

Venture Firms Seek Start-Ups That Outsource

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Silicon Valley's venture capitalists, famous for funding technology's leading edge, now are pushing the companies they fund to be on the leading edge of an employment trend: moving white-collar jobs offshore.

The Valley's ideal start-up business these days is the "micro-multinational," a company that from its inception is based in the U.S. but maintains a less-costly skilled work force abroad. Venture capitalists also are prodding young companies in which they already own stakes to turn themselves into micro-multinationals.

One recently funded start-up business, Solidcore Systems Inc., is a case in point. The company, which makes security software, is based in Palo Alto, Calif., and has a U.S. staff of 16, including its chief executive, chief technology officer, engineers and sales-and-marketing executives. It also has 15 employees in Delhi, India, including a top financial officer and engineers, and six contract employees in Pune, India.

"It was set up that way from the beginning," says Nick Sturiale, a general partner at Sevin Rosen Funds of Palo Alto, which put \$5.5 million into Solidcore along with venture firm Matrix Partners. "The key is not just labor costs, it's productivity." When engineers in the Valley are going to sleep, those in India are waking up, he says.

Technology companies "look at globalization as a natural phenomenon without borders," says Ash Lilani, the South Bay Region Manager for Silicon Valley Bank in Santa Clara, Calif. Mr. Lilani recently organized a scouting trip for two dozen prominent Silicon Valley venture capitalists to check out potential start-up businesses and markets in India.

At Kleiner Perkins Caufield & Byers, the graybeard firm of Silicon Valley venture capital, partner Ray Lane recently returned from his own trip to India. The former Oracle Corp. president says 30% to 40% of the start-up companies his fund has helped finance have sent work offshore. "These are basically five to 10, maybe 20, people. Small operations," he says.

At Mayfield, another Silicon Valley venture firm, partner Yogen Dalal says: "If you talk to all the leading VCs here, 50% to 60% of their portfolio companies have some interaction with India. But what really will happen in a couple of years, 90% of all start-ups will have some connection to India or China. There's no going back."

Start-up businesses that recently received funding include:

July Systems Inc., a mobile-data-services company based in Santa Clara, Calif., with a global product center in Bangalore, India.

24/7Customer, which provides customized call-outsourcing services from its Los Gatos, Calif., headquarters and from call centers in Bangalore and Hyderabad, India.

ServGate Technologies Inc., a security-software company that has 60 engineers in its Milpitas, Calif., headquarters, 30 in Beijing and 10 in Vancouver, British Columbia.

ReaMetrix Inc., a company making sophisticated testing kits for drug companies, with six employees in San Carlos, Calif., and 10 scientists in Bangalore.

Open-Silicon Inc., a semiconductor-design company soon to launch with 15 employees at its headquarters in Sunnyvale, Calif., and 25 employees at a development office in Bangalore.

At Norwest Ventures, Managing Partner Promod Haque says a majority of the companies his firm has funded, including Open Silicon, have located jobs offshore as a strategic practice. Some, he says, have been doing it for years. "Our experience with this phenomenon started before this was even recognized," he says.

Four years ago, Norwest put \$12.4 million behind a Boston wireless-infrastructure company, Winphoria Networks Inc. The company was started during the technology boom by two engineers from Bell Labs and needed engineers with specialized wireless expertise. In the U.S., demand for such engineers was high, and so were their salaries.

So the company set up subsidiaries in Spain and Bangalore, where it found the engineers. Besides a cost differential of four to one, Mr. Haque says, it also found new markets. "Sales and marketing and the CEO were in Boston," Mr. Haque says. "The center of gravity was outside the U.S.," he says, adding that "by having our employees based in Madrid and Bangalore, we were bidding contracts in Europe and Asia" at a time when the U.S. telecommunications market was in trouble. Motorola Inc. ultimately bought Winphoria for \$175 million, bringing Mr. Haque and his investors a handsome return.

The search for such successful "exit strategies" -- ways for venture capitalists to sell their stakes in companies -- also is driving the offshore trend, as VCs grapple with the fallout from troubled investments from the tech boom. With few initial public stock offerings these days providing a way to cash out, making the most of capital at start-up businesses is key, Mr. Haque says.

Also fueling the phenomenon is the maturation of a generation of entrepreneurs who have started, run, sold -- or been laid off from -- successful start-up companies. "During the downturn, companies were looking for clever ways to save money and survive. Employees were looking for work. A lot moved offshore," says Steve Domenik, another Sevin Rosen partner.

The success of these entrepreneurs, many of them immigrants, has made the cross-border business model a less-risky proposition, many venture capitalists say. "They come to us saying, this is how we want to start it from the beginning," Mr. Sturiale says. "They have experience doing it wrong -- then doing it correctly."

Indeed, the cross-border idea sometimes goes the other way, creating what some call "insourcing." Norwest, for example, is funding Epiance Inc., a business-improvement software maker in Bangalore. As part of its expansion the company plans to base 30 employees in Silicon Valley.

Others go outside the U.S. for experienced workers. Monterey Design Systems Inc., a venture-backed software company in Mountain View, Calif., that has received \$85 million in venture funds, designs software to make chips. In May, it opened a research-and-design facility in Yerevan, Armenia, staffed with about 50 scientists, many with advanced degrees in electrical engineering and computer science.

The company's chief executive, Jacques Benkoski, says the region is home to Yerevan University, which by government direction under the former Soviet regime became a region for semiconductor expertise. He describes his Armenian employees as the "go-to guys for graph theory," a branch of math and computer science. "They work jointly with the U.S. team to design chips," he says.

Yet what goes offshore most often are routine engineering and maintenance tasks such as software testing. "Those are fairly automated processes that can be easily be taken offshore by an engineering group," says Steve Baloff, a general partner with Advanced Technology Ventures in Palo Alto, Calif. Mr. Baloff says his firm typically advises its companies "don't plan on outsourcing the architectural or design part of the business where intellectual property is involved."

Gary Morgenthaler, whose Menlo Park venture firm bears his name, says, "It's dangerous ground to be outsourcing core R&D either in India or China, who can become global competitors to America. To the extent that we are outsourcing our intellectual property -- these are nations that don't respect our IP to begin with. That runs the risk of boomeranging on us."

Monterey Design's Mr. Benkoski disagrees. He points out the U.S. can't have it both ways. "You can't want globalization....but say [to other countries] you only get to do slave labor, and we get to do the interesting stuff."

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