

Something Ventured, Something Gained

CIOs and venture capitalists are back together. VCs are eager for CIOs' insights on startups. CIOs get access to and influence over the latest technology.

BY KIM GIRARD

ROGER SIPPL is a veteran Silicon Valley entrepreneur and executive, well known as a founder of CRM software company Vantive and database pioneer Informix. But that was then; now venture capitalists want to know the prospects of Sippl's latest startup, a Web services company called Above All Software. To find out, VC group J.P. Morgan Partners turned to its Technology Council, a group of 20-plus CIOs and CTOs who gathered in Las Vegas last November.

What started as a product pitch turned into a reality check. The Technology Council members weren't shy about letting Sippl know he is ahead of their Web services adoption curve. "We're still dipping our toes in the water," says Enzo Micali, CTO of 1-800-Flowers.com, who was one of the few IT execs present who agreed to give the technology a try.

Tough love, perhaps, but this is the kind of insight from IT leaders that startup companies and their venture capitalist backers crave. Stung by the failure of so many startups after the technology bubble burst, these days VC firms like J.P. Morgan

Partners are relying on CIO advisory groups. The Technology Council guides J.P. Morgan Partners (JPMP) on technology and provides straight talk on whether a portfolio company is selling goods that IT execs want to buy.

In exchange for their wisdom, CIOs get a first peek at new technologies and, if they choose, a chance to work with a startup and shape the future features of its product. "It's almost like having your own R&D arm," says Lars Rabbe, CIO of Yahoo. "You get all these startup companies so you don't have to do it yourself."

Besides the insight into new technologies, CIOs who participate in VC-sponsored councils say the chance to connect with their peers is a huge benefit. A CIO thinking of participating in such groups must be careful to avoid conflicts of interest, however, and should make sure that the VC firm knows the CIO's needs well enough so that it doesn't waste his time on irrelevant technologies.

How CIO Councils Work

The specifics of VC-CIO relationships vary quite a bit. There are about 700 venture capital outfits in the United States, ranging from firms that seed-fund new ventures to later-stage investors willing to gamble a lot of money on a company with a product. Though the National Venture Capital Association and other organizations that track the industry can't pinpoint the number of VC-organized CIO councils,

dozens of firms are quietly using the groups as a crucial part of their investment strategy.

Larger firms such as JPMP and New Enterprise Associates gather their CIO groups once or twice a year in person and more often by telephone. Clearstone Venture Partners, which runs a midsize fund, prefers a more loosely knit CIO group with fewer members and roundtable-style get-togethers. A few venture firms hire CIOs to provide in-house expertise or invest in CIO groups. For example, Rabbe was an executive-in-residence at Clearstone for seven months before taking a job as CIO at Yahoo. Mobius Venture Capital invested in the Feld Group, a consultancy comprising former CIOs who helped revamp the IT departments of Fortune 500 companies such as Delta Air Lines and PepsiCo. The Feld Group, which is now owned by tech-services giant EDS, helped give Mobius "visibility into the world of CIOs," says Bill Burnham, a former managing director at Mobius.

J.P. Morgan Partners, a private equity firm with a whopping \$19 billion in assets under management, held its first Technology Council meeting in January 2003. Since then, the group has grown to 24 CIO members, who collectively represent \$6 billion in technology spending. Two-thirds of the CIOs on the council—including those of Domino's Pizza, 1-800-Flowers.com, Guitar Center and House of Blues—come from JPMP's portfolio companies. (The firm invests in small to midsize companies.) One-third of the council members are "outsider" CIOs, including those from E-Trade, Otis Elevator, Priceline.com and the Vanguard Group.

Council members often hail from former JPMP portfolio companies, such as Kinko's (which was acquired in February by FedEx). Sometimes they have personal relationships with council organizers. Vanguard Group Managing Director of IT Tim Buckley, for example, was a Harvard Business School classmate of JPMP partner Buck French. They are invited on the council to give it more depth and provide an independent perspective.

