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So You Want to Be a Venture Capitalist

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BY all rights Stewart Alsop should have been a terrific venture capitalist. So why did Mr. Alsop, long considered a cyber-prophet among technology leaders, wash out in a profession in which he seemed predestined to succeed?

In recent months, as venture capital firms have announced the formation of new investment funds, a hot topic among the Silicon Valley cognoscenti has been the exodus of "tourist V.C.'s," as people from nonfinancial backgrounds are known here. Some have left the field because they did not pick enough winners; others have gone on to pursue different projects. Whatever the reason, there are hundreds fewer venture capitalists around today than just two years ago.

The business of financing start-ups, it turns out, may not be as easy as it seems. "There are Darwinian characteristics to venture capital," said C. Richard Kramlich, a founding partner at New Enterprise Associates, a top Valley firm that hired Mr. Alsop in 1996. "Below the surface there's a huge amount of turnover."

At first Mr. Alsop seemed destined for venture capital greatness. But for him and others who made the leap into venture capital in the second half of the 1990's, the experience proved humbling.

A technology journalist dating back to 1983, Mr. Alsop was the founder of Agenda, an invitation-only computer industry conference that drew the likes of Microsoft's Bill Gates. Part of the appeal was that Mr. Alsop had a talent for spotting promising technologies and undiscovered start-ups before others.

But Mr. Alsop and New Enterprise Associates parted ways in December. Mr. Alsop said he left because he felt most comfortable working with nascent technology companies, and, increasingly, N.E.A. has been broadening its focus well beyond investing in very small start-ups. He described his own track record over eight years as good but not great.

But Mr. Kramlich, who has worked as a venture capitalist since 1969, put it more harshly. The firm, it seemed, had simply run out of patience with Mr. Alsop, as it did with others who were not seen as pulling their weight. N.E.A. has raised a pair of billion-dollar-plus funds over the last five years, sums high enough to have raised the stakes of the game.

"We can't really have people learning on the job anymore," Mr. Kramlich said. Two-thirds of the partners who were at N.E.A. in 1997 are no longer at the firm, he said, and then cited an internal study that went a long way in explaining why: the surviving third accounted for 85 percent of the firm's profit.

Turnover is the story at many well-known venture firms. Consider Kleiner Perkins Caufield & Byers, widely viewed as one of the two premier venture outfits in Silicon Valley.

In February 2004, Kleiner began a $400 million fund, but it isn't managed by any of the half dozen or so of the partners who worked for the firm in the late 90's; they had either left the firm or been relegated to secondary roles. Kleiner has hired three new managing partners since the start of the year.

And when Benchmark Capital closed its own $400 million fund last June, the firm announced that David Beirne, who had helped found Benchmark in 1995, was no longer a full partner. "Sometimes it's true that a partner left a firm over strategic differences or whatever they say, but that's the exception rather than the rule," said Steve Dow, a venture capitalist with Sevin Rosen. More typically, he said, it's "because they didn't have a good enough sense of smell about a deal."

Mr. Alsop and Mr. Beirne follow many other illustrious names out of major venture firms. Mitchell D. Kapor, the founder of Lotus Development, whose 1-2-3 spreadsheet software made Lotus one of the early giants of software, should have been a natural as a venture capitalist.

Mr. Kapor had enormous success investing for himself in barely-formed start-ups like RealNetworks and UUNet Technologies, both of which provided him with staggering payouts.

Yet he did not prove to be a star the years he worked as a professional venture capitalist.

"The fact that it's someone else's money you're investing, and that you're investing as part of a partnership, that was more different than I thought it would be," said Mr. Kapor, who went to work in 1999 for Accel Partners, another top venture house in Silicon Valley. "I later found out that everybody who makes the transition like I did says that."

Mr. Kapor failed to choose a single company that made him, his partners and their investors any money. He confesses he was 0-for-5 in the investments he made during his three years at Accel. "Most of us learned the hard way that venture investing is best left to the professionals," said Marc Andreessen, the co-founder of Netscape Communications.

Shortly after America Online paid $4 billion to buy Netscape, Mr. Andreessen helped bankroll a venture firm called 12 Entrepreneuring, a short-lived partnership forged in early 2000 by Benchmark and a pair of successful Internet entrepreneurs, Halsey M. Minor and Eric Greenberg. But 12 Entrepreneuring ceased operations only 18 months after it started, and the partners, including Mr. Andreessen, lost nearly two-thirds of the money they had invested.

