camp_c01.qxd 1/8/02 10:30 AM Page 5

CHAPTER 1

Screening Due Diligence

APPARENT DEAL QUALITY

Quality of Source

From what source did the deal come or by whom was the deal referred?

A simple and effective screening mechanism used by many venture capitalists is to scrutinize the routes from which deals emerge. Venture capitalists overwhelmingly tend to favor deals referred to them by trusted sources. Kevin Fong, general partner of the Mayfield Fund, states that his firm relies consistently and heavily on its network of lawyers, portfolio companies, and other respected contacts to uncover the best deals.[1] According to John Doerr, general partner of Kleiner Perkins Caufield & Byers, of the over 250 ventures in which his firm has invested, almost every one was referred by a trusted source: "a CEO, an engineer, a lawyer, friend, or another venture capitalist—known to both the founders and [the] partnership."[2] The reason that venture capitalists take this approach is that they usually know much more about the quality of the source by which a deal was referred than about the quality of the referred deal itself. It makes sense, then, for them to use the quality of the source of the deal, which is well known, as a rough proxy for the quality of the deal, which is not.

Quality of the Business Plan

What is the overall quality of the company's business plan?

As a second screening mechanism, venture capitalists often scrutinize the business plans they receive to gauge the quality of general

camp_c01.qxd 1/8/02 10:30 AM Page 6

presentation, thoroughness, clarity, coherence, and focus. These surface aspects often convey much about the quality of the investment opportunities and the entrepreneurs, themselves, underlying the surface. Says Russ Siegelman, partner at Kleiner Perkins Caufield & Byers:

> *The variations in the quality of the plans I read is amazing. Sometimes they look like the entrepreneur's dog has chewed them, and they are photocopied sloppily onto standard copy paper, with typos and coffee stains. Sometimes they are glossy, well written, with plenty of Excel generated charts and pages of financial projections. One might think that a good VC will get beyond the stains and the chewed pages and get to the business idea to make a judgment. But that isn't my view. If entrepreneurs don't present their ideas in a quality way, they probably aren't organized or professional enough for me to want to invest. I am not typically a form over substance kind of guy, but when it comes to business plans, I can't get to the substance if the form doesn't make the quality bar.*[3]

C. Gordon Bell, Digital Equipment Corporation veteran and adviser to U.S. Venture Partners, states rightly that "the ability of a CEO and his or her top-level group to write a good business plan is the first test of their ability to function as a team and to run their proposed company successfully."[4]

At a minimum, venture capitalists prefer business plans that convey a coherent and compelling story. They like plans that are clear, concise, thorough, and professional in presentation; practical, realistic, and credible in content; and that adequately explain all assumptions on which claims are made. They also like highly focused, concise plans. Venture capitalists generally prefer business plans that present a lot of information in a very few words.

As an example of what venture capitalists typically look for in business plan topic coverage, the partners at CMGI @Ventures like business plans to include the following eight categories of information:

camp_c01.qxd 1/8/02 10:30 AM Page 7

1. The Business:
   Company's business.
   Strategy.
   Mission statement.
2. The Market:
   Historic and projected sizes in dollars.
   Market trends.
3. Product Offering:
   Product description.
   Development schedule and launch date(s).
   Product differentiation.
   Revenue model.
4. Distribution:
   Key customers.
   Customer acquisition strategy.
   Sales channels.
   Partnerships.
5. Competition:
   Key competitors.
   Competitive advantages.
   Barrier to entry.
6. Management Team:
   Roles and responsibilities.
   Background of team members.
   Board composition.
7. Financials:
   Historic and forecasted P&L (first two years by quarters).
   Projected cash flow (first two years by quarters).
   Current balance sheet.
   Projected head count by functional area (G&A, sales, marketing, product development).
   Capitalization schedule.
8. The Deal:
   Amount to be raised.
   Anticipated valuation.
   Use of proceeds.[5]

camp_c01.qxd 1/8/02 10:30 AM Page 8

Plans addressing these topics fully (but efficiently) tend to be effective in conveying to venture capitalists the overall merits of the given investment opportunities. They also provide a solid foundation on which venture capitalists can begin their due diligence.

Additionally, most venture capital investors strongly favor business plans that contain well-thought-out, well-defined milestones. Venture capitalists use such milestones to measure and monitor companies' performance. Alan E. Salzman, managing partner of VantagePoint Venture Partners, and John Doerr explain, for venture capitalists, "early detection of deviation from the plan will indicate needed changes in the scheduled financings and help identify emerging problems in time for corrective action."[6] Business plans containing appropriate and well-defined milestones facilitate this function.

