Dean's Executive Leadership Series - 2008-2009

Transcript of Presentation by Ann Winblad, co-founder of Hummer Winblad Venture Partners – Part 2

About DELS: The Dean's Executive Leadership Series at the Graziadio School of Business and Management features in-depth audio or video interviews with today's top business practitioners and thought leaders. Listen or subscribe to the podcast to hear their views and insight on the current challenges and opportunities facing the business community.

Start

Announcer: The Graziadio School of Business and Management at Pepperdine University proudly presents the Dean's Executive Leadership Series. This podcast invites top business practitioners and thought leaders to share their view on the real world of business.

Dean Linda Livingstone: I think the food stamp story just reemphasizes your entrepreneurial roots, that you can make anything into a business. I didn't tell you this but in some of the information I read about her first entrepreneurial effort was sewing Barbie clothes for her friends in the neighborhood when she was a child, so she's had this sort of entrepreneurial interest for her entire life.

Ann Winblad: And no money.

Dean Linda Livingstone: There you go. Well, you talked some about the economic summit, and one of the outcomes of that was this sense of entrepreneurship being so important to sort of rebooting the economy. I don't know how much this came up, but-- and we see our government here doing so much sort of with the big companies and the banks and the financial institutions. What else can be done, or what else needs to happen to help entrepreneurs and to really generate energy there and funding there? Or is that going to happen through the private venture fund markets?

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Ann Winblad: Well, I don't think there's much more that needs to be done here in Silicon Valley and probably not in Boston and there are some other big entrepreneurial areas. Atlanta's sort of gotten its mojo together; Minneapolis, somewhat; Austin, Texas. Because we really have a true ecosystem for entrepreneurs. It's not just: add money and you get a company. It really is, when we're working with our companies, we work really hard to help you recruit. We make sure that we get-- Your corporate lawyer is also a company builder. Everyone who's around the company is a risk reduction entrepreneur. So over the last few decades, this has become like Mesopotamia here. It's the cradle of company creation and it's even better than done in Boston. But here, we don't really have to do much except not panic, just do what we know how to do and really be very, very disciplined about how we do it. Creating that ecosystem from scratch is really, really hard.

I think schools of entrepreneurship are having a dramatic impact on some other regional areas because they're acting as a magnet for other parts of the community. They're usually endowed by people who are successful entrepreneurs so there's a role model there. But the rest of the world does not have that same value of entrepreneurs. Dubai, and we were talking about it earlier. If you say "What's my role model for success," you either want to work for the government or you want to be an engineer in infrastructure because you see all the cranes. And you don't want to fail. This idea that failure is a route to learning and wisdom and that you're in the entrepreneurship's dream and you'll get smarter over time, is really very, very unique to specific regions of the country. Some of this is being recreated by outreach of venture capitalists here, both in India and China. It's never quite really happened in Europe. If we watch these venture capital numbers again, we'll just see-- <makes plummeting sound> --investment dollars because this is not a fair weather business. This is a long-term commitment. We're usually involved in our companies on average six and a half years. So when I join a board, I know I'm probably going to go to that board meeting for six and a half years. That's a long time. And that long-term view is also something really unique to our ecosystems.

Dean Linda Livingstone: So how, as we think about the world economy and we know that that entrepreneurial culture is kind of unique to certain parts of the world, and certainly, particularly to the United States, how do we help build and develop that entrepreneurial spirit that's so important to building economies in third world countries and developing countries where that's just not part of the mindset?

Ann Winblad: Well one of the things that has been fairly successful and it's gotten fairly prescriptive is microfinance. That's working. It's working all over the place. It still has not fully scaled. What's not working is if you talk to the microfinance groups in Pakistan or anyone else and you say, "What if you wanted to give risk capital," meaning it might not come back, because these are loans remember, microfinance, somewhere between $10,000 and $1 million. They don't know who to give it to. So there is-- just like you