"I think what a lot of these guys learned, some the hard way, is that you're a natural athlete or you're not," said Sanford Robertson, the co-founder and former chairman of the investment bank Robertson, Stephens & Company, who has been investing in venture funds for more than 20 years. "Some can do it, and some can't, and like with athletes there's no way of telling until they take the field."

At the end of the 90's, it seemed everyone in Silicon Valley wanted to become a venture capitalist (except those who wanted to be entrepreneurs funded by venture capitalists). As the ranks of venture capitalists more than doubled, according to the National Venture Capital Association, from less than 5,000 in 1995 to nearly 10,000 by 2001, firms started hiring people from outside traditional fields like finance or operations.

Suddenly many lawyers, entrepreneurs, journalists and executive recruiters were trying their hand at playing venture capitalist - just as today any number of investment bankers, financial analysts and others seem to be starting their own hedge funds.

IT'S easy to understand why so many joined the swelling ranks of venture capitalists. A general partner at a top-tier firm typically earns at least $1 million in salary. But the real payoff is what venture capitalists call "the carry" - the 20 to 30 percent of the profits they share among themselves before disbursing the rest to investors.

An informal survey of venture capitalists suggested that a partner working at a top-tier firm in the 90's could pocket roughly $50 million over the life of a single fund - with venture firms typically raising a new fund every few years.

Beyond the vast financial rewards, there are the thrills. A venture capitalist is not unlike a movie producer auditioning tomorrow's stars. "Being a venture capitalist was viewed as a very exciting, top of the feeding chain sort of thing," said Scott Dettmer, a founding partner at the Silicon Valley law firm Gunderson Dettmer, who has been providing legal advice to venture capitalists since the 1980's. "But what I think a lot of people learned is that it's not as much fun or as easy as it might have looked from the outside."

Certainly, the early years are often painful. One of the industry's more legendary investors, John Doerr at Kleiner Perkins (his hits include Google, Amazon, Netscape and Sun Microsystems), used to say that training a new venture capitalist was not unlike preparing a fighter pilot for battle: it takes "probably six to eight years and you should be prepared for losses of about $20 million.

"Of course, while we take risk, we work like hell to avoid crashes," Mr. Doerr said.

By that standard, Mr. Alsop was successful at N.E.A. He didn't lose money in his eight years, and, by his calculations, earned the partnership a 100 percent return on the investments he oversaw. Shortly after his arrival, he persuaded his partners to pay $1.7 million for an ownership stake in a software start-up called Connectify, which was purchased by Kana Communications. That earned the partnership 22 times its money.

He could also take some credit for the success of TiVo, the digital video recorder company that went public in September 1999. Mr. Alsop didn't bring that deal to N.E.A., but he worked closely with the company founders as a member of TiVo's board of directors. He said that the TiVo deal had earned N.E.A. and its investors 11 times their investment.

"I think I've done very well as a venture capitalist, but I'm not in the god category," Mr. Alsop said. He defines a venture god as someone who has made $100 million to $500 million on a single investment. His list of industry deities includes Mr. Doerr, Mr. Kramlich and Michael Moritz at Sequoia Capital, who was an early investor in Google and Yahoo.

Mr. Moritz seems to prove the point that there is no obvious résumé for the perfect venture capitalist. Prior to joining Sequoia in 1986, Mr. Moritz was a business journalist and a writer for Time magazine, though one with an M.B.A.

Mr. Kramlich, who has a background in finance, said: "Venture capital doesn't necessarily take a lot of technical talent. "I mean, it doesn't hurt, but it's more about people skills and the ability to assess whether there's a market for something."

Certainly Mr. Beirne, formerly of Benchmark, has people skills. Before joining Benchmark in 1995, he had a stellar reputation as an executive recruiter able to persuade the most reluctant candidate to switch jobs. Yet how he performed in his nine years as a general partner at Benchmark depends on whom one asks.

MR. BEIRNE acknowledged that many in the clubby V.C. world may think he left because of a mediocre track record, but he disputes that perception.

"I have been personally responsible for returning a billion dollars" to investors, he wrote in an e-mail message. He decided to leave the partnership for a "personal reason related to one of my children" and "no other reason." Yet apparently for some, once a venture capitalist, always a venture capitalist. Mr. Alsop is exploring the possibility of raising a fund for new start-ups.

"I feel at this point I'm very good at this," he said. It's only a matter of time, he said, before he scores what he describes as a "godlike hit."