Dean's Executive Leadership Series - 2010-2011

Transcript of Q&A with Kate Mitchell, Managing Director, Scale Venture Partners

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Dean Livingstone: Thank you, Kate. Wonderful. Well I'm going to ask one question, and open it up to the audience. It's just a follow up to one of the things that you mentioned, but be thinking about what you would like to ask, and take full advantage of Kate being with us. But you commented that two of your best CEOs were actually students without a whole lot of experience, and we obviously have students in the room, or people that were students very recently. So what was it about those two that ended up making them such successful CEOs even though they didn't have a lot of experience or anything?

Kate Mitchell: Well, the toughest thing early on was saying, “You need to get up earlier, the work day starts earlier.” That was my first thing with the students. They said, “You know, a meeting can't be before 11.” I said, “Well actually, if you're going to hire people, try getting in a little earlier. I know you're up at three, but…” In both cases, they were technologists. They were passionate. They had thought, and they had practiced in the area that they were creating solutions. One of these companies, you may or may not know, Drop Box, has a consumer product. One of them is Box.net and Aaron Levie is the founder there, and he was the one who was going to present to my OPs, and I said, "A little earlier in the morning." Anyway, crazy curly hair, you know, and what was interesting about—and Josh James at Omniture is another example. We were talking about Josh earlier. They were young passionate people, they had relevant background, and they did actually spend time, post-school, doing their own kind of bootstrap work before they actually put together the companies. So they had some work experience, but not in a big company. Neither of them had worked in a big company.

Dean Livingstone: They weren't CEOs or high level?

Kate Mitchell: They'd never managed anybody, they managed themselves, and that was tough enough in both cases. And both of them had something that is very hard to learn; they both had high emotional intelligence. I think that's really important when you think about working with people and reading a room, and understanding a solution that needs to be solved because a lot of technologists just say, “Don't you love my technology?” as opposed to, “I've heard what you say; I think my technology can help you.” And I think it's that ability to listen and to have some maturity. It was interesting. It was this last October, Aaron is now the youngest in the stable, and I knew he'd be passionate, I knew he'd be enthusiastic, and he has a very interesting—this is about basically sharing technology. I have archives in my office and you have archives in your office. You and I could have been working on these slides by sharing them on Box.net and having a central repository, and even if I was doing it late at night, early in the morning, you could always see my latest version. We didn't have to ship it to each other or that kind of thing. I wasn't sure, and again, pension funds, a very conservative group, and here he was with his hair. He really understood his audience. He'd really done his homework. He really thought about how his product would work. And he was himself. He was a young enthusiastic guy, but I think that ability to make that connection and that emotional intelligence, and really understanding the business problem in addition to the technology. He really wowed me. And I think it was the case, in Josh James' case, and I believe this with Aaron, that he's going to be able to go the distance. And the best companies, by the way, the founders stay with them.

Dean Livingstone: What do you all have to ask Kate? Open the floor to the audience.

Kate Mitchell: Don't be shy. It's more fun this way.

Dean Livingstone: Yes.

Audience Member 1: By the way, first, thanks for a very insightful presentation. I think over the past couple of years, there's been a shift in innovation from companies or entrepreneurs, who are actually building products to more like social media and crowd sourcing and essentially building a platform that brings people together, and selling advertisement. I'd love to hear your thoughts on what the future of that is. I mean, do you think that's a sustainable business model, or do people just need to go back to actually building products?

Kate Mitchell: Building products, yeah. I sense a bias in your question, which I share, actually, that ultimately, unique products work. I think social media, though, has created some really interesting platforms, the way people can work, that I think is very interesting. But I also agree with you, that we also are going to ultimately need to go beyond that, and have products. I mean, how many ads can we all