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are pairing with UCSB to bring business intelligence to inventors and scientists, there's not that tight pairing yet of core business intelligence, how you would start a business and run a business. So there's a huge gap in developing countries in the beginning parts of risk capital. For many of these companies, $10,000 or $50,000 can really create substantial companies but we have to figure out how we go the next step from microfinance lending to the first step in risk capital. And the venture capital model is not going to work there because it's just not a scalable model even here. You say that there's less than a thousand firms in the US and maybe that boils down to 600 by the end of next year. It's not exactly huge. An average venture firm maybe has eight investing professionals at most so you're talking about six thousand people and maybe four- to six thousand. So we have to find a different way that we bring business intelligence to natural entrepreneurs so we can move them up the step of creating scalable businesses versus sole proprietorships. The reason microfinance has worked is it's been very women led, there's a lot of solidarity women share. Taking care of their kids, they say, "Here, I'll go sell my stuff. You watch the kids." So that has become very prescriptive in how it works, but we don't really have any kind of plan of the first step in risk capital in emerging countries at the lowest level to build sustainable companies that have like 10 to 100 employees.

Dean Linda Livingstone: Are the right people working on that problem to try to bring some knowledge to it, that can move in that direction so that we see more sustainable, larger businesses developing?

Ann Winblad: Well, I don't know. I think there are some opportunities. Some of the people running the NGOs that are dealing with microfinance have gotten very sophisticated organizations and are great entrepreneurs themselves. The woman who runs the NGO in Pakistan that does microfinance has 2500 employees, I mean "employees." And these are fairly young entrepreneurial people themselves. So it could be the same people who brought the experience on microfinance who might say "Okay, I'm going to take it to the next level." I think universities have a big role to play here because how they can center the educational capabilities and I think students traveling abroad and cross breeding of students traveling. At the University of St. Thomas, 85% of our undergraduates spend a semester abroad and they're encouraged to work with NGOs on entrepreneurial projects. That kind of stuff, it does become viral over time. But we also have to create more and more economies that exalt entrepreneurs, that value being an entrepreneur and that's a harder task. That's a cultural barrier.

Dean Linda Livingstone: And we know changing culture takes significant periods of time even in companies, so much less in countries when you're trying to change years and years of a different way of doing things.

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Ann Winblad: Yeah. Usually even in our startup companies, if they arrive with cultures and if the culture's not working, the company doesn't work either. So we're not very good as business builders in changing cultures.

Dean Linda Livingstone: I'm going to open the floor to the audience and I'll add some additional questions for Ann as we go. But what would some of you like to ask Ann about this evening? Yes? Stand up and speak up.

Larry Steeler: I'm Larry Steeler. I had a pertinent question right off the bat. The new incoming Obama administration and Congress are looking at some kind of economic stimulus plan, job creation probably in early '09 and of course, what we're mainly hearing is dumping all the money to GM because of the obvious political reason, it has to be done. Could one make the case that maybe the entrepreneurs and small business being the backbone of this country that that might play an important part with that money to be infused in getting our country back on track <inaudible> issue? I was wondering about that. Because a lot of people have mentioned this.

Ann Winblad: Well there are venture capital firms that had part of their investment coming from the Small Business Administration so it doesn't play an insignificant role in sort of the capital that is behind the scenes here, even in Silicon Valley. So we don't as a venture firm, but some others do. The reason this all works here is we're not dependent upon stimuluses, bailouts, et cetera. I will say I happily voted for Obama but personally, I would just let GM go. If we subsidized the steel industry, what would Pittsburg be today? If we had subsidized effectively the auto industry earlier, we wouldn't have a BMW plant in Tennessee or a Toyota plant. So if you really believe in creative destructionism, you're not going to subsidize GM now. Do I think the government's going to subsidize GM? Probably. Would I do it? I would just let it go. And it would be painful but it will be less painful to have sort of everything artificially rolled up. The business model doesn't hold anymore. It's subsidizing yesterday's business to try to drag itself forward and it's broken. It is what it is.

We face this all the time as venture capitalists where one of the hardest things we need to become a new venture capitalist is not 100% of your companies are successful. I remember John Hummer saying to me "You're going to have to shut companies down sometime," and I go "Not me! All of my companies will work. Never, ever, ever! I'll lay in front of a train for these companies." But every once in awhile and fortunately for us, it hasn't been that often, you just realize this is not working and you don't go out and get government subsidies or debt financing to hold it up, especially in software. You just have to say "Look. I'm going to let it go and move on to a better business." So we're going to face a lot of interesting

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issues as we reboot our own economy. But most of these rules do not apply to entrepreneurs here fortunately. We really have to succeed on our own or we die.