Quality of Other Equity Investors

Who are the company's existing investors, and who are the potential coinvestors?

Venture capitalists also often focus on the quality of companies' existing equity investors and potential current round coinvestors as a third screening mechanism. They do this for two reasons. First, an impressive investor list is often indicative of a good investment. Simply put, great companies attract high-quality investors. Conversely, a company's inability to find any high-quality investors suggests that an investment may not be a very promising one. Second, high-quality investors often contribute significantly to their companies' success. Depending on the particular investors, they may provide any or all of the following to their portfolio companies: general business knowledge, finance knowledge, technical expertise, entrepreneurial experience, operating experience, and business reputation. Equity investors may also bring to their portfolio companies extended networks of contacts to management recruits, service providers (law firms, accounting firms, public relations firms, etc.), customers, suppliers, strategic partners, venture capitalists, potential acquirers, and/or investment bankers.

A somewhat related point that some venture capitalists examine during due diligence is whether, and to what extent, existing equity

camp_c01.qxd 1/8/02 10:30 AM Page 9

investors will participate in the current round of financing. The failure of existing investors to support the company may dramatically reduce interest on the part of venture capitalists because existing investors often have unique information about the companies in which they hold equity. Almost surely, they have more high-quality information than that available to potential investors, even after thorough due diligence. Accordingly, if existing investors choose not to participate fully in subsequent rounds, it may quite possibly be the result of problems not visible to potential investors.

Quality of Legal Counsel

Who is the company's legal counsel?

To be successful, early-stage companies, need good legal counsel. The road from start-up through high growth to successful maturity is much too hazardous to forge ahead without a high-quality and appropriately experienced law firm on board. On one hand, law firms provide vital legal services such as creating corporate structure, addressing employment issues, and advising on contract negotiations. Companies receiving sound, quality legal advice in these areas certainly increase their likelihood of success. Regarding contracts, the venture capitalists at Accel Partners state that the "corporate contracts demanded of new companies grow geometrically—distribution agreements, employment agreements, financial agreements, patent agreements—and mistakes on any of them can seriously jeopardize a company's ultimate value. Even minor errors can require inordinate top management attention."[7] On the other hand, law firms also often provide other services to early-stage companies, such as giving advice on business plan construction and financing strategy, and making introductions to venture capital firms, bankers, accounting firms, and consultants. Receiving this assistance from experienced and well-connected lawyers can also boost a company's likelihood of success. Therefore, a fourth screening mechanism sometimes used by some venture capitalists is to evaluate the quality of companies' legal counsel.

Determining the quality of law firms is not always easy for venture investors, but, as Christopher Schaelpe, general partner of

camp_c01.qxd 1/8/02 10:30 AM Page 10

Weiss, Peck & Greer Venture Partners, explains, there are only "on the order of 15 major law firms throughout the country with a core competence in advising private high-technology companies."[8] In Silicon Valley, this fraternity includes Wilson Sonsini Goodrich & Rosati; the Venture Law Group; Cooley Godward; Gunderson Detmer; Fenwick & West; Brobeck Phleger & Harrison; Heller Ehrman White & McAuliffe; and Gray Cary Ware & Freidenrich. In Boston, it includes Hale & Dorr; Testa Hurwitz & Thibeault; and Edwards & Angell. In New York, it includes Skadden Arps Slate Meagher & Flom; O'Sullivan Graev & Karabell; and Reboul MacMurray Hewitt Maynard & Kristol. In Seattle, it includes Perkins Coie.

Quality of Accounting Firm

Who is the company's accounting firm?

Early-stage companies also need quality accounting advice and assistance to function and grow effectively. This generally involves three basic services. First, the law requires all companies to file tax returns, and accounting firms can certainly aid in that area. And, outsourcing tax preparation often makes a lot of sense for young companies because it allows them to focus on their real task: building their companies. Second, many early-stage companies can benefit significantly from assistance with bookkeeping. Indeed, a well-designed bookkeeping system is crucial to effective early-stage management. And, third, early-stage companies will, at some point, require auditing services. Auditing services can facilitate further venture financing, bank financing, and financing in the public markets, and can often aid in forging customer relationships.

