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A CEO Forum Sponsored By The Potomac KnowledgeWay Netpreneur Program

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Moderator: Esther Smith, Founder, Washington Technology

Special Guest: David Gladstone, author of Venture Capital Handbook and Venture Capital Investing

Panel Members: John Burton, Partner, Updata, Inc. and Former CEO, Legent Corporation; Charles Heller, Director, Michael T. Dingman Centerfor Entrepreneurship at the University of Maryland; John May, Founder and Executive Director of the Private Investor's Network; Mario Morino, Co-founder and Former Chairman, Legent Corporation, Founder and Chairman, Morino Institute; Chuck Stein, Former Chairman and CEO of Netrix

Featured Guests: Marc Benson, Partner, Mid-Atlantic Venture Funds; Jack Biddle, General Partner, Novak Biddle Venture Partners; Tony Carter, Chairman, International Business Group; Jeff Davison, Partner, Triad Investors Corporation; Philip Herget, Managing Director, Columbia Capital Corporation; Suzanne Hooper, Partner, New Enterprise Associates; Andy Jones, Investment Analyst, Grotech Capital Group; Patrick Kerins, Partner, Grotech Capital Group; Lyn Miller, Regional Director, Virginia's Center for Innovative Technology; Roger Novak, General Partner, Novak Biddle Venture Partners; Jim Pastoriza, Principal, AT&T Ventures; Gene Riechers, Managing Director of Technology Venture Capital, Friedman, Billings, Ramsey & Co.; Stephen Ritterbush, Managing General Partner, Fairfax Partners; Angela Tandy, President, Baltimore-Washington Venture Group; Frank Tower, Vice President , Silicon Valley Bank.

1: THE WARM UP

MS. SMITH: I want to welcome you tonight to the Netpreneur Program's first CEO Forum. If this is anything like the other events we have done, you are going to have a wonderful time, you are going to learn a lot, you are going to talk a lot, you're going to teach a lot, and we'll all leave here in better condition. I want to announce that the program will be taped. It will be made available in audio, written and digital format. Anyone participating tonight must do so with the understanding that his or her remarks will be recorded. I would also like to mention that members of the media have been invited to attend, but this entire session is considered off-the-record.

As many of you know, Netpreneur Exchange <www.netpreneur.org> went live this week and we are very, very pleased with it. If you haven't checked it out, please do. It's the virtual home of the netpreneur community, which tonight appears to be at least 400 strong. I want to mention members of the Netpreneur team who are in the room, Penny Lewandowski, who is the head of our netpreneur outreach; Holly Capps, our marketing communications coordinator; Steve Fleckenstein, our Web site producer; Ming Chen, our Internet developer; Neil Oatley, publications; Mitch Arnowitz, partner relations; and Fran Witzel, investor services. Fran has done a wonderful job linking the investment community together, as we see tonight. Fran, Penny, and Holly particularly have done yeoman's duty on getting this ready for us tonight and some of them, the names I mentioned will be coming around with the microphones when we open the forum for questions.

I also want to introduce April Young, the executive director of the Potomac KnowledgeWay Program, and the overall den mother. And I want to introduce MCI and the Morino Institute, who are our Charter Sponsors, and particularly recognize Andi Weiss from MCI who is the MCI liaison for the Netpreneur program. Also tonight, we have representatives from three of our partners Melanie Auger from KPMG Peat Marwick, and Suzanne Richardson of Friedman, Billings, Ramsey, and Lyn Miller from Virginia's Center for Innovative Technology (CIT). Welcome to all of you.

To give you a little update on the calendar, in case you haven't checked the site, the next Coffee and DoughNets is May 16th. Coopers & Lybrand is hosting it at the Four Seasons Hotel in Georgetown. There will be another Coffee and DoughNets June 27th, and we expect to have that out at Charlie Heller's Dingman Center on the campus of the University of Maryland, Shady Grove Center. Also, on June 12th, we'll have our next CEO Forum featuring An Evening With the Barons with the new Tech Capital magazine. And remember, in November, the Mid-Atlantic Venture Association is having its conference in the metro Washington area.

2: THE KICK OFF

We are so happy tonight to have David Gladstone, who is the dean of Washington's venture capital community. He recently retired from Allied Capital, a mezzanine lender to medium-sized businesses. When he started Allied, they were earning $395,000 a year and in 1996 they earned over $65 million. It's quite a growth story. David has also written two books on venture capital. Prentice-Hall is the publisher of both Venture Capital Handbook and Venture Capital Investing. The former helps you raise money and the second helps you invest wisely. David is going to set the stage for us tonight by giving us the definition of an entrepreneur.

MR. GLADSTONE: Esther told me I had five minutes to speak or it was death, so please somebody slow me down and stop me because I would like to enjoy my retirement. As Esther mentioned, I did retire from Allied Capital and I'm now helping small businesses finance their companies and helping them negotiate deals with venture capitalists, and I must say, it's a lot of fun being on this side of the table. I want to tell some of the venture capitalists out there that the techniques you are using are the techniques that I used years ago, and you need to learn techniques in negotiation because we know all of those on the entrepreneur side now. I'm also starting a finance company that, hopefully will be in business within the next six months, to help some small businesses by lending money rather than investing. As you know, most of the banks are out of the business of lending to small businesses except on a very secure basis. They are out not because they want to be, but the regulators continue to hound them about making small business loans, and asking them not to do it.

Esther said I'm supposed to give you a definition of an entrepreneur. Most of this information is in the Venture Capital Handbook and you can get it through the Web at Amazon and a number of other locations. I think Prentice-Hall also has a location.

This word came into being in the 1450's. It's a French word, and when it came into the English language, it was used to describe someone who led a small band, usually a war party, to attack a town, sack the town, pillage it, and bring back the booty. Not a bad definition for an entrepreneur today, is it?

Actually, we do use some of those terms, we talk about capturing markets, destroying the competition, exploiting a situation. If you don't have that attitude when you are starting a business, you should adopt it, because the world is very unforgiving place for entrepreneurs. As we all know, big businesses beat up little businesses most times, so you are going to have to be pretty rugged to overcome the obstacles out there.

If you look at the Venture Capital Handbook, you'll see a discussion about what venture capitalists talk about when they are looking at a good deal. I remember the roundtables of venture capitalists that I used to go to. We would sit there and try to put on the bulletin board all of the things that we thought were good about a small business, or a good deal that was coming in. About six of those, the first six that were up there, had to do with management. That brings us back to what is good management and what is a successful entrepreneur. I can tell you that venture capitalists all think that good entrepreneurs are people that make them money and bad entrepreneurs are those that lose money for them.

That begs the question, then, what would you use as a benchmark for choosing an entrepreneur? There have been a number of studies, and the one I read from time to time is the one by David McClellan back in the '50s, The Achieving Society. McClellan went out and tried to measure the amount of achievement that an entrepreneur had, or somebody who was an achievement-oriented person. He was trying to look at their backgrounds and come up with what would make you believe right away that you'd found somebody who was an achieving-oriented person. He went through a long list of things in people's backgrounds, and he came up with the highest and the lowest correlation.

What would you guess is the highest correlation in somebody's background that would indicate they are an achieving person? In this case, it happened to be an Eagle Scout. I guess getting all those damn badges one after the other sort of indicated that you were an achieving type of person. And what would you guess was the lowest correlation of an entrepreneur, an achiever? I hope I don't insult anybody, but it was a pipe smoker. I guess it's all that damn maintenance on the pipe. You are always working on that thing and you never have time to work on anything else other than the pipe. The moral of the story is, if you are a pipe smoker, don't take it when you go visit the venture capitalist.

The point being that in your background, you want to have in your resume and business plan all the things that you have achieved. What in the world have you been doing for the last 15 years. Make sure you pepper your resume with lots of achievements, and when you are describing your business plan, make sure you have a lot of things in that background that show that you have been an achiever.

I'm only going to mention one more of these items that we look for as venture capitalists, and this has to do with honesty. Honesty is one of the characteristics that every investor looks at. You have all seen people who have cheated and lied and made lots of money. But an investor or venture capitalist is not interested in that and they are going to find it very difficult to invest in your company if you are in any way dishonest. There is difficulty in defining honesty and dishonesty in the business. Every venture capitalist expects you to promote your business. You have the best company, you have the best product, you have the best service and there's nothing wrong with that. It's the point where promotion becomes deception, and I'll illustrate that by a story.

