The Peninsular Tribune - June 17, 1984

Last year's success — and excess — hurt

By Myron Myers
Times Tribune staff

The venture-capital industry has too much money and too many players and seriously harmed itself last year with success and excess, according to veteran venture capitalist Reid Dennis.

"Our industry has done a terrible disservice to the public," Dennis told a recent breakfast forum for members of the Stanford Alumni Association. "I know the market (for initial stock offerings) was there, and people say if the public is willing to pay, let it. But that is an extremely short-term strategy."

Dennis noted that some investors had suffered huge losses. On stock of bankrupt computer maker Victor Technologies Inc. in Scotts Valley, for example, the loss could have been 95 percent. The stock of Mountain View video-game manufacturer Activision Inc. is down more than 80 percent from its initial price.

"This record is going to come home to roost for us," Dennis said. "Of the 121 public offerings in 1983 ... less than one in four has shown any profit for the investor. If any disk drive or other manufacturing company was shipping products out the door where less than one in four would work, you know it would be in trouble ...

"Yet that's what our industry is doing to its ultimate customer, the public. If there are any of you who have invested in public offerings and lost a lot of money doing it, I apologize for it."

The venture capital industry's problem, as Dennis explained it, was that a surfeit of venture capitalists and venture money led to the formation of too many "me-too companies," particularly in the computer industry. The prospects for making quick fortunes in stock of new companies was so great that people invested in them without giving enough serious thought to the economic fundamentals behind them. The prospectuses came so fast at the institutional investors, such as insurance companies and pension plans, that they bought stock without thorough economic analysis.

"I know of one company that got into trouble and the president was fired," Dennis said. "The man then set himself up as a venture capitalist and established a fund. Just what expertese does he have to be a venture capitalist?"

Dennis, Mary Jane Elmore and John K. Poitras are partners in Institutional Venture Partners of Menlo Park, which has assets of $150 million. Dennis has been in the business since the early 1950s, when he and friends would listen to entrepreneurs at a luncheon in San Francisco and then raise $100,000 if they thought the company had a chance.

At that time, Dennis said, there were no small publicly owned electronics companies. Hewlett-Packard Co. was private. Varian Associates was employee-owned and jealously guarded dissemination of its stock.

"When Hewlett-Packard did go public," Dennis said, "David Packard would get up and give speeches about how overpriced the stock was. Anyone who disre-

Please see EXCESS, C-6

Reid Dennis
... too many "me-too" companies.

EXCESS

Continued from C-5

garded his advice would be a millionaire today."

Still, he said, in those days and for a long time afterward, building a company was a slow, deliberate enterprise where one usually could count on the founders sticking around to make sure the company was there five years later.

"Everything has become accelerated and in an unsustainable fashion," he said. "We can't continue to do what we have been doing. The incredible rates of return can't go on. Over the last 10 years, the average return has been at something like a 25 percent compound rate. Some of us have seen compound growth of 30 percent to 35 percent over the past five years, and a few have had 80 percent to 120 percent over the last five years.

"A friend of mine once told me, 'never confuse a bull market with brains,' but that's what's been going on."

Dennis acknowledged that his firm also has had trouble with new companies. He served 2½ years as president of Collagen Corp. in Palo Alto to try to straighten it out, and he now is a director of a dozen companies. He described one company his firm has backed as "an absolute disaster." One investor has sued, claiming the projections for profit were wrong.

"It's standard operating procedure for the projections to be wrong," Dennis said. "They never are what they say there are. Less than 5 percent of all companies beat their projections. Everybody who has ever been in business knows you have to divide (the projections) by some figure. Some use 2 or 3 ... I always divided by pi. If I do that and we can still make money, then I say the investment is OK."

Investors, Dennis said, have to negotiate more aggressively with entrepreneurs, and the public has to be discriminating about buying stock.

"There's got to be less profit for the venture capitalist," he said "There's got to be less for the entrepreneur. We've got to leave something on the table for the public or this industry is going to die."

Market forces are shaking up the industry right now, he said. A lot of institutions won't talk to venture capitalists now unless they have a 10-year track record. "That's going to separate the players. ... A lot of people have floated into this industry. They always float in and out. A lot of them are going to float out again."