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take? At some point, and believe me, I get all these pitches, I'm thinking, "Oh my God, will there be any part of my life where I won't be advertised to?" Again, back to business models for things like journalists. I'll pay not to get the advertisement, please. On Pandora, in the middle of a nice mood music, and there's the advertising. So I agree with you, that I think completely ad supported has its limits. I think the pendulum will swing back. I think social media is so exciting right now. I think it's experiencing a bubble—in the case of Facebook—a big bubble. I think it is interesting because it's a whole new paradigm, but I also think that and we use this phrase in our partnership, that "YouTube was interesting, but you wanted to avoid the 'MeTubes.'" I think in social media, there probably will be some interesting platforms. Ultimately, then, it's what products and services get built on that because I think doing the next platform, it's been done. I mean, you're not going to do 10 Googles, and you probably won't do 10 Facebooks. So I think it's really, what can you do with that? We're involved in a company in Indianapolis, ExactTarget, which is a big company now. They just acquired, about a year or so ago, a company called CoTweet, that was an enterprise tweeting company—and the only one, really, at that time. But the idea there is, back to the product and service that corporations need to buy. Bank of America needs to communicate on Facebook, on Twitter, and by e-mail with its clients on an often basis where the client wants to get alerts about a stock price. I want to know my plane is late, and which way do I want it, and that's actually a service that you charge for just like anything else. And it is interesting. I think some aspects of products, and there's a lot in Southern California, particularly down in San Diego, that's Silicon-based. I think one of the challenges is when it's really a hard product. A hardware product is more of the value has come in the software than in the hardware itself because so much of that has been commoditized, particularly in Asia. That's good, though, because—it's bad if you're a hardware engineer, good if your view is you can use now a cheaper way to get products to market if you can pull value on that hardware. So I think there's really room between kind of the pure consumer-based social, digital ad-supported kind of apps, and pure hardware. I think you'll see a lot of new products coming out, and I think you see it always in clean tech and healthcare. But you'll see it in technology too because that's really what businesses buy. They're pretty pragmatic. But it's the right thing to ask. You want the next wave that was the one that broke.

Dean Livingstone: Thank you.

Audience Member 2: Hey, Kate, Randy Churchill with PWC. As you know, I'm very–

Kate Mitchell: You're very knowledgeable. You should be up here.

Dean Livingstone: And you promised to ask a really tough question.

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Audience Member 2: And here it goes. So the one piece of data I didn't see is the LP investment data, so that's come from $100 million in 2000, down to…

Kate Mitchell: Actually, that was the exit slide, where it was $100 billion at the peak, and it's down to $12 billion last year.

Audience Member 2: Twelve, so what do you hear from the LPs and when are they coming back to venture?

Kate Mitchell: Honestly, I hear from limited partners. These are, again, the institutions that invest in venture. So if you're an entrepreneur or a VC, the source of all of our capital. I've talked to a few limited partners, recently, of ours. Two-thirds, but normally they have anywhere between a quarter and a third, of their venture firms fundraising because it's been such a difficult time to fundraise. The 10-year numbers look bad because we're still paying the sins of the bubble, and people are, "Boy, if you want liquidity, venture is not the place to be." So there's really been kind of an exodus. So a lot of people put their fundraising on hold. A lot of them are saying that two-thirds of their venture firms are out fundraising. And they have fewer spaces. So it depends on your point of view whether I have a pessimistic or an optimistic point of view on this, but I don't think that the numbers are going to go up. I think there's going to be a higher failure rate for venture firms over the next couple of years. The musical chairs are stopping. So we assume in the NVCA that our membership continues to decline over time. It has, but not at the rate you'd expect because people are still hopeful of raising another fund. I think, in the next two years, you're going to see that finally sort of come to roost. I don't think it's going to be more that $12 billion for the next couple of years.

Audience Member 2: The president of Stanford at the NVCA meeting two years ago said that they're out of venture and they won't return soon. Is that still the case?

Kate Mitchell: I don't know about Stanford in particular. Most of them have cleaned out of their portfolio. Everyone followed the Yale model for those that David Swensen, for those that have read his book, put a huge amount in venture. And when the university is relying on the cash flow to support operations, you can't have a lot of illiquid assets that have a cyclical nature to them. So I think there's been some permanent right-sizing. The balance to that is there is a lot of international capital—in particular sovereign wealth funds as well as from Europe. There are some challenges. We can talk too about Europe; there are some regulatory challenges there as well as there is in the U.S., but there is some balance to that. But I think people are realizing that just as entrepreneurs themselves, or venture capitalists, if we saw the

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late bubble in the late '90s and 2000s, all this would be easy. It's not, and you need to build it into a balanced portfolio. So I think it's going to be pretty grim and slim pickings. Again, though, it's like going on a diet—we're going to be leaner and better.

Audience Member 2: Great, thank you.

Kate Mitchell: And again, I'm going to throw questions your way because you've been—and anybody, as an example, if you want to network in this business, you have a lot of people here, Randy, Steve, from Silicon Valley Bank, a number of folks that you should be talking to, spend a lot of time in the industry.

Dean Livingstone: Let's go here, and then we'll go to Grady.

Audience Member 3: Hello. Great presentation. I'm Charissa Shaw, CEO of Ergolution. How did you start Scale, and what was your first investment?