Woman 1: Put down the <inaudible> question to that <inaudible> a company like Tesla is also unable to raise private funding and is looking to tap into the government bailout or whatever you want to call it. So if you're not going to bailout, going by the <inaudible> that let the old <inaudible>, companies like GM, that that could also impact entrepreneurial companies like Tesla for making innovations and not be able to run its business because of the money being all dried up.

Ann Winblad: I don't know much about the Tesla business model. I've never looked at it as a potential investor and I don't know how much difficulty they are having to raise capital. But this is the sort of, "if you don't get the capital and you need it, you die." This is the creative destructionism that we're talking about here. There's enough people funding interesting energy companies. Shai Agassi has gone out and raised $300 million for a play in the automotive sector and seems to have no problem raising unlimited capital. Maybe he's got a better business model than Tesla. I don't know. And maybe Tesla will be successful in raising more money. I don't know where they are in that. But if all of a sudden Silicon Valley starts getting on the bailout gravy train, we won't be Silicon Valley anymore. We really will not have the magic of company building, of really focusing on our disruptions, of really seeking new and innovative business models, having efficiency in our businesses. We'll be Detroit and we don't want to be that. So I personally think that you got to do what you've got to do to get capital so maybe Elon Musk will find capital but I doubt that it's going to be an overarching theme here in Silicon Valley that maybe an anomaly of Tesla that will be reaching into new pockets of money. There is plenty of money here for the best of the best of new companies.

Dean Linda Livingstone: Yeah, back here.

John Vudlan: Hello, I'm John Vudlan. You folks had a meeting with Alli [ph?] and you're going to make some recommendations to the GE third year <inaudible>. I was going to suggest perhaps you ought to recommend a plan that existed here in the United States in 1985. And that had a tremendous benefit for everyone. First it allowed private individuals to invest in venture capital. It gave a benefit to companies and worked as follows: a corporation could get an investment from a <inaudible> group, venture group, that could put money in the off balance sheet financing for risky products in their R&D. There are a tremendous amount of good ideas sitting around in corporations that don't emerge into what would only be called the venture capital world because corporations don't want to release their IP. So those ideas kind of sit there. This would allow those ideas to come into the general stream. The company would have

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this financing off balance sheet so any risky investment at the corporate level would not be reflected on the net income, their earnings per share, so they would not suffer by taking that chance. The private investors who made these investments would then have to get a large tax benefit which is what we had then. We offered <inaudible> who did this, 80% write off on a qualified investment in the <inaudible> off balance sheet finance. That would have the benefit of allowing more people to contribute to venture capital and benefit from the returns and bring some good ideas out of corporations. It might even spur some of the activity that you were talking about.

Ann Winblad: Realistically, it's easier said than done to take IP out of a major corporation. We have successfully taken IP out of universities several times, very successful. Two companies I was on the board of-- one with the University of Minnesota and one with Stanford. Both those companies ended up being public companies. So that works easily. And the reason that works is that most of the universities aren't trying to make money on the IP. They're really trying to get the flow of ideas out there so that they have more successful graduates. They don't make money off the royalties realistically. They make money from the wealthy graduates who become strong entrepreneurs contributing back to the institutions later. So we have not been so successful in partnering with corporations' R&D groups. While the mechanics of the numbers sound good there, it's much harder to do from an execution phase in creating new companies than it is to just say it. So I agree there's clever things. Bob has something to say about that, too.

Bob: I think the way IP comes out of large companies is people working in these large companies feed the Valley with guys who want to start companies by doing it differently and better. So that's the way IP leaves companies. It doesn't leave directly but it leaves with a better version from someone who wants to start a company. I think you've got these college graduates who are coming into the Valley. You've got people from the big companies who want to start companies. That's what feeds this valley.