Some years ago an associate and I were reviewing a company. I happened to be upstairs with the president and my associate was downstairs in the shipping room. The president continued to tell me over and over again that the printer they manufactured was the best in the world and, quite frankly, none of them had ever come back to the company for repair. When I compared notes with my associate that night in the hotel room, it turns out the shipping department had seen every one of those printers come back at least once. That, folks, is deception. You can't get away with that in the venture capital community. If you get caught at that, you can expect them to leave in minutes after discovering it.

One last story. Some years ago I was taking a plant tour and as I went through the plant, the tour moved on a little bit ahead of me. I stopped in front of this lady who was running a drill press and she continued to drill this piece of aluminium. And I stopped and said "What are you making?" She said, "Oh, I'm not making anything." I said, "What do you mean?" She said, "They just hired me for the day and told me to look real busy. Said they had a bunch of big shots coming through here they were trying to impress." We didn't do that deal.

3: THE SUCCESSFUL NETPRENEURS

MS. SMITH: On the stage tonight, we have five great entrepreneurs from our region who are going to talk about something that's important to them and which they want to share with us. The first is Mario Morino, who is the co-founder of Morino Associates, which later became Legent Corporation. Mario is a private investor and the founder and chairman of the Potomac KnowledgeWay Project and the Morino Institute, and I might say Washington's leading social entrepreneur these days.

MR. MORINO: First of all, thanks very much for showing up tonight. This is an exciting evening. There are a lot of people here I've never met, so just a little bit about my background. I broke into what was then the computer field as a grunt programmer, and I came up the ranks, technical ranks, writing code for a lot of years. Folks like John Burton made me think about marketing and sales because that was a different area. I was lucky because I had a lot of people around me to learn from.

The company went on to become a very large business when I retired in 1992. Since then, I've devoted most of my time to the non-profit sector and this program particularly. Most of my time I deal with the Potomac KnowledgeWay Project, a regional initiative trying to focus the power of this region as an information product producer, becoming for that industry what Detroit was to the automobile industry many decades ago. This region should be its world equivalent in the 21st Century in terms of information products. We do a lot of work on entrepreneurship in this program and a lot of work with youth. I spend about five percent of my time on the investment side. I'm a special advisor with a group called General Atlantic Partners out of Greenwich, Connecticut. I'm invested in about eight to ten different venture funds, and we occasionally do some one-on-one direct deals. Now, that gets you the flavor of my background.

The most important message I'd like to give you deals with getting financing. Actually, I'd rather use the term "getting the initial money you need to get started." I think we confuse that with "financing" a lot of times and you see some people trying to go to a venture fund right away. They're trying to go to a bank to get money. I'd go back to the concept of what an entrepreneur is about. I think the key word is "resourcefulness." A lot of people never get formal funding at all. I think you should be able to sell your idea early on to somebody who is going to help you but who is not a funder. It could be a customer. I know I was very blessed. I lived through several product reincarnations in other companies, so when I left, I at least had a track record of product development. But we sold a product idea, on one piece of paper, to a company and the deal was that we would get five percent of the wealth through that product and they would give us funding for two years for our expenses. They gave us offices, they gave us computer time. They sold our product for us and we got a start. While we were doing that one, we wrote the second one. While we were doing the second one, we started a third one. And in that process we started doing contract work for people like Boeing and the Federal government, and we were working our day jobs, getting our cash flow. Remember, the issue is cash flow. We were able to create the fourth product, which launched the entire line. You have to use resourcefulness to find out where you are going to get your funding.

MS. SMITH: Our next panel member is Charlie Heller, director of the Dingman Center for Entrepreneurship at the University of Maryland which, by the way, has a very robust and effective mentor program I hope Charlie will mention tonight.

MR. HELLER: I followed the rules by not wearing a tie, so I will also follow the rules and spend the first minute talking about my background. Like many of you in the audience, I started out as a techie with three degrees in engineering. I started out in the aerospace industry and then a couple of years in academia before discovering a market opportunity. There are people like Mario who have enough gray hair to remember that there was another revolution in technology which brought about a tremendous market opportunity a few years back, and it was called interactive computing. For many of us this was like the Internet today. We went from batch computing to interactive computing. We were able to do things in real time that people had never been able to do before. As a result, we started our first company, a company called Bay Tech Associates and our product was a piece of software for computer-aided instruction. We sold that company. The company which bought it went public. We came out of that and started another company in an area in which I was particularly interested, the area of computer-aided design and computer-aided manufacturing, CAD/CAM, and started a company called CADCOM. After ten years, we sold that company under a very complex earn-out type situation. I stayed with the parent company as a V.P. of corporate development for two and a half years. We put together an ill-fated joint venture with Honeywell which didn't work out, to get into electronic publishing using the same technology that we had been developing for CAD/CAM. So we started our own company under kind of a strange management buyout that one of my former partners and I did from the parent company, and started a company called InterCad, since renamed InterCad Graphics Systems. It has now become part of Intergraph Corporation in Huntsville, Alabama. Since that time, I have been at the University of Maryland running the Dingman Center for Entrepreneurship. I also run the Annapolis Consulting Group, along with my business partner, Angela Tandy, who is in the audience tonight. We do a variety of things such as working with venture capital firms, particularly one on the west coast, but others as well, looking at deals, doing birddogging for them and so forth. We also work with large companies doing corporate venturing and doing some work in Europe and doing training, and serving on quite a few boards.

When I saw what this evening was about, I actually tried to list all the types of financing we did at our three companies. I was absolutely amazed when I finished the listing. On the debt side, we did some conventional bank loans, we did SBA-guaranteed loans, we did receivables financing. On the equity side, we did the famous three F's: friends, family and fools, several private placements, an R&D limited partnership, two venture capital financings, an IPO, and acquired three times. And we also did some hybrid stuff.

What's my advice? Well, I think the first experience of entrepreneurial terror was when I discovered that a seed or early stage company really cannot get venture capital from venture capital funds. Most of the companies that we see at the Dingman Center come to us because they think they are venture-capital ready, and they are not, just like we weren't at that point. And the words we heard over and over again were "too early." In fact, we thought about changing the name of our company to "Too Early, Inc."

So what do you do? My advice is, at that point, you've got to put in your own money, you've got to bootstrap. When you're bootstraping, you get operational as fast as you possibly can. You avoid spending money as much as possible, just as Mario was just describing from his experience. You barter and you look for anything that will bring in cash as quickly as it possibly can, even though you may not be quite as focused as some people would like you to be. And more than anything else, you have to network during this period. You have to get people to know you, you have to promote yourself, you've got to attend events like this, and you have got to be a sponge. I think for an entrepreneur, the work week has about 80 hours. So don't say you don't have enough time to attend events, seminars, workshops, etcetera, where you meet people and get to network.

I wish that when I was in the early stages, there had been something like our Dingman Center for Entrepreneurship, where there was an opportunity to find mentors who will work with you one-on-one, where there is the Baltimore-Washington Venture Group, which will be described to you in more detail, which helps you find capital from private investors, where you have networking events and seminars and education events and so forth. And at that point, I think, there comes a time when angels become the key investors and I know John May is going to be talking about those. Thank you very much.

MS. SMITH: Chuck Stein is the former Chairman and CEO of Netrix, which was a venture-backed technology firm. He personally raised many millions of dollars to get that off the ground and has some interesting things to say about it.

MR. STEIN: I have also been given a format to follow which is that I'm supposed to tell you about my background in a minute and give you wisdom in two minutes and I'm not sure I can really do that. I was president of Netrix. Netrix raised $24 million in private venture capital in four rounds, and one of the things I want to talk a little bit about is the fact that at each stage we were raising money, we went to different kinds of venture capitalists. Venture capitalists are not all the same. We then raised $26 million in a public offering.

Prior to Netrix, I was with Bolt, Beranek & Newman. I am not with Bolt, Beranek & Newman now, despite the news release that you might have gotten. I have just retired from Netrix and I want to spend the next period of my life working with entrepreneurs to help them develop their companies, help raise funding, and help do the things that I think are necessary to make them a successful company.

One of the things that occurred to me is that the people I have talked to recently think about raising venture capital like selling a product. And I think that's about as appropos as getting married and selling some woman or some man on the idea that you ought to spend the rest of your life together. I think that the venture partner, the partner that you are going to get to help fund you, is going to be your partner for the rest of your business life—or at least the major part of your business life—and you ought to give as much thought to this partner as you might give to your spouse. What I've tried to do is to put down the five things that the investor is looking for from you.

First, I think that's vision. They want to see that you really understand what you're looking for.

