely."



Your own company's life stage should also figure into the selection. Some funds specialize in early-stage investments; they're comfortable with the small amounts of cash involved and are more patient about waiting for a return. Other funds have huge sums under investment and must out of necessity write larger checks. Their partners may be more familiar with large, rapidly growing ventures than with startups.

And there can be special considerations. If your target market lies in a different country, for instance, you may find it valuable to have an investor from that region. Commenting in particular on the Chinese market, one CEO said, "The best Asian venture funds can get you in to see just about anyone in the area. I'd say that if your market is Taiwan or the mainland, an investor from that specific area may be essential."

Geography counts for exit reasons as much as for operating knowledge. Ventures created in Asia, an experienced partner pointed out, are often structured in ways that may complicate an exit into the Nasdaq, or even a merger or acquisition. A firm with experience in "cleaning up" the structure of a small company to get it ready for later rounds of funding or for further growth can be essential here. The investor cited New Enterprise Associates (NEA) and the Pacific Venture Group as examples.

But the CEO who cited the importance of local-market expertise also had a caveat: "Taiwanese funds can have a very different attitude toward risk. They may be happy to get a 50 percent return on their investment in two years rather than wait longer and help build your company for the chance at an IPO. They also have a very different view of how much money it takes to run a company. Expenses are different there than in the U.S."

Another important question revolves around corporate investors. During the bubble years, it was fashionable for large companies to have venture funds that could, the reasoning went, both serve the strategic purposes of the company and make a bundle of cash. Now that bundles of cash are a little less common, many of the corporate funds have closed up shop, and many more are likely to go.

But there are still some big corporate funds that play central roles in the business. First of these is Intel Capital, which is so large and pervasive that it is a factor in just about every market segment. Other corporate funds mentioned by sources included Xilinx Ecosystem Fund, which has been active in EDA tools and intellectual property, and UMC Ventures, a strategic arm of Taiwanese foundry United Microelectronics Corp.

Corporate investors can open doors to technology partners and prospective customers in a way few others can. A foundry, for example, can make a compelling case to one of its customers that your tool warrants a serious look.

But "corporate investors have different logic," one general partner commented. "They have strategic objectives as well as financial ones. And sooner or later, there will be a conflict."

Best Rolodex

These may be useful guidelines, but there's noting like a personal reference. So we asked a number of well-known general partners, entrepreneurs with small-company experience and others familiar with the process whom they would pick if they were scouting investors. Who would bring the best operations experience, the best coaching, recruiting help, the best Rolodex? (See "The favorites" on page 1 .)

A couple of notes: First, the survey had a small sample and was not scientific. This was a collection of people's opinions, not a quantitative study. Hence the order is not all that significant. The difference between first and tenth may mean something, but the difference between sixth and eighth certainly does not.

Second, we were surprised to find that respondents mentioned far more firms and individuals than the 10 listed here. From this we have to conclude that although there are clearly first-tier and second-tier firms, there are lots of venture capitalists out there who have been a big help to their companies. Don't give up if nobody from the top of the list makes you an offer.

Finally, the answers to our survey were very much influenced by the markets involved. Not all firms are equally helpful to companies in all end markets. Some, for instance, are great folks but do only biomedical companies. None of those is listed here. Some of the people on the list are EDA specialists and won't be involved in a semiconductor startup—or vice versa. "Kleiner Perkins [Caufield and Byers] is a great firm," one respondent said, "but they don't have a lot to offer an EDA startup."