Ann Winblad: Yeah. And the other thing I would say there is that people like to work on new projects and realistically, it's counterintuitive but the first thing that gets cut in a down economy is R&D budgets at big companies.

John Vudlan: <Inaudible>

Ann Winblad: Whether they're off balance sheet or on balance sheet, they're still money.

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Bob: Why don't they just cut the marketing first?

Ann Winblad: That's because you're an engineer at heart. But again, that also contributes to new company creation for us as venture capitalists because people say, "Gee, I'm bored to tears. Life is short. I want to do something. I want to change the world. I really want to see some new technology, especially something I've already thought about come to fruition," and they leave the mother ship; versus saying, "Why don't we do a partnership out of our R&D labs."

Dean Linda Livingstone: We had a-- Let's see. Back here, and then I'll come to you.

Man 1: So you mentioned that startup costs are coming down because of some of the new innovation studies in the software space. Doesn't that represent something of a problem in the sense that you just have to go out and find that many more companies? You're investing less money per company, right? Does that result in you investing in more companies or a larger number of companies?

Ann Winblad: Well it's a very good question. Every time a company comes in-- and several people asked me this, is how much do we invest in our startup companies because we do the A round. So our last three A rounds, which were done very recently, one was $2 million, one was $1 million, one was $6 million and one was $4 million. Now they're all software companies, why were they so different? Because-- and when you take your first round of capital, we sit down with you and say, "How far do you have to get to prove that you have a place on the market map to get your next round?" So every company is slightly different. The cost of developing the software, just to build a software product-- But what are you going to do, just put it in the closet? What's your route to market? Do you need to build partnerships? Do you need a biz dev guy or not? What makes up the economic construction of a business around the software creation? Now for somebody who's incubating companies and just wants to give people some money to build to, let's say, an alpha product, that number is lower and lower. That's not what we do. We don't say just, "Hey, try out a company." We're committing to help you build a company.

So we really sit down with you and say, "What milestones do we have to get to so that when you raise your next round, you'll be able to raise it and it'll be at a higher valuation?" For some companies where the technology is so new, it might mean that you have to really demonstrate proof with quite a few customers. So you have to build the first level of your sales organization. For other companies, it will be much more understandable to investors and you just have to prove that the thing works so you get the thing into the beta stage. So that's why even though the cost of actually crafting software is lower, the cost of building companies is still efficient for software companies but is different on a company-by-

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company basis. We spend a lot of time sort of helping you construct with us a business operating plan around building a business around the product opportunity that gets you to market. This is some of the things that hopefully you'll be doing with the University of California, Santa Barbara because these are the skills that these guys-- It's like you say, well, do you have an operating plan? And you get kind of the grocery list of, "I'm going to hire three engineers, have a room that's 20 by 20, and electricity and my computer cost this." Go, "Great. Okay. Got that. Now, how do you build a business around it?" So it's an important question to be asked and every company is slightly different. And as you can see, the range of four recent companies is a $5 million range for an A round.

Woman 2: I believe in the ecosystem that's set up by venture capital as you discussed. What do you think the Valley leaders, the venture capital leaders in the country and all the different states where it's working can do to influence the political situation now, buying companies and investing money in companies and keep propping up companies so that they're not competitive?

Ann Winblad: Well, I don't think it has-- in the innovation areas, we're not funding any new financial institutions, we're not funding any car companies, we're not funding the things that-- If you look at venture capital dollars, biotechnology energy is new, maybe some new material sciences, software, hardware, some semi. We're not really affected by the propping up and we don't need the propping up money. We just don't want our whole economy destroyed but I think what we need to work on is what we can do. And we're company builders and creators. So we're not going to have any impact on whether General Motors gets a bailout or not, realistically. The venture capitalists in the country have an organization called The National Venture Capital Association, nvca.org, and they have some lobbyists that work on key issues on taxation issues, even some new regulations that might appear that might kind of steer us all off course. We do our best there although we're not that good at that either. Our pack at nvca.org is pretty young and immature. But I think really we should stick to our knitting because we're pretty good knitters at what we do. And we all had our own say in who our elected officials were just a couple weeks ago and we did our part there. But the value we can add is rebuilding the economy from the bottoms up.