Second, it's industry experience. They would like to be convinced that you know every-thing there is to know about the industry, because they want to know that as the industry changes, you are going to change, and change the company that you are developing.

Third, they would like you to focus on the business case. Ninety percent of the entrepreneurs I talk to spend the first several meetings telling you about their technology. And your technology is just interesting as hell to me because basically I'm interested in technology and I really like it. But it says little about the business, and what you really need to do is to focus on the business case and how you are going to make money and therefore how your investor is going to be making money.

I think the fourth thing they are looking for is an experienced management team, that is, you have shown some experience of having done this before or done some aspect of this before. What that means is, you have to spend some time getting people around you that are going to help you do this deal, because there is too much risk with an inexperienced management team or with an empty management team: one guy with great vision.

And finally, they are looking for a significant return. One of the things that I hear entrepreneurs worry about most is the price of the deal. What you have to understand is the venture capital investors who invested in Netrix put in their money in 1985, 1986 and 1987, and the company went public in 1992. They left their money in this company for a long time, and therefore they are entitled to a pretty good return on that.

I think that if, as you write your business plan, you can think about, those five things: vision, industry experience, the business case, the experienced management team, and the fact that they ought to get a significant return, you produce an attractive story for your company. I think from the entrepreneurial point of view, what I was always looking for was recognizing that this was going to be a long-term partner and I wanted to interview them as much as they wanted to interview me. I wanted to find out what deals they had done, what deals they hadn't done, what deals had they done that had gone bad and what did they do when they went bad? Were they there to put more money in? Were they there to help you? Because the business plan that you guys are writing today isn't the way it's going to happen. It's going to happen some other way, and you need your partner to recognize that and be prepared to stay with you through the long haul. You should be looking for help and guidance from them. You need more than the money. The thing that was always pleasing to me was that I had three venture capitalists on the board of Netrix and all three sat on the boards of a lot of other companies, so when we would come up against problems, they were problems these folks had seen before and they were really able to give me help in terms of other CEOs, of other partners, of other people they had worked with who had been through this, and I got a lot of advice from other companies in their portfolio.

The third thing you should be looking for is chemistry. Just like when you look for your spouse, I think you should recognize that you are going to live together through the good times and a lot of bad times, and you want the chemistry to be such that you can really work together through this period.

And finally, I think you are looking for the money at a fair price. So there is a conflict of interest here. They are looking for a great return. You are looking for the money at a fair price. And I heard Mario say that if neither of you worries about what the other guy gets and worries about if you get what you want, that this will really be a successful deal. So I would focus on the long term and the partnership on both sides and I think if you do that, you are in a good position to get the money and the help that you need.

MS. SMITH: Next up is John May. John is an associate of Calvert Ventures and more importantly to this group, the founder and executive director of the Private Investors Network (PIN).

MR. MAY: I think the best thing I can do would be to repeat verbatim what Chuck just told you. The entrepreneurial effort I have been spending the most time on in the last six years—and this is something you have to realize about money sources—is that almost all of the money sources that you'll approach have had to raise that money themselves entrepreneurially. Either they are cashed out CEOs and entrepreneurs themselves or they're general partners of a venture fund, in which case they raised the money that they are putting out in a fiduciary relationship. So don't assume we are all on the other side of the table. We are all entrepreneurs together, in a way.

I've been managing Calvert Social Venture Partners. It is fully invested, so I don't bring my checkbook to these events. We do represent Solstice Capital in Boston, and they are looking for opportunities here, which is a good sign for all of you that outside money is looking here. And I'm advising a new fund, which I think is great for this area, to get a new fund, which is the Women's Growth Capital Fund, to invest in expansion stages of women's capital.

The main thing I want to talk to you about, though, is the Private Investors Network. There's a sheet in the back that says it better than I will. But there's also a list in the back of all the resources that we think you should be aware of. I have been trying to encourage all of the venture capitalists and other funding sources in town, instead of just saying "no" to you—99% of deals that come to venture capitalists get a no—to have a nice "no," and in this, give you some hints as to where else to go, Dingman Center, George Mason, and so forth.

The Private Investors Network is a group of angel investors, cashed out entrepreneurs, CEOs of companies, general partners of venture funds, investment bankers that have gotten together in this region to try to look for opportunities like yours. They meet once a month and to circulate the opportunities among them-selves. That's described in the front. Other resources you can go to are in the back. I encourage you to use that resource and any other resource to get to angel money.

A few tips or thoughts: Patience. I cannot stress more fully, patience. Persistence. We will dangle. We will let you twist. We will let you wait to see what your persistence level is. Creativity. What other ways have you tried, how much of your own money, how much of your friend's money, what of your customer's money, what of the credit cards? What is your creativity level, and most importantly for the funding sources: management, management, management. Venture capitalists and angels never invest in patents and technology. They invest in people. It's how you come across, and one of the greatest things that was said here tonight from David Gladstone was the issue of honesty and disclosure. Never fail to disclose a negative in your background to a source you hope to get. They will find it out and you will lose that relationship. Always disclose.

Last, there is a lot of opportunity in this area. There is a lot of money coming into this area. We are trying to find the vehicles like the Private Investors Network, like increasing the Mid-Atlantic Venture Association, like trying to be helpful to individuals who are trying to make these investments. It's what I call warm money. Always look for somebody who brings you more than money. You will be disappointed in a spousal relationship if you don't have a whole relationship. Look for warm money. Have a good time.

MS. SMITH: Our last speaker and sage resource tonight is John Burton, a partner in Updata, Inc., and a former CEO of Legent Corporation.

MR. BURTON: For those of you who want to know a little bit about my background, I started in college learning how to program, soon realized that it would be better for my life and humanity if I sold it instead of built it. So I got in the marketing and sales side. In Boston, where I was, there was a lot of opportunity in the services sector and I went into the software business with Cullinane, which later became Cullinet. Frankly, I was a student of how the business operated. It was a very successful organization, and about the time I figured out I knew what I was doing, I joined a startup company—which was well-backed—as the marketing and sales guy, and it was an unmitigated disaster. It was the most important experience I ever went through, and it served me well thereafter. I co-founded a business in Boston called BST with some other partners, and that business was quite successful. We formed relationships with several software companies, including Morino Associates, here, and Morino Associates, which had become Legent, acquired BST. I moved down here and became, eventually, president and CEO of Legent which was a lot of fun. We had an opportunity to grow the company and meet with a lot of entrepreneurs because, as you well know, Legent was very acquisitive from a strategic standpoint and we bought a lot of small companies. So, I've seen it.

Updata Group is an M &A firm in the IT industry which has a very good background, and we have been the partners independently, individually as well as collectively, investing in small startups, angel-level as well as some post-public opportunities. I have had very good guidance or counsel, and as the other guys that have kind of a marketing and sales background can think about things, and that's very simply five things: A, B, C, D, E.

A, you will be judged by who your Advisors are. Pick the best ones you possibly can: people with backgrounds, people you can learn from. Be highly selective and be very persistent in finding them.

B, you are Building a team. You are not building a product. You are building a team first and that team will be people who complement your skills, who do things you don't. If you are an engineer, find the best marketing and sales guy. If you have a marketing and sales and engineering guy, find the best financial guy. Build a team, and that team should include customers or people who will eventually use your product and service, and that's just what Mario talked about.

Find somebody, even if they don't pay you. Will you buy this if I build it? Will you help me build it? Can I build it according to your specs? Get consulting money, ask them for that. Ask them for office space. Get a consortium of people who will then say, I like this thing.

C, you are building a Company, you are not building a product. VCs do not invest in products. If you think you want to build a Vermeer here because you can sell your front page to Microsoft for $130 million, you will not last. It will be just like playing the lottery. If you build a company, you can survive a lot of things in a lot of different generations. At BST, our first product idea was absolutely phenomenal. It was a mainframe-based voice messaging system. Pretty good, huh? We had a great team. People told us that it was really stupid. We didn't do it. We continued to bootstrap though consulting and eventually came up with another product, which we built with funds from our customers, and sold to Cullinet for about $3 million, which was an equity-free round of capital to build our eventual product. The team was able to do that because of the agility the team had, and people invested in the team.

D, Disclosure. Run your operation as if you were public. Communicate with people as if they were shareholders. They will be stakeholders. They will be your friends. Communicate. Memos, calls, do everything you possibly can. Run your business as if it were public, and do not do anything you would be afraid to disclose to a lawyer, a friend, a relative, or one of your shareholders.

