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## Micro-Fund Manager a New Friend to Start-Ups

BY CONSTANCE LOIZOS, Mercury News

To be a serious player in Silicon Valley, you've long had two options: working for a venture capital firm or becoming an angel investor and plowing your own considerable wealth into budding technology start-ups. Now a new model may be emerging, that of the microfund manager.

For a variety of reasons, a growing number of investors are raising their own, small funds of \$10 million to \$15 million. Three, all with a slightly different makeup, have sprung up in the past month alone, all with one thing in common: Each is run by one individual who is showing up at the table with other people's money.

Some of these investors are frustrated with the structure of venture capital partnerships, while others want to invest in extremely small start-ups that traditional VC firms that have been ballooning in size have begun to ignore.

"It's sort of the next step of angel investing," says Mark Heesen, the president of the National Venture Capital Association. "VCs just don't have ability to invest in extremely early stage companies any more, and someone needs to do that in organized fashion. So I think there is a market there, that the timing is right."

The microfunds are not for the faint of heart, or the thin of wallets. In venture capital, in addition to taking 20 percent of whatever profits they make, VCs earn salaries through management fees, which customarily eat up 2 percent of the overall size of a fund. In short, a smaller venture fund of \$150 million, managed by three people, translates into \$3 million for the three -- minus the team's costs, including support staff and rent. In managing a \$10 million fund, an investor is making -- well, considerably less.

Then again, the idea -- for VCs, angels, and microfund managers alike -- is to spin investments into big profits, and growing numbers of investors think seeding start-ups is the way to do that. "People are trying to figure out the industry right now," says venture capitalist Stewart Alsop, who co-founded a small venture firm in San Francisco last year after leaving New Enterprise Associates, which manages billions of dollars. "The consensus seems to be that the more dollars you put to work at any one time, the less likely you are to get great returns."

Bill Burnham, a Wall Street-analyst-turned venture capitalist who has worked with both Softbank Capital and Mobius Venture Capital, is behind one of the funds, a \$10 million vehicle called Inductive Capital, in Palo Alto. Burnham raised the money from more than two dozen individuals

-- mostly VCs -- and he plans to use both his background as a public technology stock analyst and his venture industry connections to identify and invest in undervalued public stocks.

"If I hear that five new venture-backed start-ups will soon be pressuring a big tech company, I might not invest in that company," Burnham says. "It's inductive logic. I can't prove it to be true, but a lot of things point in one direction."

Mike Maples, a co-founder of the e-commerce software maker Motive, has also just put the finishing touches on a new fund in Palo Alto called Maple Investments. Since Motive went public in 2004, Maples had been spending time at both Foundation Capital and August Capital in Menlo Park, where he helped evaluate companies as an entrepreneur-in-residence. There, he realized that "a lot of companies could grow to a million users without a spending much, and that it's very easy for a good idea to propagate quickly."

Maples, who also wanted to "have the flexibility to do any deal," last month raised \$15 million from 10 individuals, money that he plans to invest in nascent Internet start-ups such as Digg, a popular site where users submit and either promote or demote tech-news stories by voting on them, or "digging." Maples is an early investor in the start-up; he has since backed three start-ups and plans to invest in a company each quarter.

Vince Vannelli has also launched a \$10 million fund called KPG Ventures in Lafayette, in which he anticipates investing over several years. Vannelli was an executive at Inktomi before joining San Francisco-based VSP Capital in 2002 -- a company that very publicly went out of business last year owing to internal strife. Vannelli says that despite several offers from a number of firms willing to pay him "\$600,000, \$700,000" in annual salary, he is not looking back.

"VSP was hugely unpleasant, but it was certainly not a unique situation," Vannelli says. "While there are advantages to great working relationships, there are very few great working relationships in venture capital."

Vannelli -- who is personally financing one-fifth of his fund and receiving the rest from Adams Street Partners, a Chicago-based institutional investor -- also says that most firms are simply managing too much money to back the seed-stage companies that interest him.

It's a point with which Bill Draper, who helped pioneer the venture industry, agrees. "I understand these smaller funds," Draper says. "Today, funds have gotten into the billions (of dollars) and the general partners are increasing the amount of money they manage in order to keep increasing their fees, and that's not a good thing for the valley or the VC industry or even the partners themselves because they tend to aim at the wrong target."

## KEY PLAYERS IN NEW VALLEY MICROFUNDS

Inductive Capital

Bill Burnham

Based: Palo Alto

Amount Raised: \$10 million

Investors: More than two  
dozen individuals, mostly  
venture capitalists

Focus: "Information arbitrage." Burnham hopes to capitalize  
on news in the venture world  
to better invest in public stocks.

Investments to date: None disclosed

Maples Investments

Mike Maples

Based: Palo Alto

Amount Raised: \$15 million

Investors: Ten individuals, mostly those who know

Maples through the company he co-founded and took public, Motive

Focus: Seed-stage investments in Internet companies

Investments to date: Digg, Revision3, YuMe Networks

KPG Ventures

Vince Vannelli

Based: Lafayette

Amount Raised: \$10 million

Investors: Vannelli,

Adams Street Partners

Focus: Seed-stage investments in Internet companies

Investments to date: Doppelganger, Abazab, Ludic Labs

Source: Mercury News research