Furthermore, like their legal counterparts, venture-oriented accounting firms offer services beyond traditional accounting-type services. As Jeffry A. Timmons, professor at the Harvard Business School, points out:

> *Accountants who are experienced as advisors to emerging companies can provide, in addition to audit and taxation, other valuable services. An experienced general business advisor can be invaluable in helping to think through strategy, in helping to find*

camp_c01.qxd 1/8/02 10:30 AM Page 11

> *and raise debt and equity capital, in mergers and acquisitions, in locating directors, and in helping to balance business decisions with important personal needs and goals.*[9]

Therefore, a fifth screening mechanism used by some venture capitalists is to assess the quality of the accounting firms companies have chosen to retain. An appropriate accounting firm is both high quality and well qualified in working with early-stage venture-backed companies.

Quality of the Origin

Does the origin of the company conform to successful patterns?

A sixth screening mechanism used by some venture capitalists involves an examination of companies' origins. They feel much more comfortable with companies whose origins resemble those with whom they have met success in the past—that conform to successful and familiar patterns. For example, venture capitalists are used to backing companies started by well-known executives who have "spun out" of established, market-leading companies, or by well-known university professors who have developed cutting-edge innovations, or by hungry and brilliant graduate students who have happened on the "next big thing" during their studies. Companies with these origins, and others conforming to other patterns of success, tend to find venture backing relatively easily. On the other hand, companies that have questionable or unusual origins may find that venture capitalists are very tight-fisted. Recognizing patterns of success makes sense for venture capitalists, because patterns, by their nature, repeat themselves; all things being equal, companies whose origins conform to successful patterns tend to be successes themselves.

Quality of Customers and/or Partners

Has the company signed any impressive customers and/or partners?

One thing that often gets a company quickly past the screening phase of due diligence is the ability to list an impressive customer or two, or

camp_c01.qxd 1/8/02 10:30 AM Page 12

to have inked a deal with a strategically valuable partner. The venture capitalists at Oak Investment Partners state that they look for "distinctive relationships that have been formed with customers or partners that give [them] good visibility into the near future."[10] The ability to close important deals is indicative of the ability to succeed, especially in the early stages, where one key deal can make or break a company. Closing such deals also demonstrates momentum. Companies that can sign one important deal usually have a much easier time signing the next, and the next, just as a snowball builds mass quickly once it starts rolling. Therefore, venture capitalists tend to be strongly drawn to companies that can demonstrate they are just beginning to roll.

It is certainly most impressive when such deals have been finalized, but venture capitalists also are interested (though slightly less so) in those for which companies have only received letters of intent (LOIs, also referred to as memoranda of understanding or MOUs). LOIs are usually nonbinding, but they lay the foundation for final deals by spelling out their principal terms. They are often an important and necessary intermediate step toward finalizing deals, and companies that obtain them offer strong evidence that the other party is seriously interested in striking a deal.

Shopped Deal

Has the deal been shopped around to many investors, each of whom rejected it?

An eighth screening mechanism used by many venture capitalists is to determine whether deals have been "shopped," that is, whether they have been presented to and been passed over by other investors. Venture capitalists generally avoid shopped deals. Properly employed, this strategy makes a lot of sense. Shopped deals, by definition, have been reviewed and rejected several times by other venture capitalists. If a particular venture capitalist trusts the business and investment judgment of another investor who rejected the deal, there is no reason that the former should not rely on the latter's negative due diligence. However, rejecting a deal solely because it was

camp_c01.qxd 1/8/02 10:30 AM Page 13

shopped, without finding out *who* rejected the deal and *why* it was rejected, could result in the venture capitalist missing a great opportunity. Twenty venture capitalists turned down Hotmail before Draper Fisher Jurvetson invested; Hotmail was later sold to Microsoft for over $400 million.

INVESTMENT COMPATIBILITY

Market Space Compatibility

Is the market space that the company is targeting compatible with your investment strategy?

Venture capitalists invest in more than just companies, they invest in the future of a particular technology or a particular market. However, the enormous breadth of markets and the rapid pace of innovation make it impossible for them to maintain a sufficient depth knowledge across all market spaces to understand every investment opportunity. According to Robert G. McNeil, general partner of Sanderling Ventures, because of spiraling "technological complexities," the "ongoing trend in the venture community is specialization" in a few market spaces.[11] The venture capitalists at El Dorado Ventures state that they invest in only four areas: communications, enterprise software, Internet software and services, and semiconductors.[12] They add that even if a company has "a fantastic product, if it doesn't fit into one of those categories, [they] won't be interested."[13] Such investment discipline ensures, to the greatest extent possible, that venture capitalists make well-informed investment decisions.