E, Examine. And by that I mean, examine yourself, be honest with yourself about what you can do well, what you don't do well. Take the input from the venture capitalists very seriously. Ask them hard questions: "if you don't like this, why?" "I can learn from you." Also, ask them "will you invest?" and be hard on them, because they will string you along. It will take time and you don't have time to give. Be direct with yourself, be direct with everybody else, it saves time. And be very persistent in the way that you examine yourself, and do it daily, weekly, monthly and ask everybody you possibly can their opinions about where in your organization you are strong and not strong. The agility that you get and the discipline you get from following those ideas tend to help you raise money along the way in multiple ways, because your recruitment and your fundraising effectively never end, whether you're running a company with an idea or a company that's $600 million.

4: THE INVESTORS

MS. SMITH: I'm going to introduce our featured guests, who will be prepared to take questions from the audience. Starting in reverse alphabetical order, we have Frank Tower, vice president with Silicon Valley Bank.

MR. TOWER: I'm Frank Tower with Silicon Valley Bank, with an east coast office of the bank. We lend to technology companies, emerging growth, high technology companies. You know, there aren't a lot of banks that do that. We are one. The one pearl of wisdom I have is really reiterating what John and the rest of the folks here have said. That is, really take the time and build a strong group of advisors. Attend events like this. Attend the Netpreneur Program, go to George Mason, go to the Dingman Center and they will help you build your advisory team, because you truly are building a company, not a product.

MS. SMITH: Next we have Angela Tandy, president of the Baltimore-Washington Venture Group.

MS. TANDY: Good evening. I'm Angela Tandy. I'm with the Baltimore-Washington Venture Group. The Venture Group has been around since the early '80s. We are a membership organization. We have over 500 members today. We create a forum that brings entrepreneurs and investors together. We hope to facilitate win/win business relationships. We are the sole gateway to the Private Investors Network. We screen all the deals that go on to John May. And if you have any questions, there is some information in the back or you can talk to me afterwards. My advice is just get out and network, network; be persistent, as John mentioned, and be pro-active.

MS. SMITH: Steve Ritterbush, managing general partner of Fairfax Partners.

MR. RITTERBUSH: Thank you. I'm a general partner in Fairfax Partners. We are an early-stage venture capital fund here in Washington, D.C., in the Northern Virginia area. We have been around since 1989. We invest in three principal areas: health care, medical devices, drugs, etc. We do a lot in information technology, with a strong focus on health care information systems and business-to-business Internet. The third area is what we call applied technologies, where we look for technologies that have been spun out of the defense sector: sensors, lasers, and the like. I might add that while we do invest—we've probably invested in over 50 companies in the last eight or nine years—we also develop companies on our own. Every one of the partners in our group has created companies on their own, and I think we've taken about seven technologies and built businesses within our organization which we then spun off into others. So we are a bit of a hybrid between a straight venture capitalist and an entrepreneurial group.

MS. SMITH: Gene Riechers, who is the managing director of technology venture capital at Friedman, Billings, Ramsey & Company.

MR. RIECHERS: I come to this from a very different background. I spent the last 17 years helping entrepreneurs build businesses and now have joined a venture capital fund and created a venture capital fund. So I'm going to do it more than one at a time. Pegasus Venture Partners is part of Friedman, Billings, Ramsey & Company. We were raising $50 million to invest in electronic commerce, tele-communications and Internet and intranet software and services companies, focusing primarily, but not entirely, in this region and we are going to do early, middle and later stage investing. Generally not seed stage—investing the smaller amounts. We are going to do $1 to $2 million per round, to give you some sense of what we are about. I can't add to the level of advice that's been given already. I think the emphasis you have heard on building a company and building a management team is exactly right. I have seen people do that successfully and I have seen people try do it by themselves with one product, and it doesn't work. So let me add something very different. I have seen a lot of entrepreneurs in this town develop consumer ideas, and they don't have consumer marketing backgrounds. My recommendation is to go find consumer marketing talent, if that's where you are going with your technology.

MS. SMITH: Jim Pastoriza, principal with AT&T Ventures, which opened here not quite a year ago.

MR. PASTORIZA: That's right. We opened an office here just about a year ago because we believe that this is a terrific place to be. We have got an office here now. We have got an office in New York. We've also got an office in Silicon Valley. We are an independent venture capital firm with about $230 million under management. We have one limited partner, which is AT&T, so our charter is to look for businesses that we think ought to be strategic to our limited partner.

A couple of areas of interest to us are enabling technologies that can do things like multiply band width, things wireless, things local loop, things Internet. We have got a portfolio now of about 40 companies that we have been able to build up over the last couple of years. Our group consists of a mix of professional venture capitalists, as well as people who have a pretty strong operational background.

MS. SMITH: Lyn Miller is the regional director for the Center for Innovative Technology, a Virginia institution that has two incubators under its wing.

MS. MILLER: We have two primary sources of funding. One is a seed and early-stage capital fund, which will be operational at the end of this summer. It will be a $25 million fund and it will be used to cover those that Gene's funds don't cover, which are the much earlier stages. We also have an even earlier stage, technology awards, which are primarily for research and development stages, and those involve partnerships with universities. One of our primary skills is putting you together with potential research partners from universities around the state and other institutions that can help facilitate some of your R&D work. So we have two sources of funding.

MS. SMITH: We also have Patrick Kerins from Grotech Capital Group in Baltimore. He joined them recently from Alex Brown, where he was in corporate finance.

MR. KERINS: Thanks. Grotech is an investment partnership located actually in Timonium, which is a suburb of Baltimore, not a chemical element, as somebody suggested earlier. We have $200 million under management to invest in a broad range of industries. We would like to put as much as 20 to 25 percent of that to work in information technology. We are focused in the mid-Atlantic and southeast and we have made a number of investments in this area, including currently being the largest shareholder in Digex. So, I look forward to having discussions with many of you and my colleague, Andy Jones from Grotech, is also here.

MS. SMITH: Not on the program, but at this table is the managing director of the new Women's Growth Capital Fund, Pat Abramson. I would like her to stand up so you'll see this new face in the crowd.

MS: SMITH: Suzanne Hooper from New Enterprise Associates.

MS. HOOPER: Hi. I'm from the NEA, as it's known. We are an early-stage venture capital firm based in Silicon Valley and Baltimore, and we just recently opened an office in Reston, Virginia that houses our technology team, which is myself, Peter Barris and Art Marks. We invest about 60 percent of our portfolios at the early stage. We have about a billion under management, but we are currently investing in a $310 million fund. Some of the local companies we have invested in are Netrix, UUNet and AMISYS Managed Care Systems, and most recently, two companies in Reston Virginia—Netstart and CTI Information Services.

We have about 300 companies that we've invested in over the last 20 years. This is our 20-year anniversary, so we're very proud. About a hundred of those have gone public over the years. Words of wisdom: I think one thing I haven't heard tonight, when you've actually gone to a venture capitalist and you've spent some time with him, make sure you ask about the process. You may think this person thinks you are the greatest thing since sliced bread. But in our firm, there has to be a majority vote. So you need to make sure you get in front of those other partners as well. Different firms have different processes, so make sure you ask about that process.

MS. SMITH: Jeff Davison, partner with Triad Investors Corporation in Baltimore.

MR. DAVISON: Hi. I'm Jeff Davison, and I have spent ten years in the venture capital business—all in the early-stage end of the business—and three years as the VP of sales for an advanced materials company in between two five-year stints. Triad is headquartered in Baltimore, and about two-thirds of our investments are pre-alpha companies. We have also started companies from scratch. One of the ones that we did that with was Dolly the Sheep, which you have seen on the Pizza Hut commercials recently.

We are focused on the Mid-Atlantic region. We spend 50 percent of our time in information technology, a third in health care, and the balance in others. We invest up to $750,000 per company, and typically co-invest with angels—sophisticated individual investors—as well as other early stage venture capital funds. I would, as far as advice, talk about something that no one else has talked about tonight, which is how to determine whether or not you and your company emotionally and psychologically want to get into the venture capital game, because this is one crazy business. You really need to look in the mirror and understand, for your lifestyle and your personal goals, whether you want to bring an outside shareholder, like a venture capitalist, into your business, because once you bring that money into your company, you have an obligation to those investors because those investors have an obligation to their limited partners.

There is nothing wrong with building a nice $5 million company that isn't venture driven. That can be a great lifestyle, and frankly I wish I owned a few of those companies, but I don't. So in any event, I think it's important to focus on whether or not you want to play the game.

