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Working with VCs– An Interview with Larry Sullivan, Software Entrepreneur and Former Member of Band of Angels

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Q: Can you provide some background on your work and time in the software industry

~ I graduated from Columbia I moved back to Palo Alto, and started with the “Institute for the Future” (<http://www.iftf.org/>), writing and researching the future of Asian technology development. This included writing reports and analysis for a number of Asian governments. I then did some work for a cross-border Asian VC and then the band of Angels (<http://www.bandangels.com/>). I saw the development of speech recognition and natural language on the Internet and decided that I wanted to look into the Asian space. I found two leaders in the industry who happened to be in Asia, talked them into starting a company and then away we went. After moving this company along for 3 years, I took a few years off, doing a bit of consulting for telecom-type start-ups that had an international component. After 9/11 and a serious cycling accident while training for a race, I reevaluated what I wanted in life. I am now in film school- the first American to be accepted into the graduate directing program at China’s only film school. My entrepreneurial experience is very helpful. Each film is like a start-up- you begin with an idea, and then add a business plan, team building, raising funding, execution, and sales and marketing (and lots of stress and elation). But, to quote the Godfather, Just when I try to get out, they pull me back in! I do a little advisory work for Chinese start-ups and I teach venture capital and technology entrepreneurship at Peking University (BeiDa.)

Q: How were VCs helpful, if at all, in the growth and success of your software company?

~ We raised two rounds of angel funding from Silicon Valley (“SV”) and Asia. (We had the highest valued Angel round ever in SV.) From the very beginning, we were international- we were incorporated in three countries within three weeks. So, we went with angels with the idea that we would have a balance of people from Asia and from Silicon Valley. Basically, it was an A list of investors from both sides of the pacific. The problem was that no one took ownership of the company-In hindsight, this is understandable. We used everyone for advice but no one had true skin in the game. This was a problem.

Q: How could have your experience with VC have been better? What mistakes were made by VCs that angered or bothered management?

~ In the later rounds, we were frustrated by VC’s lack of operating experience, SV experience, and tech understanding. Let’s talk about cultural differences for a moment- the problem with working cross-border is that you have to deal with two or more cultures

and then the intersection of the two. You better know what you are doing- empathy and operating experience helps. For us, when things got crazy (right in the middle of funding, we were on the front page of the Wall Street Journal), this cranked up our valuation. When there is more money, sometimes there is more management problems. When things get tough, you run into the same thing. Add cultural differences and it has the potential to get ugly. In our situation,, there were cultural differences between parts of the management team. In this specific instance we had trouble because approaches to management control is very different in Chinese culture. One expects that someone will change dramatically based on their experiences, for instance, in SV. However, culture is hard-wired in all of us (I've been going to China for 15 years and I love the culture and have wonderful friends, but no one will ever confuse this 6'2" blond guy for Chinese.) So, here is the predicament- how well do you think you can incorporate yourself into the other culture and vice-versa. When things get too good or too bad, the base of original culture raises its head. Only experience can tell you how to deal with this. In China, one of the cultural difficulties that affect the core of management of start ups ,is that you have to educate to loosen the grip on power- share responsibility. This flies in the face of traditional Chinese approaches to management which tends to be more micromanagement and less open.. That's the good thing with a VC, an outside hand who can help guide these things. It is good management that pushes growth or craters the company. I also hammer this into my kids at BeiDa. My program is heavily dependent on teams or groups. Two weeks before the final, I also remixed the groups to put extra stress on each team. So, I try to push my students outside their comfort zone because I think that this is good, very good preparation for being entrepreneurs. We go over company formation, team building, company building, guiding growth, brainstorming, and company and industry analysis. Another very important cultural difference is transparency, transparency, transparency. In China, companies don't want to come out with bad news. Its embarrassing- affects face or "mian zi." This is very is different from how the people in Silicon Valley might build and deal with issues in a technology company. We lay out problems immediately so that we can solve it or work around it and go forward.

