



Stanford eCorner

Drivers for Software Innovation

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Ann Winblad of Hummer Winblad Ventures argues that there has been a steady dealflow in venture capital from 2002-2004. The software sector is still the big leader, though biotech is catching up. Though she doesn't discuss outsourcing, Winblad emphasizes that a company must consider where they can get the best intellectual capital. Today, company strategy starts globally. She also discusses trends in the software market, including open source material, Moore's Law (storage is free) and Metcalf's Law, and mergers and acquisitions.



Transcript

What's happening in Venture Capital? There's a rumor out there that Venture Capital is not doing much these days, but actually we've been in a real steady state for the last two years. About 4.5-5 billion has been invested every quarter. That's a lot of money. It sounds like a lot less than 1999, but it's still a lot of deals. Software is still the big leader here. In the third quarter of last year, biotech sort of edged out software a little bit but it's gone from being widely danger-filled in the early 90's to being really a focused segment of investing. It's a couple reasons that software's really exciting now. It's a capital efficient business. You don't build plants. You don't have to manufacture things.

You pay salaries, those aren't cheap but that's your only fixed cost. So it does match the capital efficiency people are requiring in this new era of investment. It's still was the largest investment area last year. And it was 20% of all investment dollars quarter after quarter. What's happening out there? You know if you picked up Business Week this week, guess what was on the cover? "Software" the word software. If you picked up Fortune Magazine, guess what was on the cover? "Ten High-Tech Trends." And if you open the magazine, almost all of them are software. There's a lot going on here. Whenever there's a lot going on, that spells. I was going to say smells; it probably smells to the larger companies. But it spells to me turmoil for not the start-ups, but for the incumbents.

And there's a lot of things challenging the incumbents right now. I'm not going to go into outsourcing, but I will say that almost every one of our companies that starts today - and this is something you should be familiar with as a student of contemporary companies - starts by looking at where can I get the best intellectual capital? Where can I find the best engineers? We don't have any company that we funded the last year that doesn't start with an engineering group somewhere else. Most specifically India, there's no language barrier. India's made it cookie cutter to setup a subsidiary. The talent pool was huge. And frankly, we can't find enough engineers here in Silicon Valley to fill the spots we have open in our companies. It's not that we're giving the jobs to someone else; we can't find people for the jobs. We're not graduating enough engineers or PhDs. So again, right on the starting point, think about being global. Think about where you can localize first versus second.

It used to be you never saw someone internationally wanted to launch your sales first. Today's contemporary company starts global. Second is the open source. It's really not so much as open source as it is the word open, it really is open source in it's purity as a real driving force for innovation for entrepreneurs. One of our companies, we helped Microsoft start a new project where if you were VC funded, you could get at least your first year of development tools free. Microsoft did this after I went to them and I said, "We have a brand new start-up." And they've got 10 engineers and it's going to cost us \$58,000 to buy

the software we need to write code. And that's a lot of money. So we're seeing a lot of engineers sort of search around for adequate tools, some excellent tools that they can get started with for free because the cost of building software is very expensive tools once you've become commercial. At the same time, we've seen some hybrid companies develop peers such as MySQL. JBoss was recently funded in Atlanta that started bought with open sources.

The Trojan Horse now are charging lots of money for their software and services. But for most companies in the long-term, the keyword here is open. I'll give you another example, I spoke to the CTO of a very large investment banking firm who has Microsoft exchanged as their messaging platform. They wanted to add instant messaging to their core architecture. And they picked Java, not because they didn't like Microsoft IM, but because there were no tools to program to. They wanted something open where they can add their own value to it. In the case of one of our new companies, Voltage, which was here out of Stanford, our toolkit is a free part of our software to let people program to their specific uniqueness and frankly, unique environments. So when you're building a company from scratch, it doesn't have to be open source, but it has to be open. Customers today are more capable of building software. They have lots of programmers.

They have technology available. There are more programmable environments than closed environment. So proprietary is out, open is in. Who else have seen Moore's Law and Metcalf's Law firing on both cylinders simultaneously? Broadband has reached critical mass deployment here in the US which has changed a lot of markets, specifically consumer and small and medium business. And storage costs and I call that Moore's Law. Storage is free. There are 400 million handheld devices shipping this year relative to 20 million PCs. Those 400 million handheld devices some of them are very powerful computing platforms. On demand solutions, IBM is the top leader here. I see their advertisements on television.

It means you don't have to install everything. That software as utility you can turn it on, you can subscribe to it. We have some companies just ready to go public mass. Salesforce.com is a local contender for being a successful IPO. It means you can think about the models differently. It's not the old pricing model, the old enterprise model. There are different forms of delivering technology these days. And last but not least, mergers and acquisitions. Huge companies are being sucked into other huge companies. EMC bought Documentum as well as VMware and a few other things.

Taking out a leader where there weren't very many contenders. The whole area for example of document management, content management, wide open; it's a very big space. Rational is not part of IBM. Who is the big tools vendor independent of Microsoft and IBM? No one. J.D. Edwards, ERP Consolidation. So consolidation at the top means openings in the middle or at the beginning. Who else have seen technology not just slow down but speed up? It seem like it went really fast from the period of 1988-2000. But it really has kept accelerating. And for many industries including Telecom and Entertainment, this is separating the languorous from the leaders.

Companies are still having digital hangovers like they know that the world is digital. I was just at the "World Economic Forum in Davos" and every world leader, every person who even ran a completely analog company had a BlackBerry that they were using as a phone. And they were all showing each other their BlackBerries and saying, "Well, you know mine's colored. Is yours colored?" "Mine has big type. I can use mine as a phone." That tells me that that is over. We are all digital now. So we do have gaps still between what were the incumbents and what the small fast companies can actually do.