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NET PROPHETS

<u>**Internet Resources**</u>
Where the money is, and more

<u>**Who's Doing It Right**</u>
Four venture-capital magnets

December
The '97 Round-Up

Financing the Net: A Guide to Venture Capital
by Pamela Weintraub

In the midst of New York's Silicon Alley, a world hub for creative ventures in cyberspace, the cavernous book store/café called Housing Works is surprisingly apt. Pipes strung boldly from the ceiling reveal their functionality. A hodgepodge of dishes and mugs glow with the distant warmth of a hundred country kitchens. The tables are family style -- thick pine and oak affairs that have traveled the used-furniture route to end their lives here.

It is inside Housing Works that Anna Copeland Wheatley, editor of the start-up newsletter, <u>Alley Cat News: Investment Opportunities in Silicon Alley</u>, holds court. Wheatley and her partner, publisher Janet Stites, have helped to define the world of venture capital that fuels the incipient cyberspace industry forming at light speed today. "There's a lot of talent and creativity out there, a lot of great ideas, and those are important," Wheatley says. "But it is the money that is the driving force of the industry. When a major investment firm like Kleiner Perkins Caufield & Byers puts their weight behind a software like Java, and when a financial power like John Doerr of that company speaks out for a technology, it is convincing to the world."

Indeed, given the enormous resources required to create a business in cyberspace, venture capital is

often a prerequisite for success. For those not yet involved in cyberspace, meanwhile, investing in an online business may be a way to go through the learning curve -- a way to pave a path to the future -- whether or not that initial investment succeeds. In the end, the partnership of the venture capitalist and the entrepreneur defines the cutting edge of the Internet industry, as it has with personal computers, biotechnology and the host of high-tech industries that have come before.

Ventured, Gained
Whether you sit on the giving or receiving end of the venture capital partnership, it seems, the game has rules. According to Wheatley, for instance, the first thing a company must remember when seeking venture funding is the importance of networking. Glancing around the intimate, no-nonsense familiarity of Housing Works, she explains that even in this high-tech era, it is high touch that counts. There's nothing like knowing someone to keep the money flowing. As in the days before computers, she says, "it is the personal connection -- and faith in individuals who are known and trusted -- that convince investors to sign on. Most of the major venture capitol firms will not consider proposals unless they have come in through recommendation or some other, personal means."

Of course, we weren't all born with millionaires in the family, adds Wheatley. "That's why it's important to get out there and mingle, join those organizations, and go to the meetings and events."

While connections will get you in the door, Jerry Colonna of Flatiron Partners says you've got to have a plan. Flatiron, a 14-month-old New York-based venture investment program created in partnership with Chase Capital Partners and Softbank Technology Ventures, has invested $33 million in seven separate ventures since its founding, and each case represents a cutting edge business model for the Web.

Four examples: eShare Technologies markets chat software that works behind firewalls, a crucial element for corporations who want to participate in real-time Web events; while Resonate builds server software that allows giant sites to efficiently

manage traffic over many machines. Yoyodyne, a direct-marketing company, drives waves of traffic through the Web via sweepstakes, shopping sprees, prizes, puzzles, games and more. And Flatiron hopes that Star Media, a gigantic Internet service and content provider, will become the America Online or Yahoo of Latin America. "In terms of Internet development," says Colonna, "Latin America is about two to three years behind the U.S. It is the fastest-growing market for Internet access in the world -- it has a huge emerging middle class, it is united by language." It is prime territory, in other words, for venture capital's biggest guns.

Meanwhile, Brian Halle, who has advised the AOL Greenhouse on venture-capital investments, says the most significant profits for investors may come from electronic-commerce companies that spend heavily to build brand names. Halle invokes the name of Amazon.com as a group that's doing it right. "Amazon.com has allocated over half of their expenses to marketing," Halle says. "But I consider that an investment in branding and the future of their company, with almost immediate results: everyone knows who they are. Sales over the summer quarter grew 36 percent, and sales from repeat customers have run around 50 percent. Their stock tripled six months after their initial public offering. That's pretty hard to beat."

It's the Team, Stupid
But even with the idea and the connections, investors are likely to part with their money only when a third element is in place: the team. "We only invest when the team is backable," says Colonna of Flatiron. "That means knowing the business you want to be in. A software executive should not try to succeed by selling advertising. The best teams have succeeded in creating profitable start-ups in the Internet area before, preferably with companies that have been venture-backed." Halle agrees. "There's more than enough money out there," he says, "but management talent is scarce."

For those who put the elements together, however, the pay-off can be big. When Bahar Gidwani acquired Index Stock Photography back in 1991, it represented photographers and licensed images to

third parties, like other stock houses. But tapping his background in software development, Gidwani used a combination of proprietary technologies and network architecture to make images available to clients <u>electronically</u> as well. His company's dramatic growth -- from 2,000 customers in 1991 to 40,000 in the U.S. and 35,000 abroad today -- has been fueled, in part, by venture funds.

"Before I got my first round of funding," Gidwani recalls, "I contacted more than 400 sources of venture capital. I finally succeeded with the Polaris Group, created to support business in Alaska. There wasn't enough going on in Alaska, so they funded me." Gidwani has since gone through subsequent rounds of funding and has used the money to purchase technology, acquire smaller companies, spread to new countries and hire staff.

"Almost everyone knows someone who might be useful," he opines, on the art of procuring funds. "When it comes to funding, the thread of acquaintanceship is vast and begging acceptable. You must pursue people ruthlessly, and you can't be proud." His rationale? "If you want to grow your company to scale within your lifetime, funding is the only means."

Yet venture capital may not be for everyone. Though this resource has become the holy grail of the Internet entrepreneur, those who can build businesses without it may sometimes be better off. Take Wheatley and Stites, owners of AlleyCat Information Sciences, geared to provide information to the venture capitalist, and its publishing arm, Alley Cat News. Offered money to grow fast and furious, Wheatley says that she and Stites have declined. Though they must still conduct their personal lives on a shoestring and their business meetings at Housing Works, they say they prefer to grow their company to their own specifications, their own inner drummer, without any interference from on high.

"Just getting venture capital isn't everything," notes Wheatley. "If you don't use the money well, you wind up with just as much as if you never got any at all."

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