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Risk takers — big losses, big profits

By Peter D. Whitney

Venture money — the kind of risk-taking investment that sent Columbus off in what the conventional wisdom said was the wrong way to look for the wealth of the Indies — has an ancient and honorable history.

Many see it as the seed of the great capitalistic system by whose achievements we are surrounded.

In modern times, venture capitalism and venture capitalists have a mysterious and at times a bad reputation.

Which is curious, inasmuch as it was venture capital, advanced by monarchs or nobles or merchant bankers, that launched privateers and whaling vessels, built railroads and dug mines, strung telegraphs and, through the fur trade, explored the West before the national government was ready to sanction its winning.

For the Bay Area, the whole subject of venture investment has a particularly glamorous significance because of all those burgeoning companies down in Silicon Valley, feeding their profits into our lifestream, employing all those people who weren't even born when Hitler and Tojo were defeated.

There is hardly one of them, the Hewlett-Packards, Varian Associates, Ampexes, National Semiconductors, Syntexes, that wasn't brought into the world by one or more venture capital investment companies.

An officer of one of them said the other day, "We're the obstetricians and pediatricians of industry."

The little-known venture capitalists of the Bay Area are so few that they all know each other. Most of them, in fact, have cross-fertilization of ideas and share in one or more investments. That is because, like Lloyds of London, they have to spread the risks, and they all value the judgment of their nominal competitors.

It is a high-risk game, with occasional fantastic profits to give it spice. One of the most spectacular coups was by Reid Dennis, who put $20,000 into a little-known company called Ampex in his twenties. In time, that grew to a million dollars, and today, in his fifties, Reid Dennis has two airplanes, a Rolls Royce and a pair of Aston Martins.

More to the point, Dennis persuaded the company he worked for until recently, Fireman's Fund, and then American Express after their merger, to go into the venture capital business.

Solomon L. Miller

Reid Dennis

Examiner Photos by Katy Raddatz

Dennis felt then, and continues to believe with a kind of religious passion, that big capital concentrations have a duty to the free capitalistic system, to plow back some of their safe-and-sure profits into the risky little companies that have little more than some good ideas and some good people to build on.

Dennis, with three partners, founded Institutional Venture Associates. They got the backing of American Express, which Dennis had just left as a vice president, and of the Ford Foundation, plus a number of insurance companies led by Mutual of New York.

The climate for venture capitalism could hardly have been worse, and Dennis counts himself lucky that they were able to raise $19 million, well above his goal, before the climate of no-confidence closed down on the over-the-counter market.

The four have looked at 750 situations since then, and have actually made just five commitments — the latest only a few weeks ago.

It should be understood that venture investments are not like buying stock through a broker. There is no market for the shares of most of the companies the venture men are interested in. They are too new, may have little or no sales volume, have little credit at the banks, and couldn't get a nod from a Wall Street investment banking house.

And the venture investor has to be uniquely cautious because, once in, he's in for years. If the company has a particularly long gestation period, that may mean a decade or more, in which time he gets neither interest nor dividends. In the absence of a trading market, nobody even knows for sure what his shares are worth, and the only investor capable of making an independent judgment would be another venture capitalist.

Solomon L. Miller, a consultant for the Phipps family estate's famous Bessemer Securities Corp., says that, in contradiction to popular myth, "it's tough to make a living."

A good scenario nowadays, with a virtually non-existent new issues market and an over-the-counter market that is still deep in a unique depression of its own, would be a 7-year period of investment, with a 5-to-7-times return, Miller said.

An urbane and judicial, but candid analyst of what he firmly says is "a profession," Miller came to

—See Page 69, Col.1

They think times are bad

—From Page 68

California as a transistor scientist, in an enterprise that quickly failed.

He had been in Bell Laboratories when the transistor was invented, then at IBM. From science, he moved smoothly into finance in Silicon Valley's torrid days of growth.

Like almost all the venture men interviewed by the Examiner, Miller thinks we are in bad times, first of all because of the crisis of confidence, but also because of this year's tax law, with its capital gains provisions and the virtual destruction of stock options as a means of rewarding company management.

But Bessemer has had some recent successes, including the establishment of Fotomat, whose selling idea was the film processor in the kiosk in the supermarket parking-lot, as a money-maker after some tough struggles.

Another success was the launching, earlier this year, of Four-Phase Systems as a publicly owned company. But Bessemer, like most of the other venture investors, had to hold on to its shares — to have sold then would have seemed like bailing out.

And Miller grimly notes, too, that "We lost everything in less propitious investments, too, many times."

Perhaps the dean of the venture capitalists of the Peninsula is Thomas Davis, who has had a series of time-limited investment partnerships since 1959. His first, with co-founder Arthur Rock, started with $3.2 million in 1961, and distributed at least $65 million to its investors in 1968.

He feels strongly about the new tax laws, pointing out that options were the inducement that prevailed on highly paid engineers and scientists to leave big companies and work at much lower salaries on inventive new projects.

Ironically enough, Congress supposedly favors small business, making special loan funds at low interest available through the Small Business Administration, which are sometimes used by some venture capitalists. But the new tax law takes away the inducements that make such small businesses viable, says Davis.

William C. Edwards, president of Bryan & Edwards of San Francisco, agrees. "We are doing something very creative, something that isn't done at all in communism, and very little in Europe nowadays.

"Think of all the jobs we've created, and the fine products.

"The government is destroying the opportunity for that creativeness."

Bryan & Edwards have been involved in a number of electronic pioneering investments like California Microwave, but are proud also of having been the lead outside investor in the highly successful magazine, Psychology Today.

There are onetime venture professionals who are on the sidelines, feeling that the climate is unpromising. Phillip Lamoreaux and his partner, John Glynn, worked together on behalf of American Express in nursing Intel, the Santa Clara computer memory maker, into its present good health.

But now with their own investment advisory firm, they think there's more money to be made at less risk acquiring the more mature companies that have gone public.

Next: The venture investor sometimes has to fire the man who started the company, but he usually makes him rich in the process.