Stanford eCorner

The Ins and Outs of Financing a Company

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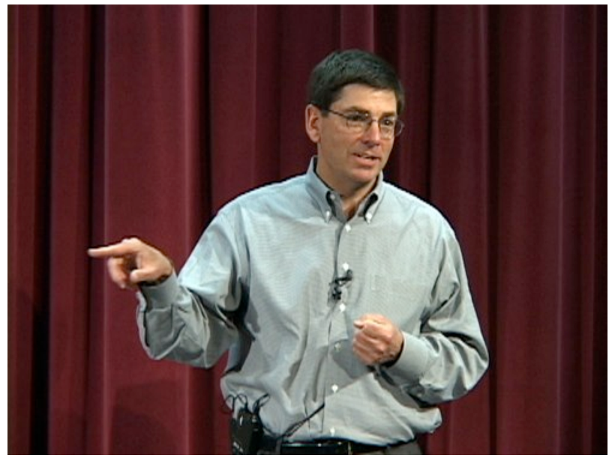
Scott Cook and Tom Proulx of Intuit approached Gordon for advice on what venture capital to accept. Gordon recommended they accept the funding based on the two lowest valuations for the company because the offers came from John Doerr and Burt McMurty, two of the best venture capitalists in the business. Even at the lower valuation, Gordon predicted that the leadership from these two men would more than make up for the lost profits in the long run.



Transcript

Ventures have role models SDST had Art Rock who was the dean of venture capital. He really invented venture capital in Silicon Valley in the late 1960s. He came out of New York and funded Intel ultimately. SDS had couple of companies before that but Intel was their big hit. And Mike Markkula was their first CEO of the company. He first held the first adult supervision, as they liked to say in Apple. Larry Ellison was down on Lucas. He was an investor banker before, one of the early investors in National Semiconductor. Scott Cook had John Doerr and McMurtry. And my favorite story about this when they're both venture capitalists is that after Quicken finally got finally got a reaction and is making sales and even a profit, only then did Scott Cook and Tom Proulx go out of venture capital.

By then the company is worth a lot of money. They didn't really need venture capital. What they needed to do was to pay off the debts that they incurred to finance the company. So when they raised a venture capital, they were selling their own stock. That company's stock was stock out of their own pockets, and they collected term sheets from five different venture capital funds. And Scott called me up and said, "I like your advice on which of these venture funds to go with. To avoid biasing you, I'm going to tell you the valuations. I'm going to tell you the funds but I'm not going to tell you which one is which." And so the valuations ranged from roughly $50 million to roughly $75 million, which is a lot when you're selling stock. It's a difference between $1 per share in your pocket and a $1.50 per share in your pocket. That's 50% more money.

First thing I did was I connected the dots and told him my guess as to which venture funds had offered which valuations. He said, "How did you know that?" I said, "I dealt with these folks and I know are value investors and which ones maybe there to buy Intuit and wants a good deal there." "Well, what's your advice?" he asked. I said, "Take the two lowest valuations you were offered." He looked at me and said, "You must be kidding. Why? That's 50 cents less in my pocket per share." And I said, "Because those two offers come from John Doerr and Burt McMurtry who were, in my judgment, two of the very best venture capitalists in the business." And this is in the early '90s before John Doerr is as well-known as he is today. He was certainly an extremely bright, capable and successful venture investor at the time. And Burt McMurtry was one of the patriarchs of venture capital. Like Art Rock, one of the early venture capitalists in the area and I worked with both of them. I said, "These two fellows are going to make more difference in the value of your company than the difference in the valuations now. And someday, this company will be worth a lot more money because of them." And Scott has kindly acknowledged that that is true. He recognizes that this is true although he didn't take my word for it.

He did something quite remarkable. He asked them both for 10 references so we could do some customer checks the way he did at the time with Procter &Gamble. And he asked them both to write a 10,000-word essay on how they would deal with encroachment if Microsoft tried to compete with the two of them. John, I think, wrote the essay. I don't think Burt ever wrote the essay but John's version of the essay still exists and a couple of years ago when Burt retired from the board and retired from venture capital, they both read the essay at the retirement there. So Burt was on the board for 10 years plus and John Doerr is still on the board for going on 14 years, even though their venture funds have long since been distributed. They have no real economic interest and no professional reason to be on the board other than they liked the company and they stayed with it. So it's very unusual behavior for venture capitalists to stay on the board for so long. But now, the company is worth many billions of dollars and Scott did very well with the advice. And then, of course, I think he had Bill Campbell speak.