Global Silicon Valley and China

I see the idea of Silicon Valley as transcending the geographic boundaries of the Bay Area- San Jose to San Francisco. Now there are people in Bangalore, Ireland, and Russian who have more in common with people in SV than they do with their neighbors. This also includes the Haidian District in Beijing. China has the added benefit of having a huge market in which they can safely grow with less competition until they are ready to move into international markets.

Lets talk about China- the downside of the country's huge education system is that it does not support creativity. This is a problem in building new technology. However, Chinese companies grow tremendously fast by watching what happens overseas and replicating it for the Chinese market. The Chinese market is huge and still growing. Another driver of growth is the return of overseas temporary workers. Chinese B-1 temporary workers in SV and those who were educated in the US and then worked in technology companies are

also helpful in bringing over management ideas, financing understanding, and technology ideas. They also develop customer or partner relationships.

One other thing you are seeing, or starting to see, is that Chinese companies are starting to go overseas and are making an impact. There are more Chinese companies who have gone public this year in the USA than European companies. And it will only accelerate. They are also starting to take over name brand companies. We all know about Lenovo taking over IBM's computer division. For some companies in China, the next thing they need is more creativity and branding. They can get both of those by acquisitions of overseas companies.

The cultural issue of *mianzi* or "face" is obviously important. Everyone knows this- However, the problem is that when things are bumpy, which they always are at some point, some are unwilling to talk or confide these issues with outsiders and sometimes insiders. This is something which VCs who work with Chinese companies must deal with early. Tech management works by spreading responsibility and by TRUST. Culturally, Chinese are hardwired by *mianzi* to not release bad information. But, from my point of view, this is the sin of omission. The earlier you get this out, the better chance there is to find a solution. VCs need to work on this and develop trust. You would be surprised when ugly secrets rear their head. More than one company has been affected by secrets at the IPO due diligence level. Alternatively, in China, the benefit of taking the opposite approach is that there is a premium for being a super clean, transparent company.

Q: If you were advising young VCs on working with start-ups, what advice would you give them?

~ As a lecturer at BeiDa (Peking University, referred to as the Harvard of China.) I stress get operating experience, get operating experience, get operating experience. This will give you an understanding of how to go forward and how to help with problem solving. It will also give you a relationship network. When you jump into a VC as a young recent graduate, you are good at evaluating business plans or if you have a good tech education, you can drill down on the company's technology. And anyone can get smart with the market. So, I tell all my kids to go work first- even a few years and then go back. You will be more valuable and it will help your career.

Q: Turning to your Band of Angels experience, can you describe them and also explain how you got involved with them?

~ I grew up in SV, Palo Alto actually, an industry town and I got an introduction to them via a family friend. The original angel group was smart, aggressive, and able to step in and help. Andy Bescholm was an early member, Ron Conway was the first to invest in Google, Bob Harrington organized first option lending for start up founders-there were other old school entrepreneurs and VCs. The rules are that a member has to invest first before a company can pitch to the group. Every month, 3 company pitches over dinner.

Those who express interest then meet over lunch a few days later. They also have a good sidecar fund. There is a problem in trying to stay under the radar. If you want to be stealthy, you may have a problem because, afterwards, it's all over town.

Q: Do you feel that Angels as a group are beneficial to the venture capital and start-up process?

~ Good and bad- First, VC's (as opposed to angels) don't deal with the earliest rounds, so a little money is helpful to get out of the garage. Second, they move fast and think with their gut (if they are good). However, not everyone has good operating experience. And some are clueless.

Q: What were some of your frustrations in working with BOA and of being an Angel investor, in general?

~ I never went to them for funding. I learned a great deal from my experience there. I opened up a relationship network that was good for advice but they did not have cross-border experience. It did give me credibility. Angels- its good and bad- some don't have the bandwidth to work and drill down with you but others do and they can throw themselves into the situation.

Q: Do you have any thoughts, positive or negative on the other angel groups out there?

~ I felt that BOA is unique. There are and were many other angel groups that wanted to replicate the success of BOA that just did not have the experience. Its good to get people going but I am always concerned about getting funding back to investors and I just think that there was a lot of money thrown down with no possibility of returning it.

Q: For young professionals interested in becoming VCs, would you suggest linking up with Angels and Angel groups to get good experience and build skill sets?

