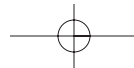
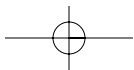
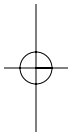
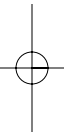
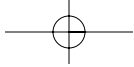


# **PART I**

## **DOING YOUR HOMEWORK**

### *Preparing for the Venture Capitalists*





# CHAPTER 1

## THE VENTURE CAPITAL REVOLUTION

**A**s an entrepreneur, you are living in extraordinary times. Never before has so much money been made available in so short a time for so many businesses.

Only a decade ago, there was little money for new companies because the venture capital industry received significantly fewer investment dollars. In 1990, for example, a mere \$3 billion flowed into venture capital funds. By 1998, the annual inflow had risen almost tenfold to a then-record \$30 billion. In 1999, the torrent of funds almost doubled again to \$56 billion. Indeed, more money has flowed into U.S. venture funds in the past two years than in the previous 20 years combined.<sup>1</sup> What happened?

The first event was the revolutionary shift in the American economy to the high-tech companies of the 1990s. These technology- and Internet-focused start-ups had to get money somewhere. Banks wouldn't touch them, nor would established companies, which either perceived the start-ups as a threat or simply didn't understand their business plans.

Enter the venture capitalists (VCs). Led by a new generation of risk takers like John Doerr and Don Valentine, well-funded VCs fueled the

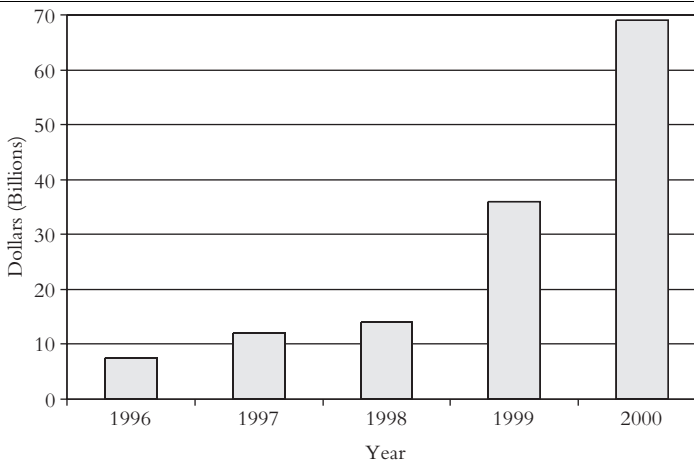
## DOING YOUR HOMEWORK

transformation of the U.S. economy. The explosive growth of high-tech companies created scores of billion-dollar corporations and unprecedented individual wealth that powered the greatest bull market in U.S. history. By the end of the decade, initial public offerings (IPOs) for Internet companies alone vaulted to over \$12 billion.

Wishing to partake in the phenomenal success of the VCs who backed the high-tech revolution, more and more investors were attracted to venture funds, which continued to produce stupendous returns as wave after wave of IPOs soared. The winners are the legendary leaders of an entrepreneurial Hall of Fame that continues to add to its illustrious membership: Microsoft. Cisco. Netscape. Amazon. Yahoo.

The spectacular results of the high-tech revolution transformed traditional industry and commerce *and* the venture capital and investment industries simultaneously. The billions of dollars that surged into venture funds poured into companies with little more than a business plan. As Figure 1.1 shows, in just the past few years there has been a dramatic rise in VC investments in start-ups. From 1996 to 2000, the outflows grew over ninefold from \$7.5 billion to over \$68 billion.<sup>2</sup>

**Figure 1.1**  
**Venture Capital Investments**



## THE VENTURE CAPITAL REVOLUTION

Not surprisingly, during the past decade, about 90 percent of VC funding has gone to technology companies. Besides the increase in overall dollar volume, the size of individual deals has increased geometrically. The “big deals” in the 1970s involved investments of \$500,000. In the 1980s, they ranged to \$5 million. In 1999, the big deals dwarfed all that had come before: Webvan, an online grocer, received \$275 million; CarsDirect.com, an Internet auto dealer, obtained \$280 million; Equinix, an Internet infrastructure builder and maintainer, won \$280 million; Veridian, a computer network security provider, was given \$325 million; and Zhone Technology, a telecom company providing “last mile” delivery of voice, video, and data, got \$500 million.<sup>3</sup>

Incredible amounts of cash have poured into individuals’ pockets as well. Once upon a time, only a few celebrities—Rockefeller, Mellon, and Carnegie—had untold wealth. Today, the venture capital revolution has created too many super-rich for them all to be household names. In 1999, for example, 54 entrepreneurs were included on the *Forbes* 400 Richest People in America list. Individuals’ net worths ranged from \$625 million to \$5 billion. Only a few of them, like Steve Case of America Online (worth \$1.5 billion) and Scott McNealy of Sun Microsystems (\$1.1 billion), have become famous. The majority, like Pierre Omidyar of eBay (\$4.9 billion) and Joe Ricketts of Ameritrade (\$2.4 billion), are not.<sup>4</sup>

Unlike the notorious robber barons of yesteryear, many of today’s captains of industry did not toil for decades to amass their fortunes. Indeed, centimillionaires and even billionaires are often created virtually overnight. What has changed?

Vcs, armed with overflowing coffers, have provided the necessary capital—and, sometimes, the management talent—to jump-start new businesses. As a result, the time necessary for the journey from business plan presentation to IPO has been dramatically reduced. Scalable businesses that threaten established entities are being built in three years or less. This is truly the golden age of entrepreneurship. Brains and energy are rewarded with the riches of Croesus—or, better yet, of Bill Gates.

But victory is far from certain in this realm of endless funding and spectacular successes. If it were that easy, everyone would end up like

## DOING YOUR HOMEWORK

Jeff Bezos of Amazon or Jim Clarke of Netscape. Further complicating the picture was the wild ride in tech stocks in 2000. A sizzling IPO is no longer a guaranteed exit. In fact, as of this writing (December 2000), the IPO window has virtually been shuttered. As a result, VCs, despite overflowing coffers, need to be dazzled before they write a check. This book will help you do that dazzling.