MS. SMITH: Tony Carter, the Chairman of International Business Group's venture incubator.

MR. CARTER: The International Business Group is a venture incubator company. It does concentrate on the first three stages. I guess the nearest model would be Bill Gross' IdeaLab. We do, actually do, hands-on help in putting deals together, so we actually help hands-on with putting the team together. It's based here, but it's an international fund. We look forward to speaking and helping—mentoring—some of the new businesses go to the next stage of traditional venture capital.

MS. SMITH: I want to apologize to Phil Herget. I skipped over him briefly.

MR. HERGET: I'm with Columbia Capital. We have two sides to our shop. We are based in Alexandria, right down in Old Town. We have an investment banking operation that's focused on mergers and acquisition advisory services, and we have our direct investment side, where I spend most of my time. Our direct investment strategy is focused on investing in early-stage telecommunications and information technology companies. As you build your business, one word of advice is: stay focused. Remember that you have limited resources. There's limited capital and limited people to accomplish what you are trying to do.

Manage the expectations of your stakeholders and that includes your customers, your investors, your employees. Be conservative, be realistic. Be upfront and open about issues, especially with us investors. We really don't like surprises, and we like to be treated as if we are partners and members of the team. And as you go out to raise capital, make sure you have a very clear, concise story that encompasses the product, the market opportunity, and really gets across your competitive advantages.

MS. SMITH: We have both Roger Novak and Jack Biddle of Novak Biddle Venture Partners, the most recently closed fund in our area. Congratulations, guys.

MR. BIDDLE: I'm Jack Biddle of Novak Biddle Venture Partners. Just a quick background on the fund. It's a new partnership. My partner was the founder of Grotech in Baltimore. Grotech has become very large and he likes early stage, so we're actually interested in very early-stage deals from $100,000 to a couple of million. As for my background, I actually was hired for Intercap—the successor business to the one that Charlie started—to close the company down. The venture guys figured I could do it a couple of days for a few weeks, and ended up turning it around. But I had the experience of going out to raise venture money, and everyone turned me down. The venture people like to back winners, and winners do not put themselves in positions where their futures are a binary yes or no. I was able to get the business profitable by doing deals with suppliers and customers and then I could raise venture money. Most of the money in our fund is from entrepreneurs who built successful companies before there was a venture business.

The other advice I want to give, when you do go the venture route, every venture person, and every CEO, and every entrepreneur has three tall stacks on their desk. The stack on the left is a big pile of things that if you don't get to, some-thing bad happens to you. The stack in the middle is stuff that something good happens to you, and the stack on the right is stuff that's indeterminate. Nobody ever gets to the stack on the right. So you need to make it easy for the people to get you onto the middle stack where there's some upside, where you have a chance—which means go ahead and pester them to commit to look at your plan.

Other advice: business plans are not operating plans. It's like a resume. When you have a stack of 300 resumes, you are looking first for a reason to say no. So we just want a reason to say no, we'll throw it out, and then what's left, we'll think about. The reason we'll say no is because you don't understand the market, you don't show us the business model. We want to understand the fundamental drivers. Then you get your meeting and you move towards the deal. It's the operating plan that you are going to be held to, not the business plan.

I have one other piece of advice. What we used to call in the business—I started in the venture business and then went to the operating side and am coming back—Rosen's Revenge. The 40-page spreadsheets in the back of the business plan are real heavy to carry in your briefcase and venture guys read these things on airplanes. Rosen's Revenge. They put up the original money for Lotus, so keep it light.

MS. SMITH: And finally, we have Marc Benson, a partner with Mid-Atlantic Venture Funds, formerly known as NEPA, who has a very exciting announcement to make.

MR. BENSON: We manage a total of about $80 million. We have offices in Pennsylvania and just down the street in Tyson's Corner. Our latest fund, capitalized at around $50 million, was closed two months ago. We've made three investments or commitments to date out of that fund.

We have been in business for 12 years and we have made 45 investments, mostly in the Mid-Atlantic area, which is where we focus. Thirty-three of those 45 investments were pre-revenue at the time that we did the first capital infusion, so it's certainly an area that we are comfortable in. We are comfortable in the $500,000 to $2 million range. Some of our most recent investments in this area include leading the first round at Visual Networks and NetSolve. I'm also pleased to announce that we have made two commitments in the last few days, one to Women's Connection Online, represented here tonight by Susan DeFiffe and Gary LeFevre, so we will do Internet deals, for those who said we wouldn't. My advice to you is start the process early. It's time-consuming. You are in a far better position to raise money under terms and conditions that are acceptable to you if you're not desperate for capital. So start the process early, get the business plan out there and start talking to people.

5: THE AUDIENCE WANTS TO KNOW

MS. SMITH: Now we are ready for questions. If you have on a tie, it's going to work against you. Questions will be directed primarily at the people on the stage. We are going to run this until about 9:00, and then we'll break for some more networking.

AUDIENCE MEMBER: Hi. My name's Raj Khera. I run a company called GovCon. It's a pretty popular Web site for government contractors. We started about a year and a half ago, and we had maybe 100,000, 200,000 hits a month and we are up to three million a month now. My question is, how do you know when you are ready for venture capital? We are doing okay. I don't know if we need to get it. But I'm curious to hear your response.

MR. HELLER: Let me start by saying, rather than knowing when you are ready for venture capital, I think the first question should be "do you need outside capital?" My advice would be to wait as long as possible to get outside capital, because we want your valuation to be as high as possible and, obviously, the longer you're in business doing well, the higher the valuation. So I think that would be step one.

MR. MORINO: From day one the total amount of money we had in our company was a thousand dollars. When we went public we had millions of dollars in the bank. If you don't need the money, don't go for it—unless it's a way of getting a superb partner. When we went out, we started literally with a thousand dollars, only because we had to clear the books. There was no money invested in the firm. It was all bootstrap. In fact, the only reason we went public—we did not need the cash—we needed the currency to do acquisitions. There was no need for the cash in our business. We were cash rich for quite a while.

MR BURTON: I think there are a couple of reasons why you might consider outside capital. BST, my company, was similar to Mario's in that we did not bring in venture capital for working capital. The first VC's we brought in were to take their money to buy another company. I would say that the reason to have venture capital is if you're constrained in your growth, number one, or number two, if you find somebody that you really believe can help you network and further your cause, and the cost to have them do that is a piece of your company, and that gets into relationships. I would suggest you merchandise yourself and look for money, and when you need money, you'll be ready. You'll have primed pump, so to speak. But I would not rush into it for the sake of having a VC on your board and their glamour.

MS. SMITH: Any additional comments, Suzanne?

MS. HOOPER: Don't wait too long. Don't go out looking for venture capital when you have $100,000, because you won't have a good negotiation point.

MS. SMITH: Did you hear what Suzanne said? Don't wait until you are down to your last dollar.

MS. HOOPER: Yes, don't wait until it's too late. If you have a little money in the bank or you are about to run out and try to negotiate with venture capitalists, you don't have a very good stand. So you need to raise it a little bit earlier than you need it.

MS. SMITH: I will add one thing. I have been to a couple of venture capital conferences recently, and have sat in on a couple of planning meetings for the MAVA conference. It's clear that the companies that get to present largely will be institutionally backed, and I do think that there is a positioning and PR element at some point that people ought to consider.

AUDIENCE MEMBER: If anyone still wants to be an entrepreneur after hearing this, I guess you're really determined. But one of the things that a lot of entrepreneurs really, I think, are concerned about as they go to get money—especially the last couple of years in a sort of overheated market—a lot of people are thinking about how they are going to move on and move out of that business. Should entrepreneurs be concerned about that or is that just a funding source?

MR. STEIN: I think that one of the things that I said was remember that the venture capitalists want to get a good return on their money and the only way they get a good return on their money is if they have a way of turning equity in your company into money. So I think the extent to which you should think about exit strategy is that an investor is to be your partner for a long time. What you ought to have in mind is how is he going to turn this work into money. That's the point of view, I would think about it from.

MR. BURTON: I'd add one comment. If you're building a company, you're doing it as a long-term endeavor, and the thing to keep in mind—which has changed, at least briefly—the way to create an exit strategy is to create a company that makes money. If a company makes money, you will have multiple opportunities to exit that company with somebody buying you, somebody taking a piece of it. But companies are built to make money, and that's the thing that you have to remember, and that takes a long time. If you put the exit strategy before making money, you have a high probability of failure.

