THE WALL STREET JOURNAL. ONLINE

February 25, 2005

New Kids Arrive On the Venture-Capital Block

By ANN GRIMES
Staff Reporter of THE WALL STREET JOURNAL
February 25, 2005; Page C1

When Harvard University's money managers went looking to rev up their venture-capital investment returns last year, they turned to Ignition Partners, giving the upstart Bellevue, Wash., firm $50 million and snubbing more-established Silicon Valley funds. Princeton and Stanford also bet some of their venture-capital cash on the five-year-old firm.

Ignition is part of a new breed of venture capitalist, the financiers who raise money from institutions to invest in promising new businesses, hoping for outsize returns when the companies are sold or launch initial public offerings of stock.

Rather than investing in a range of business ideas, many of these so-called emerging funds are highly focused, concentrating on particular regions or industry sectors. So while Kleiner Perkins Caufield & Byers, the dean of the Silicon Valley firms, wagered on both social-networking Web site Friendster and the Segway scooter, Ignition has built a team of former Microsoft Corp. and McCaw Communications Inc. executives to focus on software and telecommunications businesses.

"We all want to find the new generation of Sequoias and Kleiners," says Clint Harris, managing director of Grove Street Advisors, an investment-advisory firm for institutions in Wellesley, Mass., referring to Kleiner Perkins and another well-known venture firm, Sequoia Capital, that backed Internet search engine Google Inc. Staff turnover at some established firms and the poor performance of some of them also is prompting investors to shop elsewhere.

The sums that the newcomers are raising aren't huge. The 15 first-time venture funds that closed last year took in about $1.3 billion, only about 7% of what the whole industry raised in 2004, according to VentureOne, a research firm owned by Dow Jones & Co., publisher of The Wall Street Journal.

But that was double what new firms raised in 2003. The increase could be a harbinger, because in the venture-capital world, investors of all stripes mimic bets by elite players like Harvard, Princeton and Stanford. Already, Duke and Brown universities and the pension funds of **General Motors** Corp. and

Motorola Inc. have followed suit by investing in emerging funds. Georganne Perkins, manager of venture-capital investments at Stanford, says she likes the fact that many Ignition partners hail from Microsoft; just last month, the software giant's chief financial officer, John Connors, said he was quitting to join Ignition.

A Shift From Silicon Valley

The financiers on Silicon Valley's Sand Hill Road still dominate the industry, and at the moment they are turning away money. But newcomers like Ignition represent the first meaningful shift in the balance of power away from Silicon Valley. These new venture firms include Lime Rock Partners of Westport, Conn., which focuses on energy investing, and HIG Ventures of Miami, which concentrates on biotech investments in the Southeast.

"Sand Hill Road, to a great extent, is less the center of the universe than it used to be both in terms of skill sets and technology," says Greg Blonder, a partner with Morgenthaler Ventures, a 35-year-old Silicon Valley venture-capital firm.

Longer term, that could mean more dollars flowing to regions and entrepreneurs previously underserved by venture capitalists.

Ignition was started by a group of former technology executives who had become wealthy from years at Microsoft and McCaw, a wireless pioneer acquired by AT&T Corp. in 1994. They put in a chunk of their own money for an initial $140 million fund and focused on what they knew best. The group raised its first institutional fund in 2001, hauling in about $285 million after many months of effort. Its newest institutional fund more quickly raised $300 million in 2004.

"In the Bay Area, you find more money chasing good ideas than the other way around," says Ignition partner Cameron Myhrvold, who spent 13 years at Microsoft, explaining why Ignition thinks it better to be in Washington state. "If you are an experienced entrepreneur, it's easy to get a good auction going on your next venture, but that's not the best dynamic for the investor."

Not everybody thinks the narrowed focus of the newcomers is the way to go. At Sevin Rosen Funds in Dallas, general partner John Jaggers says his venture-capital firm "is a big believer in not being specialized." He says he can see some advantages from zeroing in on an area "as long as it stays hot," but the approach can be "short-sighted." He also believes specialists can be so close to a particular sector that they think they can have more of an impact than they really can.

Added Risk

Placing bets on emerging funds is risky in a business already fraught with risk. According to data from Rumson Capital Advisors, a Princeton, N.J., adviser for institutional investors, fewer than 7% of new firms, those that have three or fewer funds, generate top-quartile returns.

So far, Ignition's 17-member investment team has put money into about three dozen businesses and chalked up several hits. These include Avogadro Inc., an instant-messaging software company bought by **Openwave Systems** Inc. for about $100 million in 2001; Ignition was part of a group that early on put in $7.5 million. Ignition and several other investors put another $16 million into UIEvolution Inc., a company that shoots multimedia content to mobile devices wirelessly, before it was sold to **Square Enix** Inc. for $58 million in March 2004. Two businesses it backed have shut down, but that's still not a bad track record, given the hammering the tech sector took during the economic recession.

"We think the portfolio has quite a bit of potential but it's still early," says Douglas W. Breckel, senior associate treasurer at the University of Washington, which has invested in Ignition's two institutional funds.

'Deep Green Crystals'

Some of the new firms allow investors to take big stakes of their funds, a strong selling point after the dot-com debacle left many investors put off by their inability to influence decisions, terms and fees. Established firms typically limit any investor to a slim 1% of any fund, while Harvard owns 16% of Ignition's $300 million fund.

In another sign of their openness to new ways of doing things, all but one of Ignition's 10 general partners have launched Internet "blogs" for regularly posting thoughts. Among the more popular are Martin Tobias's "Deep Green Crystals" and Rich Tong's "geekfishing.net," which offers an inside look at everything from new technologies to what entrepreneurs should look out for in striking deals.

"We're a very open firm, more open in terms of getting feedback," Mr. Tong says.

Write to Ann Grimes at ann.grimes@wsj.com[1]

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