When venture capitalists find themselves not sufficiently qualified to evaluate companies in particular market spaces, they often seek outside assistance in the form of technical consultation. For example, the venture capitalists at Draper Fisher Jurvetson state: "To evaluate technology, Draper Fisher Jurvetson does not rely on in-house expertise alone, but contacts appropriate specialists to evaluate the feasibility of developing the entrepreneur's vision."[14] Most venture capital firms actually make technical experts a part of their firms by making them venture partners or special limited partners.

camp_c01.qxd 1/8/02 10:30 AM Page 14

Development Stage Compatibility

Is the company's stage of development compatible with your investment strategy?

Successful businesses progress through several stages of development and numerous substages. The "early stage" is generally considered to cover three substages: seed, start-up, and first stage. Venture financing is required during each, but the proceeds from such financings are used for somewhat different purposes during each substage, as William Sahlman, professor at the Harvard Business School, describes:

> Seed Financing: *Seed financing is the earliest stage of funding. A small investment (typically $25,000 to $300,000) is made to support an entrepreneur's exploration of an idea. Often there is no business plan, an incomplete management team, and little assurance that the basic technology is feasible.*
>
> Startup Financing: *Startup financing entails the commitment of more significant funds to an organization that is prepared to commence operations. A startup should be able to demonstrate a competitive advantage. Most high-technology firms should have a product in prototype form embodying a proprietary technology. A research-oriented venture, such as a biotechnology firm, might instead exhibit an impressive research staff.*
>
> First-Stage Financing: *First-stage financing is provided to ongoing businesses. A first-stage company is generally not profitable, but it normally has an established organization, a working product, and, preferably, some revenues. First-stage funds are usually used to establish a company's first major marketing efforts, and to hire sales and support personnel in anticipation of higher sales volume. Often, funds are also applied to product enhancements or product line expansion.*[15]

Venture capitalists generally have strong preferences for one or more of these substages. Some prefer earlier deals with lower company valuations and higher potential returns, but also higher risk. Others

camp_c01.qxd 1/8/02 10:30 AM Page 15

prefer later deals with higher valuations, but lower risk. Of course, such preferences are usually not set in stone. Most venture capitalists will invest in companies in less preferred substages if other characteristics of the deal are sufficiently attractive.

Keiretsu Strategy Compatibility

Does the company fit into your keiretsu *strategy?*

The *keiretsu* concept originated in the Japanese business system. Japanese *keiretsu* are groups of firms that bind themselves together in webs of obligation. They are controlled under Japanese law and are built such that cooperation between firms is virtually mandatory. The theory behind Japanese *keiretsu* is that each associated firm gains a competitive edge through the creation of a long-term strategy for the entire group, as opposed to a situation where each firm merely pursues its own strategy. The bellwether venture capital firm of Kleiner Perkins Caufield & Byers has adopted this concept and the term, but the venture capitalists there apply them in a slightly different manner than do the Japanese. Like the Japanese, the Kleiner Perkins *keiretsu* is also based on company cooperation, but they merely *encourage* their portfolio companies to cooperate.

Much of the value venture capitalists bring to early-stage companies comes from leveraging their extensive networks of potential managerial talent, advisers, customers, strategic partners, acquirers, and other sources of capital. These networks, which all venture capital firms have in varying qualities, are significantly composed of people associated with their current or former portfolio companies. A few venture capitalists actually incorporate the drive to create powerful networks into their investment strategies (they choose to invest in companies that can benefit, and benefit from, their network). It is this concept—an extensive network of carefully chosen portfolio companies—that Kleiner Perkins has captured in their adoption of the keiretsu concept. It can be a powerful and valuable approach when trying to build early-stage companies. The venture capitalists at Kleiner Perkins explain: “The companies in the KPCB Keiretsu

camp_c01.qxd 1/8/02 10:30 AM Page 16

consistently share experiences, insights, knowledge and information. This networking resource, comprised of more than 175 companies and thousands of executives, has proven to be an invaluable tool to entrepreneurs in both emerging and developing companies."[16] Doerr states that venture capital *keiretsu* "are rooted in the principle that it is really hard to get an important company going and that the fastest and surest way to build an important new company is to work with partners."[17] Venture capitalists, like those at Kleiner Perkins, who sit at the center of these *keiretsu* networks create valuable connections between members of the network, such as facilitating management hires, customer relationships, partnerships, and acquisitions. Such connections add value to each company involved, and that value translates into enhanced returns to venture capitalists.

Portfolio Compatibility

Will the company be competitive with any of your existing companies?