AUDIENCE MEMBER: You've all said that it takes a good bit of time to obtain financing, for startups, to get money to get your company going. But in this very fast-paced new environment we all seem to be working in, what can one do in order to get money quickly so that the competition doesn't beat you out, if you're a small company.

MR. MAY: The main thing is to be as creative as possible, to network with as many of your peers who have been through this, mentors. You cannot assume that venture capital alone, the big V big C, is available. It is a very small tip of the iceberg and you have to look at all the other funding opportunities and be working on them at the same time. So whether it's angels, whether it's suppliers, whether it's your friends and family and a second trust, you cannot wait for the answer from the stack that's on the desk until you go to the next—you should be going parallel tracks at all times and trying to find out who in the community is finding what creative sources, and then tap into those yourself. But never assume that what was used five years ago or what the venture capitalists want is the only way to go.

AUDIENCE MEMBER: I have a tie on, so I apologize for the tie. I'd like to get comments concerning the use of venture capital to acquire other companies. My operation has acquired two companies, but we need about three more that we've eyeballed to crush the competition. We need cash to acquire these companies. There's a lot you can do with equity but you can't do it all with equity. So I'd like comments from the investment group and advisors on how do you go about getting the money to buy others—we have to buy them in order to make some real money.

MR. MAY: Just as an aside, what you're describing to me is this phenomenon we're getting in the community of merchant bankers and investment bankers. Venture capitalists are patient money. They want to grow companies. In general, they are doing this over a three-to-five year period for their limited partners. In this community we haven't had that much M &A, investment banking, merchant banking, which is coming into this area in droves. Carlyle, Thayer, you name it. There are a number of opportunities, special funds to look at opportunities as opposed to long-term capital, you may want to look at that as well.

MS. SMITH: Frank Tower, do you have anything to add to that?

MR. TOWER:, John makes a good point that you've got to pick the right partner and it is going to be a merchant bank or an investment bank that's going to help you. But as you are putting your plan together, feel free to chat with a commercial banker or a merchant banker and find out how much would he be willing to take a piece of this, because it is going to be a mix of debt and equity, and you're very rarely going to find an equity player to take the whole thing or a debt player to take the whole thing.

MS. SMITH: I think our networking session would be a good chance to get some follow-up on that.

6: KEEPING SECRETS

AUDIENCE MEMBER: It's probably a common belief among the people here that the easy part is having the idea and where it gets hazy is going from the idea to actually having the business. This is a two-part question. The first is, what are the merits of starting from scratch, building your team, following all of the advice that we've heard and going from nothing to something, or being opportunistic and forming a partnership with an existing company. So from their point of view, you might be "intrapreneurial;" they'll see you as a potential business they can add on to an ongoing business. And the other part of the question is, what are the risks of shopping an idea around, putting together a proposal, a business plan, and divulging it to people, because at some point, someone else may like the idea enough to do something with it and then it gets to where it's a race to see who can get to something first.

So how do you deal with that? You have to divulge enough information to be interesting, to be appealing, to be a good investment, but if you do it too much too often, you might find you are taking more of a risk than you want.

MR. BIDDLE: One of the most successful people I've met in the computer industry—I worked for him a few years ago when we bought a company that was a bit of a mess and went in to put a new plan together as a public company, $25 million, and put together a business plan. We distributed it to all the employees and a bunch of the people on the senior management team got real upset that our trade secrets would come out. We said, "You can publish this on the front page of the Wall Street Journal. The money is going to be made in the execution. And that's the bottom line."

I think if you've got a trade secretÖsome truly magic thing where one sentence is going to allow a bunch of people to figure it out. I have never seen one of those in my life. It's execution, not an idea that makes things work.

MR. MORINO: I think because we've been around the security community, that we are a little paranoid in this region, and we think we have the only ideas. I can't tell you the number of times someone comes in with a non-disclosure agreement, and we go through all the trouble of signing the non-disclosure agreement, and they have nothing to tell us that we didn't know before the meeting started. And by the way, it also tells us something about you, and you don't know that in the process.

Execution is everything. There are ideas that are very unique and perishable. Believe me, they are few and far between. There is a good chance that not only did somebody else have the idea, there are probably ten people ahead of you someplace in the country right now, especially if you're on Web time. The key is moving on your idea, getting a prototype and getting out there fast into that market so you can get to a customer, try it, adapt it, make it successful and execute.

MR. STEIN: I'd like to come back to the person that asked the question about shopping the deal around. I think that what you heard every one of these venture capitalists and investors say was we have X dollars that we want to put to work. Their job is to invest that money. They are eager to invest it in great ideas and great concepts.

One of the techniques that Netrix used to raise money, and to raise it very quickly, was to select three or four potential investors and show them the deal at exactly the same time, tell them, "By the way, we are showing this to these other three or four people and we are going to go with the guy who steps up first." You then have created a reason for them to invest. Of course they like to drag their feet. The longer that they go on, the more chance they have for you to prove your concept. And so I believe that there is a real benefit to showing this to a number of people, and to saying, "We are going to close this deal as quickly as we can."

MR. MAY: Never approach an angel network, whether Texas Capital Network, the Capital Network in Boston, the Private Investors Network, and ask if we'll sign a non-disclosure. You have to disclose what you are doing to get some feedback, so there is no problem with shopping it or sending it out. The idea is you're trying to get people to call you back and get attention. So you have got to publicize, whether it be on the Web or in these networks, what you are doing to get attention. There is a lot of activity out there. You have got to get in front of people.

MS. MILLER: I have a follow-up to the issue of partnerships. There are some very creative ways that you can partner with other companies and also other organizations. There is a lot of money out there in the Federal government, in state governments, for companies doing something that is of benefit to other people. There's just vast amounts of money out there. So, partnering with universities, partnering with other people who are connected with those other sources of funding can be extremely creative. So if you're thinking about some creative financing, that's another way of going about it, and we have a lot of information about that.

MR. HELLER: I'd like to just return to this area of disclosure. Obviously, you hit a hot button with everybody, and what I find is that there are two areas of paranoia that we constantly see among high-tech entrepreneurs. One of them is the area of disclosure and I see more people who don't ever get anything funded and never build a company because they intend to keep this thing a secret. They want people to put in money, but they're not going to tell them anything about what they do, or at least the details.

The other area of the paranoia is control. Our philosophy on this is, if you are so obsessed with control, you probably don't have anything that's worth controlling. Investors are not interested in controlling the company, just as they're not interested in stealing your idea and giving it to someone else and starting another company.

7: EAST VERSUS WEST

AUDIENCE MEMBER: I'm Pat Claussen. I'm the president of TeleGraphix Communications out in Winchester. We are an Internet software company that relocated our company here one year ago from Southern California. We relocated here so that we could to be a player in the Netplex. Our company has developed some rather innovative products that allow graphics and multimedia to go over regular phone lines like lightning at modem speeds as low as 2400 baud. We have out on the table the first product that we released with this new technology and I encourage you all to get one.

For several years, I have had a foot on both coasts. I lived have here in Virginia, done business here, and I have commuted to California and done business out there. I have noticed a dramatic difference in the venture capital climate here in this region vis-a-vis that of California. Our company has had a very difficult time raising any capital since we have been here. We were, one year ago, the first American software company in history, to receive venture capital financing from the government of Japan, from the Japanese Ministry of Trade. We have found that means absolutely nothing to the venture capital community here in the area. The reaction has been, "Gee, we don't know those guys." We are going berserk to raise capital to get our products out to market.

I am just curious what the perspective is of you gentlemen. What can be done in here with the venture capital community in the Northern Virginia area to increase the availability of seed and first-stage funding for corporations? I am sick of hearing, we are too early, okay? What can be done to get a more risk-taking venture capital community here in the region, similar to that found in California? There seems to be a real problem here. Most of the VCs I've met are more content to put their money into real estate and insurance companies than they are into technology companies.

MS. SMITH: I think this is sort of a first step in that direction, and there are some players at this level that are new to the area and early to the game, but I know some others want to comment, so Jeff?

MR. DAVISON: There is plenty of money available for good, early stage deals in this area. Ciena got financed, Light Speed Communications got financed, Visual Networks got financed, NetStart got financed, NetSolve got financed. In other words, there is money from all over the country targeted on this region and everybody in the venture community is excited about what's going on here in terms of new company formation and entrepreneurship. And all of the new funds that you heard about being raised tonight are an indication of the level of interest and sincerity on our industry's part in investing in the region.