Kate Mitchell: Oh, okay. How did I start Scale? Well, we were part of a venture group at B of A, and B of A decided to get out of the business right at the peak of the market. And so we looked around. We all, I mean, everyone was hiring. That was the right before the wave crested, and we all had offers from other firms. We had gone through some tough times together. We had an interesting group of people. There was a leadership issue in there. There was a fellow who ran that business, who ran it hierarchically, and it's a partnership business, so that was number one. So he was definitely going to be on his way out. We looked around the table and said, “Golly, we all have job offers, but there's a LIFO [last-in-first-out] aspect of this.” I could be the last in that fund, and the first booted out. I mean, it felt like a tulip mania. We didn't know when it would end, but we felt the music was ending. And we liked and really trusted each other. So we sat down and said, “You know, one of the things that had been lacking with this leadership, they were very hierarchical, but they didn't have a business plan.” We did what entrepreneurs did, I remember sitting there with one of my partners late at night typing out a business plan just like an entrepreneur does to go ask for the business. Our first investment was a company called Seattle Genetics. It's a very large public biotech company. It spun unwanted IP out of large companies. Mike and I were talking about that earlier. The CEO knew one of my partners, who was a former Genentech partner. He sat around the table and he gave us this whole pitch. He was passionate about it and the CEO came in, Clay Segal, again, founder – he's still CEO, those are the best companies. And at the very end, he said, "But I don't want to lose our money, and your money" because we're writing personal checks alongside our limited partners. We said, “You know, it's a partnership, Lou. You gave us all the information. This is our investment, not your investment.” And off we were to the races. So it was our first IPO. By the way, it did really well. It did really well, so it was fun, but it was taking a risk. We could have failed. I went home and said to my husband, "This might not work out. I hope you're ready for that." He's like, “Ahh.”

Dean Livingstone: Hope that job offer is still there.

Kate Mitchell: Yeah, exactly. Every time I go by Starbucks, it's like, I did that job, I know I could do it again, you know?

Dean Livingstone: Grady, you had a question.

Audience Member 4: Hi, Grady Fever, the Fever Advisory Group.

Kate Mitchell: Another knowledgeable investor.

Audience Member 4: Oh, bless you, dear. A couple of questions, I agree with most everything you've said. A lot of the limiteds are broke, bankrupt.

Kate Mitchell: Or not uninterested in–

Audience Member 4: Or they're not interested any longer. The sector just hasn't returned to the–

Kate Mitchell: Right, no, and then we didn't give them more–

Audience Member 4: And here we are, the thing blew up, the wheels fell off in 2008, and here we are. You're talking about 7,000 plans a year you get to look at.

Kate Mitchell: Isn't that incredible?

Audience Member 4: There's pent up demand, and there's a scenario out there in capital that says that we're now expecting more from less. A couple of examples might be SAS and the cloud, that investors are expecting that a company is more fully cooked before you look at it, before it's really ready for its first institutional round. And to carry that thought forward, there are some who are bullish and believe that venture is poised for a real good run up in the next 10 years. How do you comment on that?

Kate Mitchell: Well that's why I was thrilled about that slide that showed early investing up because I agree with you. We can't just take a company over the finish line. If that's where all our money goes, how do you get to the finish line? Because remember, you have to take something out of R&D and bring it to the finish line. The other thing is, there's an element of industry right now, and you guys have probably talked about this in the various businesses and-or school, which is the rise of the super angel and or the micro-VC. Although I talked to a micro-VC, and he said, “I don't want to be called micro.” He's like 6'4.” And I said, “Yeah, I can see that. I could be called micro.” But anyway, these are, in some cases, super angels that are investing their own capital as successful entrepreneurs. In some cases, they're institutionally funded, so they're 25, 50, 75 million in size. Interesting enough, there's a back to the future aspect to this because that's just where the industry started. So you have the big hugely successful names like Sequoia and Kleiner, who continue to be successful, but they have become so much bigger. They're managing billions of dollars worth of assets. It's harder for them to do that really seed stage local investing, where the investor has the time to ask the CEO, “Oh, I just had this disaster last night, what can I do?” That doesn't fit with some of the larger firms on Sand Hill Road. That’s why I'm so enthusiastic. Not only that early stage investing is up, but why I'm so enthusiastic about the micro-VCs seed firms. At the NVCA, we've been really active on working with the Angel Capital Association and helping them out. In fact, they don't have as much money as we do, so we, frankly, help them on a couple of issues in Washington because we think angels are a really important part of the ecosystem. We do events with folks like that. Then even within the NVCA, we're starting a new kind of emerging manager, but it's really meant to be a smaller manager of capital. And frankly, I think it's great for LPs, I think when you think about a billion dollars and you go back to the multiple, we need to make institutions happen. The feel, even now with IPOs going up, how much market cap do I need to create to return a multiple on a billion dollars? That's a lot. I think there are a lot of LPs that think that model is quite challenged. When you start looking at being able to return capital on $100,000 dollars, a million dollar exit is a 10X. So the economics, actually, and particularly now that there are, you can build companies with less capital. Maybe you don't need to create a public company. Maybe you can sell it to Google for $6 or $7 million and have a really healthy company. Or you sell it like CoTweet did to a company like ExactTarget, and you actually don't then need to take 10 years to go public because you probably were a product or a feature. Those guys, by the way, are all still with the company because they really inform the whole social media aspect of what ExactTarget is doing. So we kept them because they're really valuable. So there are various ways that early stage entrepreneurs, and early stage investors can be, I think, incredibly valuable part of the ecosystem. Interesting, I don't know, Randy, if you've heard this, but limited partners, these days I've been at a couple of events, are talking about building a portfolio of these because they think the economics are so much more interesting for smaller vehicles because the upside potential is so much higher. So I think now is the time for that phase of investing. People are hungry and want a cocktail.