It is unusual for venture capitalists to invest in competing companies. Those at @Ventures state in no uncertain terms: "We have a policy against investing in new business opportunities that compete directly with our existing portfolio companies."[18] Significant legal conflicts can arise when venture capitalists invest in competing companies, particularly when they take positions on competing boards of directors. When two of Draper Fisher Jurvetson's portfolio companies became competitive (they were not truly competitive when they initially invested), the venture capitalists at the firm had to erect a Chinese wall to inhibit the flow of confidential information from either of the companies to the other. They put one managing director, Tim Draper, on one company's board and put another, Steve Jurvetson, on the other company's board, and then attempted to have them avoid speaking directly about either of the companies. This arrangement actually worked out quite well, but to minimize these awkward situations (and serious legal problems), venture capitalists in general create policies similar to that of @Ventures. So, whether new companies compete with existing portfolio companies is another widely used screening mechanism.

camp_c01.qxd 1/8/02 10:30 AM Page 17

Investment Amount Compatibility

Is the amount of capital sought by the company compatible with your investment strategy?

Venture capitalists generally have a preferred range for the amounts they like to invest. For any given venture capitalist, Tyzoon T. Tyebjee and Albert V. Bruno, professors at the Santa Clara University School of Business, explain, the upper bound of this range is "determined by the capitalization of the portfolio and the desire to maintain an investment base that is diversified. . . . [19] Investors must make a sufficiently large number of investments to reap the risk reduction benefits of diversification. At the other end, as Tyebjee and Bruno explain, the lower bound is determined by the fact that active venture investors "cannot afford to spread [their] portfolio[s] over too many small deals because the subsequent control and consultation demands . . . are essentially the same regardless of the size of the investment."[20] William Sahlman elucidates this idea:

> *In order to realize value from their investments, the fund's managers need to commit time to board meetings, consultation with management, and other monitoring activities. Because of the number of competing opportunities for the VC to add value, there is a substantial opportunity cost (or shadow price) to the VC's time. Thus, an investment must be large enough to justify the commitment of time it entails; if the number of investments per manager becomes excessive, it will become impossible to add value to any of them. In addition, if a venture capitalist will be one of several investors, that VC will wish to have a large enough holding relative to the other major shareholders to be able to influence company policy.*[21]

The following are some examples of venture capitalists' preferred ranges: the venture capitalists at AVI Capital average an investment of $4 to $6 million in each portfolio company;[22] the venture capitalists at Benchmark Capital typically invest $5 to $7 million;[23] the venture capitalists at Sequoia Capital invest anywhere from a $50,000 seed investment to $10 million;[24] the investments of venture capitalists at

camp_c01.qxd 1/8/02 10:30 AM Page 18

Oak Investment Partners range between $2 million and $15 million;[25] and the venture capitalists at Battery Ventures make investments of $5 to $20 million, or more.[26]

Geographic Compatibility

Is the company geographically accessible for adequate due diligence, and is the company strategically located for success?

Geography has historically been a large factor for venture capitalists during due diligence. Traditionally, many would only invest in companies that were located within two hours' drive from their offices. This actually remains largely true today. The venture capitalists at U.S. Venture Partners state that they "tend to focus on opportunities that are geographically close to [their] offices in Menlo Park. . . . "[27] Likewise, the venture capitalists at El Dorado Ventures say that they invest "only in companies that operate primarily from the West Coast."[28] They state bluntly: "We love it here in Boston" from a company would be a "sure-fire deal-killer."[29] On the opposite coast, the venture capitalists at Flatiron Partners focus their investing on the New York metropolitan area because when investing in early-stage companies they also "prefer to invest close to home."[30] Most other venture capitalists echo similar sentiments, though a few maintain a nationwide scope (e.g., Sevin Rosen Funds).

The reasons behind these geographic preferences are largely logistic. Venture investors need to be able, geographically, to do several things: (1) perform adequate due diligence, (2) monitor and periodically visit portfolio companies, (3) consult regularly with senior management on strategic decisions, and (4) attend meetings of boards of directors. To do all these things adequately while maintaining a national focus translates into an enormous amount of travel. Benjamin M. Rosen, founding partner of Sevin Rosen Funds, states that because of their national focus, when active, he was spending most of every week on the road and logging over 250,000 miles per year.[31] Most venture investors prefer to spend less time traveling and choose instead to narrow their geographic focus.

camp_c01.qxd 1/8/02 10:30 AM Page 19

Location can also have significant ramifications for companies' long-term success, as Kevin Fong notes: "[A] big consideration is geographic location. If a company is in a place [that] doesn't have the necessary infrastructure, I'm not going to give that much time."[32] Having adequate access to the appropriate infrastructure is crucial for early-stage companies. They need access to a high-quality labor pool and leading service providers such as cutting-edge consultants, top law firms, accounting firms, and public relations firms. They also need to be in close proximity to attractive customers and strategic partners. When necessary, venture capitalists sometimes counsel (and often successfully persuade) their portfolio companies to strategically relocate in order to increase their likelihood of success.