~ I would not, because I think that I was lucky to get great experience from some people who really knew what they were doing. It was based on my personal relationships. Should people hook up with angels? This is where I get opinionated- Angels tend to work alone or with other angels. There usually is not a fit for single individuals who are still running up their learning curve. My suggestion is to get operating experience- go around the horn once or twice. Know what it is like to toss and turn at night wondering how to get funding to pay your employees that you hired, they put their trust in you. You need to struggle with how are you going to close this deal, how are you going to fire this guy who is older than you- with grace and strength. How are you going to raise funding passionately and work with the investors, partners, like you have an obligation- its their money, not yours. And learn how compete like there is no tomorrow, with every drop of

your soul. In my opinion, being an investment banker or consultant does not give you as much skill as operating experience does.

With my students, who are some of the brightest in China, I impart the idea of passion. This will drive you in good times and in bad. This semester, I had 60 students apply for 16 spots for my class on technology entrepreneurship and VC at BeiDa. I took 20. Anyway, the first day, I asked them how many wanted to be an entrepreneur- one raised his hand. Pretty lonely, right? About half wanted to be VCs, the others wanted to be bankers. I followed that by saying- good. Don't be an entrepreneur. Because being an entrepreneur takes a certain mind set. Its tough and brutal but ultimately joyful. You feel like you have an impact and you have done something. Personally, I think that this is the only pathway to being a strong VC. Operating experience. In SV, I can only think of one successful VC with no operating experience- Bill Gurley. Back to my class. Well, the last class, everyone raised their hand. And they plan to do interesting things. I cribbed (stole) a step from Tom Byers class at Stanford and I am setting all the students who successfully went through my class, (it was structured to be very, very difficult and to push them in ways they had never been pushed) to be paired primarily with start-ups in Beijing and some in Silicon Valley if they get Visas. (2 do have Visas for this fall, another comes in spring of 2006.

Q: How did BOA source their deals and are these fruitful sources for others to tap?

~ All good angels have operating experience and strong relationship networks from working in SV for years. The relationship network brings in the deals. It's the same as a VC. In VC funds, very few deals really come in through the transom. They get vetted by other friends, people in the industry, word of mouth, lawyers, accountants who know what to look for. If you want to tap their deal flow, develop relationships with established angels. If you are on the relationship network of a member of BOA then you can utilize that. You can source deals as the company's grow. If they have money sunk in, they want to see growth- they don't want companies to die on the vine which means they have to go back to the well again. More mature emerging growth companies is where it VC's step in. So, they can be a feeder to VCs. As a practical note, if you are a young VC or want to be a VC, and are lucky to know successful angels well, then ask to mentor you. The same goes for young entrepreneurs. Everyone likes to give advice and to talk, if they have time. Here's a little secret- surprise them later with a gift of equity. It will have an impact.

Q: Our organization is focused on having young professionals learn more about VC and dealing with start-ups, is there anything you would say they should know in dealing with young companies?

~ Yes. Once you bring in each successive employee or partner into a company, the difficulty grows exponentially. Learn to manage people and to see things from the founders/ the CEO's/ and the employees' perspective. Investing in the right deal is only

the beginning. This really functions in two ways- one- you can help guide the company. (I am assuming that you put all of your experience and that of your VC to bear. This includes recruiting, marketing help, partnering and customer help. VCs should be able to strap a rocket onto the company, capital can be rocket fuel.) Second, if you have been good to work with- regardless of whether the company craters or goes IPO, you get a reputation of being able to work with others. Word gets around - your reputation and that of your fund gets around pretty quickly. And ultimately, its all we have, right?

One more thing that young VCs should know- there is a cycle for VCs as much as there is for technology. In the 80's, many VC closed their doors and a few, now famous ones, almost did. Others evolve into something else- people leave, retire, etc. We saw that recently as well. Merrill Packard became Benchmark, IVP guys left to start Redpoint. Softbank. Others, that I know of (nameless to protect the innocent), just shut their doors. Joining a VC is not necessarily the pathway to being successful that one would expect. So, that reputation is important. Particularly if you are a young kid.