He got that supporter. He's gone there every year. But I would say dozens, literally dozens of entrepreneurs in the Valley have been coached by Bill Campbell. He's a mentor simultaneously to about half a dozen companies that I represent today. He's just a phenomenal catalyst in this area. And of course, there has to be a touch of capital to make it all work. And fortunately for Stanford, it's kind of at the bottom of Sand Hill Road and all the money is just flowing downhill to Stanford. I don't know why, you know why a real estate developer named Tom Ford decided to build Sand Hill Road as the seat of venture capital and made it very easy for venture capitalists to locate here. Of course, the proximity to Stanford is a big deal. There is always been this history of Fred Terman and Hewlett-Packard in this area, and the very mutually beneficial cooperation between Stanford and entrepreneurial community.

There is always part of it in venture capital and the Arthur Rocks and the Burt McMurtrys of the world are located here now. Something like 60% of the world's venture capitalists has managed up in 3000 Sand Hill Road, a few miles from here. And you'll see venture capitalists in gatherings like these, crawling around, looking for ideas. And Jim Gibbons, as I mentioned before, used to organize something called the "Sunrise Breakfast." I don't know if he did that anymore here but it was early morning, it's typical of Jim. It was a 7:30 in the morning session where a faculty member, a grad student and somebody from the industry would talk about the newest technology in disk drive readers or something. And students and venture capitalists were invited, but no lawyers. I was allowed to come because of my prior credentials as an engineer. Jim would let me come. It was a very, very rich environment for networking. You would see companies getting funded from these exchanges of ideas.

And venture capital is readily available in this Stanford environment, fortunately. As you know, the way Silicon Valley companies are organized is stock options for all. Very democratically doled out and the theory that all owners work harder and have an additional incentive to build a company. It seems to work marvelously. Certainly, all the companies that were on that slide I showed you before benefited greatly from doling out stock options as broadly as possible. Now, as you know, it is threatened by some accounting charges that would make stock options appear as expense in income statements. And people are wondering if they are still able to dole out stock to the same degree, the democracy across companies in these accounting charges come. That would be beginning 2005. So that's something that's got the world shook up. And then of course liquidity, the dream for IPO, although most companies achieved liquidity through an acquisition rather than an IPO, probably 80-90% is required really to go public.

Now, let's talk about one that is going public. Google, the dictionary word means a very large number, 10 to the 100th power. The company that adopted an eponymous name there has since solving a very, very big problem. We all, of course, use Google. It's ubiquitous. Talk about drive. One story that is wonderful about this company, technology was developed here at Stanford by some graduate students. The search technology, algorithm and search, and they tried hard for the Office of Technology to license the technology outside the university and couldn't find anybody to take it. So they gave up and decided to start a company to exploit the technology. Stanford has an equity stake and royalties.

And they're off and running. They had great mentors, Eric Schmidt who was he CEO of Novell and interacted with other companies in the Valley, John Doerr, again; Mike Moritz from Sequoia Capital; Ron Schram who was a successful entrepreneur before sold his company to Microsoft; Bill Campbell as I mentioned; our own John Hennesy were all advisors and members of the board or at least unofficial advisors. I think Bill Campbell was remembered for being very, very helpful at Google. And of course, Google couldn't have been started without venture capital from Kleiner Perkins and Sequoia Capital. Ron and Andy Bechtolsheim who gave them the first seed investment here in Stanford campus; he wrote them a $10,000 check with no questions asked and no business plan, nothing, because he was, as you all know, the founder of Granite which sold to Cisco for $100 million in the early '90s and is a very, very successful serial entrepreneur. And now, the biggest IPO by Silicon Valley standards, there are bigger IPOs in the financial industry and so on, but this $2.7 billion IPO was a couple of orders of magnitude bigger than a normal IPO.