Personal Compatibility

Is there personal compatibility between you and the company's management team?

Venture capitalists tend to maintain close working relationships with their portfolio companies during the life of their investments. Only a small percentage of early-stage venture capitalists choose to be passive investors. Spending a substantial amount of time with entrepreneurs over several years is virtually a necessity. Therefore, personal chemistry between themselves and entrepreneurs is extremely important to venture capitalists. Says John Fisher, managing director of Draper Fisher Jurvetson, "I don't care how good the concept is or the market is, if I don't like the guy I don't want to do the deal."[33] "Life," he says, "is too short."[34] The early-stages of a company's development can be extremely intense and can put great stress on all parties involved. If the participants can maintain effective working relationships in that environment, companies are much more likely to succeed. For precisely that reason, the partners at New Enterprise Associates consider the following question one of their "three key considerations" when doing due diligence: Are the entrepreneurs "people we can work with 'through thick and thin'—especially thin?"[35]

camp_c01.qxd 1/8/02 10:30 AM Page 20

Harvest Strategy Compatibility

Is the company's projected liquidity strategy compatible with your investment strategy?

Mitch Kapor, founder of Lotus Development Corporation and general partner of Accel Partners, says that he will only invest in ventures that are targeting specific liquidity events.[36] He is not alone. Most venture capitalists scrutinize companies' harvest strategies carefully, in terms of both the type of liquidity event projected and the timing. Liquidity strategies are of vital importance to venture capitalists because they determine the schedule and the size of their harvests—when and how much they get paid. With regard to timing, Fred Dotzler, general partner of Medicus Venture Partners, explains: "The time required for an investment to turn into liquid securities or cash is important. The sooner cash is realized, the higher the rate of return."[37] For that reason, venture capitalists generally make sure that entrepreneurs fully understand that they must have the ability to liquidate their ownership positions at some point in the not too distant future. The venture capitalists at Draper Fisher Jurvetson specifically state that they prefer "an exit after a five to seven year holding period."[38]

Howard H. Stevenson, professor at the Harvard Business School, explains, "Not all ventures have the same alternatives for harvesting; some cannot be harvested at all and must simply be operated for cash."[39] Venture capitalists, however, will almost never consider investing in companies that do not have strong prospects for successfully achieving (and are not working diligently toward) events that will provide them with liquidity. Essentially, two types of events do this: (1) when companies effect IPOs that create liquid markets for their securities in the public securities markets; and (2) when companies are acquired, either for the stock of a public company for which a liquid market already exists or for cash.

Whether an early-stage company sets its sights on an IPO or an acquisition can depend on several factors. Ed Glassmeyer, a general partner at Oak Investment Partners, explains, "A lot of times a plan to sell has a lot to do with whether you are building a company or a product."[40] Companies that are projecting and working toward

camp_c01.qxd 1/8/02 10:30 AM Page 21

IPOs, he explains, have to build "fully developed enterprises that can grow on their own with a capital infusion from a public offering."[41] Companies that are projecting and working toward acquisition may focus less on building fully developed enterprises and instead on building some sort of value (maybe a product or a product enhancement) that has the potential to attract corporate acquirers.

Traditionally, venture capitalists have tended to favor companies targeting IPOs. The venture capitalists at Hummer Winblad Venture Partners say that they "are always thrilled by IPOs, but are open to other positive strategies, such as acquisitions. . . . "[42] Acquisitions have, however, recently gained in popularity relative to IPOs, partly because many acquisition values have begun to approach IPO values. And, according to Ray Rothrock, general partner of Venrock Associates, sometimes it is just "easier to be swallowed."[43] Regardless of individual preferences toward IPOs or acquisitions, the most important thing for most venture capitalists is that companies have some sort of liquidity strategy in place. The reason is simply that, in general, companies whose investors realize the greatest capital gains from harvest are started and grown with a liquidity objective in mind.

camp_c01.qxd 1/8/02 10:30 AM Page 22