Dean Livingstone: I have a question. One of the things I would add, and I didn't mention this in my introduction. You mentioned our First Wave Accelerator.

Kate Mitchell: Yeah, that's so cool.

Dean Livingstone: It's actually a perfect example of that piece of it. We are very close to rolling out an accelerated kind of a proof of concept component that will have a $50,000, probably about $100, $150,000 funding early stage to help folks make sure that the technology and what they're trying to do is really going to work, so that they then are ready for the next real stage of funding. So it's very, very early stage. It will be available to students, alums and others that are interested. The 15X project I mentioned, we believe that out of that will come eventually really fabulous ideas that can feed through the accelerator. We'll have a board and others affiliated with the university in forensic and actually be advisory as well. So that really early stage stuff that isn't quite sure it's ready for prime time yet, can figure out if it is.

Kate Mitchell: It's the coaching and the grooming and has a much higher chance of success. I think those kinds of programs have great benefit, and I think really allow the opportunity to unlock all that IP and smooth the process so that you're not one of those thousands of plans that just falls on the floor, but really, if we could figure it out, has potential. So I applaud you guys for doing that. I think it's a lot of fun.

Dean Livingstone: Well I think it's a great capstone to an educational experience where we started at the very beginning, saying, “What problems do you want to solve, and how are you going to solve it?” and now let's create a business plan and now we can help get it kicked off on the back side.

Kate Mitchell: I think it's great. When you were talking about this, the 15X idea, that there's all this great technology coming out of UCSB. They don't have a business school. And that is one of the things you see all this great technology, and you're thinking, “Oh my God, the guy has no idea how this…” I think that's a great partnership.

Dean Livingstone: It's fabulous.

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Kate Mitchell: You know, for the students, for the faculty, I think that is going to be exciting. That's, I think, going to be, and again, a great opportunity for the region.

Dean Livingstone: John Shearer is back and he's our entrepreneur in residence. He's working with those teams.

Kate Mitchell: Oh great. Oh, good for you.

Dean Livingstone: And one of the things he told me was what and even in the few weeks that they've been working together, he's seen the scientists starting to ask business questions.

Kate Mitchell: That's great.

Dean Livingstone: And he's seeing the business students start to sort of get the whole technology and ask more technical questions, so it's just been a great learning experience.

Kate Mitchell: That is great, and those entrepreneurs are the kind of entrepreneurs, the engineers, that can go out and start companies. Obviously, your business students are getting prepared to be CEOs. I mean this is all a great experience for them because they're learning what it takes to put together a viable business plan. Well good for you, I think that's a huge opportunity there.

Dean Livingston: Well, so as we close, do you have any sort of one or two words of wisdom for our budding entrepreneurs out here that they can take home and sleep on tonight that will get them inspired to wake up in the morning and go for it?

Kate Mitchell: I'd say you are the answer to what's ailing our economy because I do think, when you look at the United States, one of our greatest assets has been our ingenuity and our willingness to try new things. All of us in the west, you know, somebody made a choice to come here. None of us were born here. Our ancestors were born here and I think it's really taking those kinds of risks, and being willing to move forward. It's hard because it is some of the unknown, but I think you'll get a lot out of it, and I think we all get a lot out of it. So I appreciate that you're here. Thank you.

Dean Livingston: Kate, thank you.

Kate Mitchell: It was fun. Thank you.

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