Dean Linda Livingstone: I'll take a couple more questions. Let me go here, and then I'll let Michael have the last one as our sponsor tonight. So you first, and then Michael.

Sergio: Hi, I'm Sergio. I started my company three years ago. If you could expand on what you were saying, that your job is to take the small companies and grow six and a half years. Which I think three years ago, the first year was miserable. The second year--

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Ann Winblad: But you survived it. That's really important.

Sergio: The second year, we have <inaudible> now. We've grown 300%. We've secured revenue until December 2009. We're self funded. We have the contracts in hand. The question is, you were talking about from the time somebody sits down with you and decides with you, and you go through the six years, I don't want to leave my job as the CEO for my company to start begging for money for six months. So I need to know when is the right time to start looking for venture capital? Because it takes a long time and a lot of meetings and when is the right time--

Ann Winblad: For you, and you've done it without venture capitalists.

Sergio: So far.

Ann Winblad: So far. So when my company became profitable and we were generating a bunch of cash, that's why we got acquired. As I got a larger company, venture capitalists started flying to Minneapolis to see me, which is a story in itself. And I kept asking myself, why would I take venture capital? And the reason that I thought is, am my performing unnatural acts because I don't have enough capital? Would capital make a difference, first of all? Maybe you don't need any more outside capital. So if you feel like you really are sort of slightly crippling the business, not knee capping it, but you find yourself when you're doing your strategy reviews or whatever, that "Hey, if I had a little more capital, I would have a more secure place on the market map. There's business I can't get because I can't afford to hire that extra salesperson. I really did not get the last guy to come and work for me because I couldn't quite pay the salary or they wanted to know did I have backers behind me."

When that stuff starts to happen, then you're starting to perform unnatural acts against your business opportunity and it's probably time to look for capital. You're in an advantageous position where you can go out and meet venture capitalists and see if there's also a company builder that would sit on your board that you feel would also help you as a resource as well. That some unfair competitive advantage would happen not just from the money but by having this venture capitalist and that venture firm associated with you. So you should not think of it as going out for six months begging for money, but auditioning for the investor that may or may not be the right fit for you. Asking questions like, "Hey, what would you expect of me as the CEO? If you invested in me today, what would you expect me to do a year from now, two years from now?" And start that engagement. The challenge I also had as a non-funded entrepreneur is, I was a little petrified of, what if I got these people on my board? What would happen then? We're kind of doing a good job here. I'm sure we could do better.

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When my company was acquired, I was acquired by a New York Stock Exchange public company that was a big software company. It was called University Computing. It later merged with Computer Associates. So I actually attended the board meetings and they were such a learning experience for me. I actually got a sense of how I was leading the company, what the strategic cadence should be to move to the next level. So that six months that I sat on that board before I bolted for California-- because I did discover that not only was winter optional but I had enough money to take the option. It was a really good learning experience for me. So if you really are looking for venture capital and you have a viable business, don't think of it as six months of leaving your post and begging for capital, but six months of finding, is there the right investor for you out there? That's a fit for the long vision you have and can help you exceed your goals in that vision. And I know Bob is funding later-stage companies so you may want to talk to him.

Dean Linda Livingstone: Last question.

Michael: When companies approach you, there's usually two sides of the equation. You have the people, the management team that have come up with the idea and you've got the actual idea itself. In your experience, have you found that there is a better success rate if you fund companies where you've got a really solid management team. In other words are very business savvy, can continue to generate the innovative ideas. Or companies where the management team may not be as solid but the idea is just so amazing that you can replace the management team. Or do you find that one or the other is not good enough, you really need both?

Ann Winblad: This is a question asked by all venture capitalists. Is it the market opportunity or the team or both. And you're going to get different answers from different venture capitalists. If it's a small market, no matter how good the team, you're going to get a small company so park that one aside. But I will tell you one quick story, the story of Jim and Bob. So I got sent this giant business plan-- it was like Encyclopedia Britannica for a company called Multidimensional Solutions from a professor at Imperial College in the UK. I'm thumbing through it and I thought, well, maybe I'll read the part about the product because I'm never going to read this whole thing. And that's another thing, that if you send a big, thick plan like that, they are guaranteed to be swept into the desk.