MR. NOVAK: I think Jeff said it pretty well. I have invested in California a lot and did a number of seed-stage deals out there, and one of the reasons we decided to locate and focus our efforts here, is that we were beginning to see a high quality of seed-stage and early stage deals here. The biggest difference I see between east coast and west coast is just the quantity of seed and early-stage dollars. It's going to come as there are more successful start-ups in this area. The biggest difference I see in terms of who's doing seed deals on each coast is that on the west coast, a lot of the seed deals are being done by people who have done it once before, and they have a new idea.

Entrepreneurship and commercial companies are just beginning to occur here. The change came three years ago, and I think that one of the things that really attracted me is that you have the AOLs, you have the UUNets, you have the PSIs, and you have a lot of people who, for the first time, have made $100,000, $200,000 or more from those deals. Those are the people who have been through successful start-ups, who now can take a year off to write a business plan. I haven't seen your plan. We're happy to look at it, but I don't think the issue is going to be lack of early stage money in the future. I think it's got to be the quality of the deal, and if they are good deals, they're going to get funded.

AUDIENCE MEMBER: We have found it very hard to find any VCs in this area that are interested in early-stage deals.

MS. SMITH: Okay, we'll take this up during the networking session.

8: PRODUCTS VERSUS SERVICES

AUDIENCE MEMBER: Thank you. Rob Montgomery from Argosy OmniMedia, and formerly from TeleTV. Two questions, actually. One, it's always been my perspective, that the investors would favor or look more favorably upon product development activities rather than services, simply because the leverage is higher. I would like for a couple of investors to comment on the comparative characteristics of service companies or service startups versus product startups. And the second question is: if you have a management team that comes out of an existing company or has done some very impressive things and has a track record in existing companies, does that carry more weight than when you've got a bunch of guys trying to start something from ground zero, and it would be considered a zero stage startup?

MR. RIECHERS: Just a comment briefly on the product versus services question. Some of fellows here mentioned earlier that the key thing for most investors is the business case. One thing that's happened in the last several years is that there is now, compared to seven or eight years ago, a lot of very successful business case models in the services business, the Cambridge Technology Partners, the Sapient Corporation, and that side of the services business; a number of roll-up situations for professional services and technology, and some of the more Internet-focused Web consulting businesses that have become successful. There was a time, when Mario and John were running Legent, when having service revenues inside a software business was a negative and now it's almost flipped to be a positive. So I do think that model has changed somewhat and everything comes down to whether the business case is compelling. I do think you are going to see a lot more willingness from the venture capitalists to fund services deals if they look like other successful service models that got venture capitalists successful investments in the past.

PANELIST: Yes, maybe I could add a point, too. I think it all depends on the industry sector you are in. For example, I mentioned earlier that we do a lot of health care investing and we've done a large number of service deals in the health care area. We are doing a roll-up for physician practice management companies. We're doing one in the dental area. So I think it all depends on the industry sector.

AUDIENCE MEMBER: I have a question regarding an evolving industry. If you were to have a contract with a large multinational corporation for five years, based upon a speculation that a certain market would evolve, and they are willing to lend support to an organization to run and manage that infrastructure based upon that evolving market, what would you expect to be the participation of a venture capitalist in that kind of environment? Let's just say that the ratio of earnings to your profit were maybe four to one.

In other words, if you have an evolving market and you have to set up a certain type of infrastructure in order to accommodate that market, and let's just say that we have a five-year contract with a company that is willing to house this environment, what would a venture capitalist be looking for beyond that? Certainly there is a market. There is a built-in a sales force that the client has that is going to be pushing that market, so we actually become part of their infrastructure, but we're providing a value-added on top of their own surface.

MS. SMITH: We have to take that up one-on-one. I think it's too difficult to repeat it for the audience here.

AUDIENCE MEMBER: My question has to do with the kinds of deals you all are interested in investing in as a community, and the observation I want to make reflects some comments that have been made earlier here about the type of deal seen on the west coast, and the type of deal that comes in a software community. I assume most of us here are software types. I worked out west with four guys who started a company called Netcode. You may know that name. After seven months, they were bought by Netscape for $16 million. They had a product which became JFC. It's now a part of the Java run time. That was not the same kind of company structure I have heard talked about tonight. It wasn't a long-term investment. It wasn't market-oriented. It was focused really on an exit strategy, which was a buy-out by a big vendor. I would like to know if you are interested in doing that kind of business.

MR. MORINO: I'll speak for myself: no. That doesn't mean other people won't be. I don't want to grow to sell to somebody who wants to dominate the market. That doesn't mean you don't sell out in the process. Don't get me wrong on that. But to go in with that in mind is a very tough call, because so many things can happen to an exit strategy between point A and point B, especially dealing with a Netscape or Microsoft, as an example. It could be a very good business model, but I'm giving you a personal view. I would be going after the person in whom I see a compelling desire to succeed in the long haul, rather than to dominate a space. Again, there are definite niche plays that you described that are very useful and can be funded well.

MR. MAY: I think the answer is, there are people who are interested in everything. This is why you've really got to get into prequalifying the money.

Never assume there is an unified class of anything in the room out there, but always prequalify. Ask, “Have you done a deal like that, are you interested in this kind of relation-ship; could you help me execute this idea? My goal is to be out of this in 12 months, is that your kind of deal?” Don’t waste people’s time unless you’ve prequalified your vision and exit strategy the same as the money. But there is money out there to do that.

9: WHICH CAME FIRST? THE MONEY OR THE TEAM?

AUDIENCE MEMBER: Hi. My name’s Harry Richardson and I’m a Netpreneur. I mention that because we’re all involved, to some extent here, I think, with this concept of the Internet. And to me, it’s fertile ground for lots of great ideas. And yet the consistent story I heard from all of the venture capitalists is, “it’s just not about the idea, it’s about the management team.”

And I want to raise here a question I raised at one of the Coffee and DoughNet sessions. There seems to be a potential Catch-22 here. You have an idea, but you don’t have the team. You can’t get the team because you don’t have the financing. If you have the financing, you could attract some good team members. Somebody in the other session commented that on the west coast, venture capitalists tend to help idea people form their team; that they seem to be more proactive. You’ve got a good idea and you’re one of three players needed. We’ll help you find the other two, because we want to seed some good people into your idea and into your organization. I would like to have the venture capitalists here comment on how they feel about this dilemma of a great idea but no team; or team but no idea.

MR. RIECHERS: Let me tell you a real-life case I’m dealing with right now. First of all, I’m willing to invest in what I define as leverage-services companies, which is different than billable body hours. It’s some kind of leverage because I’ve seen it work. I helped build Transaction Network Services, which is now a $60 million revenue company and the biggest bill they’ve ever sent on a per-unit basis is about two cents. But it’s leveraged and it’s repeatable and it’s a great business. He has brought in a management team. They’re all employed at other companies. They bring someone in and can’t tell their bosses where they’re meeting right now. He says here’s the things I know. Here’s the things I don’t know. Here’s what I need help with. Myself and somebody else at FBR are spending a couple hours once every week or two helping this guy assemble a business plan and helping him find the rest of his team. But he showed up with three quarters of the story and a great idea and some really good key people who are all being paid by other people and they’re all working their jobs very diligently. But they’re ready to join this guy if things come together. So that’s the way a venture capital firm—not just us, everybody here—can help, in helping somebody assemble an idea. He didn’t show up with a complete business plan. He said, “I’ve got half of it,” but it was a really good half. So there’s people here who I have helped build businesses before, as have many of these others, and we’ll do that kind of thing, and I think that any of us would sign up for that.

MR. HELLER: Let me address the issue of the team as well. When we first started our company, if you had called a meeting like this, you could probably have held it in the men’s room of this hotel. That’s how many people would have shown up, because in this area, the so-called entrepreneurs were either pushing paper for the Federal government or they were playing with other people’s money in real estate. There just weren’t any people like us around.

But today, things have really changed. You’ve heard quite a few here. There are cashed-out entrepreneurs here who are looking to do other things. I think the way one builds a management team today is to mix the youth with the gray hair, and get some of the people on your management team, on your board of directors, board of advisors, and so forth, who will strengthen your management team. They’re around.

AUDIENCE MEMBER: Is there anything inherent about the Internet that scares the venture capital community or makes them excited?

MR. MORINO: I just want to go back to your previous question. I think there are a lot of comparisons between east and west. You’ve got to realize that some of the same players are playing in both, and I think we lose sight of that when we talk about Silicon Valley and Greater Washington, D.C. Good investors in both markets, by the way. So some of our perceptions are fallacious. To the issue of investors here helping people get people, I can tell you it’s going on every day.