So I read the stuff about the product and it was kind of interesting. I said, "Well, who are the people?" and this professor said, "Oh, it's Jim and Bob." So Jim and Bob show up and Bob was a sales guy for a company called Com Share, which was an old executive information system company and it kind of had gone nowhere. It was that kind of '80s software company that came and went, got to maybe $70 million,

$80 million in revenue, I don't know. And Bob was a rocket scientist at the NASA Ames Research Center, had never written any commercial software. They show up and I said, "Okay, this was an interesting section of the encyclopedia you sent. Who are you guys?" and Jim said, "I'm the sales guy," and Bob goes, "Well, I'm a rocket scientist." Bob actually spoke like that. I said, "You've got a great company name, Multidimensional Software. Wow." We don't name our companies but that one was a mouthful. And Jim said, "Look. I've been selling this executive information stuff for about five years and it's just terrible and we're not solving the problem because people really do want to look at all this data pulled together. And so I sat around and thought of a product." I said, "Well, are you an engineer?" He goes, "I've worked with enough engineers that I figured it out and went to this university and found this guy and they said 'Get a programmer,' and somebody said 'There's this guy at a desk at NASA Ames,' so here I am." He goes, "In fact, I've talked to 50 customers on my own." I go, "Wow, 50 customers." So I hauled in John Hummer, which it's hard to haul in John Hummer at 6:10. I said, "John. They may have something here. This guy's been selling to these thousand customers at Com Share and 50 of them said 'The stuff doesn't work but I might buy this stuff.'"

So we took Jim and Bob and stuck them in a car and said, "Let's go talk to the CFO of Sun and the CFO of Cisco and see if they would buy this if they built it." So we got meetings with these guys and we put Jim and Bob at the blackboard in front of these CFOs. Then they'd leave the room and the CFO goes, "Yeah, if they built this, I'd buy this." That company became Arbor Software. We asked them if they could rename it because nobody could-- Multidimensional. So Bob, the rocket scientist says, "We've renamed it." I said "Great. What's the new name?" He said, "Arbor Software." I go, "Fine. How'd you come up with Arbor?" and he goes, "It's the street I live on." Anyway, Arbor ultimately became Hyperion. We gave the company $1.2 million. Doug Leone and I were on the board. Sequoia gave them $1.2 million. They raised another five from Mayfield so they raised $7.5 million. They went public in 1995, the largest IPO, even larger than Netscape, and last year, Hyperion was purchased by Oracle for $3.3 billion.

So, for most venture capitalists, Bob and Jim would've been mutts. They went to even less named universities than the University of St. Thomas in St. Paul, Minnesota. At least people think I might've gone to school in the Bahamas. So they had no pedigree whatsoever but they brought the customer in the room. They knew that there was a breakthrough opportunity. They went out and found the technology. They built a little prototype of how you really did this multidimensional analysis with a spreadsheet view front end. So you created these OLAP cubes. Today, there are 70,000 customers worldwide that their finance departments have an OLAP application installed. And if you're a CFO, you're likely using the Hyperion product. So I don't know if that answers your question but we kind of have a great love for the smart mutts who really can tell us unmet market needs.

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Dean Linda Livingstone: That's a great story to conclude our evening on. I would say that says as much about you and John as it does about Jim and Bob because you really have a nose for what's going to work and what's going to be successful because of all the years you've spent in the industry.

Ann Winblad: Remember, we're only the opportunists and the entrepreneurs are the visionaries. So we're nothing without the Jim and Bobs, so it really is all about the Jims and Bobs.

Dean Linda Livingstone: Well, thank you so much, Ann. We really appreciate you being with us. You will be able to see this video of our discussion tonight on YouTube University shortly. And you will also--we did a podcast earlier where I interviewed Ann and we talked about some of these things and some other issues as well, that you will be able to listen to on iTunes if you would like to. So thank you so much for being here. We look forward to seeing you on April 7 where we'll have a discussion about the healthcare industry. So healthcare and software, two big industries doing a lot of interesting things and a lot of challenges in both. So thank you so much and have a safe drive home.

End

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