You go down into NetStart, the work that Updata has done with Rob. It is going on. We’re working with Raul Fernandez at Proxicom; same case. Ken Tarpy just joined them as CFO—used to be with John’s organization. These things are happening. They are happening almost every day in this region right now. Do not underestimate how much is already taking place right now, today. You’ve got to be right to have it. That’s the frustration I think we are all feeling—at what point is the venture guy going to step up to give you that level of support.

Going back to your question about the Internet. Personally, I think it scares a lot of investors. It’s speed, it’s time. Sometimes you are going into an investment today in a specific niche and by the time you make an investment, there’s a technology rolling out 90 days later that’s changing the space.

That's why the individual becomes so key in this space, that the individual—or management team, I think that's the way you may be using the phrase—it could be a single person who has such a command of their space that you know this person can grow that business, and inherent in that one individual is somebody who has the ability to recruit the right people. But there is a lot of fear of the unknown, and you don't hear it just from casual investors. It's big guys looking at it, and they're concerned because of its speed, how it changes. And there are guys who are taking some risk. But, you know, I'll go back and look at one of those risks we're taking, and there were some pretty definitive elements about that company when they made the call. So I think you've got to look at it more than once.

MR. RITTERBUSH: Let me follow up. I think it's a point that from our community here in the investor's side should be stressed, and that's that I think many of us here at the tables have started companies. In fact, we're doing two companies where we're providing the help that was asked for down there. Basically we're helping put the team together. We created an incubator of four different venture funds both here on the east coast and on the west coast to do exactly that, over time.

But I think from the entrepreneur's point of view, you have to recognize that those deals take a great deal of your time. And, from the investor's point of view, you are under pressure to also put out the money you have under your management. And so you can only do so many of those. In some cases it's luck, being in the right place at the right time that you hit one of us, and we say, "that's what we're looking for, that's what we want to do," but I can only do one or two of those. And I would bet that at this table with eight of us here, you'd be lucky to see eight of these going on at one time. You just can't do more than that.

What we're really looking for is the entrepreneur who can put the team together. Remember, we're looking for entrepreneurs, and not for people that want their hands held. Come to me with your team, and show me what you've got. Show me what you can do to get our interest, because we've all been entrepreneurs. We know what it's like. We've put ourselves on the line, we've taken risks ourselves. And we're looking for people who want to do the same.

I have heard the contrast between east and west, but 20 percent of my deals are on the west coast. And there are differences between Silicon Valley and here. There's no doubt about it. One of those differences is the quality of the managerial class; and the people that have done it before. And one of the things we're seeing in the last three years is the development of a group of professional managers that are stepping out and beginning to do it here, which is great. That's what we need to see. But there are differences, and I think it's going to take time to work things through. But what we have here is the basis of a group that's beginning to work together. This is the first time we've had a group like this in a room of this size. And I would argue that six years ago we probably could have put us all together in the bar out there. So it's a big difference.

AUDIENCE MEMBER: My name is Vernard Gray. I'm from Northeast Washington. I'm probably the only person in this room from Northeast Washington. And I'm involved in a local effort out there to create a community development initiative around arts and culture and technology, and I'm shopping for partners. So anybody in the room who's interested in talking about that effort, just let me know what you are interested in.

AUDIENCE MEMBER: Suppose an entrepreneur convinces a venture capitalist that his company will be worth about $50 million in five years. So let's just take that as a given. What kind of a percentage of his company should the entrepreneur expect to give up for a million dollar investment today?

MR. MAY: You can ask any of these people down here, but remember they're looking for three to five times their money in three to five years, at least. And so you can all play the game together on how to do that negotiation, and these guys can help you talk about that.

MR. REICHERS: It really depends on the amount of money you need, and the stage at which that money goes in. In an early stage investment, and different people have different parameters, but just a general rule, we like to see a company that can get to be a large market cap and have a dominant position. Because if you're doing very early-stage investing and your market five years out is $100 million, the margin for error is relatively slim. And when we look at something, you tell us you're going to get 50 percent of the market, we assume that you're probably going to get ten to twenty percent of the market. So it then works on an ROI basis. If we put a dollar in today, we probably want in five years—I'm looking for 50 times my money on a seed-stage deal.

AUDIENCE MEMBER: What's that, like 200 percent of the company?

SPECIAL GUEST: When I talk about a seed stage deal, I'm talking about two people with an idea. One that I did a while back, we put in $300,000, took 25 per-cent of the company, we assumed we'd have to put in more. The principals never took another dollar from the investor group. They basically did exactly what these people up here did. And the other thing that is really important to take away is that profits are good. They really are good. These people lost $200,000 year one, then disciplined themselves to make money every single time in succeeding years. Rather than go back to the investor group, they hocked their houses, they deferred their salary, and they were determined to do it. Today, we've had valuations on the company of $200 million. Now that's a type of deal that is near and dear to all of our hearts. The investor group is waiting. We've had offers to go public, but we're waiting because it's still building value. And so we're going to exit in probably seven years. That's just an example.

AUDIENCE MEMBER: This is the second meeting where there is a clear disconnect between some speakers who think there's absolutely no money to be gotten from the venture people, and venture people who think there's lots of money there. And if I approach this intellectually, there is a little bit of a question of honesty here. This time the other way around. I would like our venture friends to be very honest when they tell us entrepreneurs why they're rejecting a plan, and that doesn't seem to be always the case. The entrepreneurs can learn a lot, if we're not told "it's too early, it's too late, this will never fly." Be honest, tell us why it doesn't work and then we can improve the plan.

I understand venture people are not in the business of revising business plans or helping with developing business plans, but there's got to be a better way, a more honest way than just not returning phone calls or saying it's too early. Personally, I've worked very well with venture people. I actually found, and got the first loan to financing and matrix done. I have many friends in the venture world, but I also know a lot of people here would appreciate more honesty and directness when plans are rejected.

Since I spent most of my life doing what you're doing, which is trying to raise money, the good news is, that over my years of financing a bunch of different companies, I never got a no. I got a million unreturned phone calls, I got appointments canceled, and I got all kinds of things, but I never got a no. I think that world is changing. I think people are trying to be better about it. And it's something I've sworn to be better about. But I figured out why those guys don't give no's. No's are really a pain in the neck. I've had some very complex and emotional—on the other side—conversations with entrepreneurs when I've tried to deliver a no. So you make it easy on me, and I'll give you all the thoughts I have.

AUDIENCE MEMBER: I represent Washington, D.C. City Pages and the D.C. Music Web, and we think we have a good product, and we think we have the traffic right now, but one weak link is the marketing part of the team. Where would I go to find a person that would have a good marketing strategy on how to promote our product.

MS. SMITH: I think you ought to come right up here and talk to these guys when the program is over.

AUDIENCE MEMBER: My name is Michael Stroh, the co-founder of Pro-Ball Sports, where every second counts and every child matters. I have a concern. I hear a lot of investors here speak about investing in technology. I think technology is great, but I think we need to step down a little lower and invest in our children.

10: WRAP-UP

MS. SMITH: Thank you again so much. I want to reintroduce Mario Morino—spearhead of the Netpreneur Program and this whole idea—who has a couple of wrap-up comments.

MR. MORINO: Well first of all, to everybody thank you. Thank you David Gladstone, to my friends up here on the stage and my friends in the audience who helped to give us some comments in the finance area. I want to make a point of reality. Entrepreneurship is really tough. And I think this meeting had a different tone than all the ones we've have had so far. All the ones we've had so far have been very motivational. And tonight you hit an entrepreneurial speed bump. You faced reality.

It's just as important in these meetings to convince people who maybe shouldn't be entrepreneurs to stepout of the game, and to make those who are very determined push harder. It is not going to come easy. You face one of the most difficult aspects of entrepreneurship today, getting somebody to believe in you to invest in your firm. It was a hard discussion. I can tell by some of the faces, I could tell by some of the sighs, there were some things just not "clicking." That's the nature of the game. Don't let that discourage you. Keep faith in yourself, and keep pushing until you find the person that believes in you. And keep making sure that you yourself have the fortitude to continue. Realize that the Netpreneur Program is for you. It is about you, and it is you. Help us on meetings like this. You asked to bring these groups together, we've brought them together. Let's use this to build relationships. Let's use this to learn from. Tell us how we should take this further. Very sincerely—from all of us, from April, from the entire team, thank you very much. Let's network.