Initially, the Technology Council was slated to meet in person once a year. But technology changes too quickly to wait that long—particularly if his company wants to stay ahead of investment trends, says French, an entrepreneur-turned-VC who was the group's founding father. "We had a conference call about Linux [last year] and the CIOs were saying, 'I don't know if the TCO for Linux is there,'" he says. "A year later, a bunch of CIOs are adopting Linux." To keep up with technological change, Will Johnson, who chairs the council, bumped up the meeting schedule to twice yearly and added monthly teleconferences.

VCs view the CIO councils as crucial screeners of new technology, warding them off of costly investment boondoggles. Carl Showalter, a general partner at Lightspeed Venture Partners, says CIOs help him separate startups that he calls "vitamins"—companies with technology he considers more of an add-on feature than a problem-solver—from those that are true pain-relieving "aspirin." VCs are more interested in the latter because it takes them four or five years, on average, to make money from selling a startup or taking it public. The last thing a VC wants is to fund a company with a me-too technology or a product that quickly becomes obsolete.

Enthusiastic approval from CIOs can mean the difference between a startup nailing a \$10 million funding round or disappearing. Evangelos Simoudis, a partner at Apex Partners who coordinates his company's 25-member CIO advisory group meetings, says that Apex's investments in several startups—such as Bristol Technology, a

developer of transaction monitoring software—were influenced by council CIOs from companies such as Bristol-Myers Squibb and Hartford Insurance. "Do these [CIOs] become customers?" Simoudis asks. "Yes."

What's in It for CIOs

During Technology Council meetings, JPMP introduces the assembled CIOs to technology startups it helps fund, both to get feedback and to give the CIOs a chance to follow up if their interest is piqued. Johnson says he won't waste the CIOs' time with a pitch that doesn't offer something of value. "We've earned the trust of these [CIOs]," he says. "Our filter is very high. We spend enough time with them to understand to a pretty strong degree what's important to them." For now, JPMP is eyeing investments in security, Web services, wireless computing, supply chain management and networking.

No matter how much work the venture partners put into screening the companies that appear before CIO councils, however, it's ultimately up to IT execs to decide whether to purchase new technologies. Many CIOs are conservative, particularly in the aftermath of the dotcom bubble. Others find startups—particularly embryonic companies—a risky proposition.

At 1-800-Flowers.com, Micali wanted to find an easier way to manage data from the company's many product lines. The company sells plants, gift baskets, toys and many other items online, in company-owned or franchised stores and through catalogs. Micali is hoping the Web services software from Above All (which is backed by JPMP and other VC groups) will help integrate orders that come in through call centers—not only within 1-800-Flowers.com but also from its acquired brands such as HearthSong and the Popcorn Factory. Micali also wants to be better prepared to tackle integration challenges that crop up during future acquisitions. "I don't want to reinvent the wheel every time we acquire a company," he says.

Louis Gasparini, senior vice president of Internet systems development for Wells Fargo, sits on a CIO council organized by Outlook Ventures and works regularly with several other VC firms. He turns to startup companies when large technology vendors don't have what he needs to solve problems, such as removing bugs during software development, improving network performance or service levels or tracking Java development. "What are we supposed to do, build it ourselves?" he asks rhetorically.

Today, Gasparini is working with, among other startup companies, Euclid, which sells software that tracks network downtime, among other features. The relationship with Euclid succeeds for several reasons. First, Euclid's technology is unique, Gasparini says. Plus, "if Euclid goes down, it's not going to get Wells into the paper," he says. Finally, he says there's no way the bank would have received from a large company the special attention, training and time that Euclid spent with his staff. "When you work with startups, you work with the founder, who transfers knowledge to our staff," he says.

CIOs who take part in the VC councils say the gatherings are a surprisingly candid forum for airing problems, mulling over new technology and discussing management issues such as employee retention. "There are only certain people you can share with," says Micali. Adds E-Trade CTO Josh Levine, who sits on a few VC councils, "It's a forum where there's no pressure, and you really get a chance to have real

communication between your peers."

It was Levine rather than a venture capitalist who turned Micali on to Linux. At the JPMP Technology Council meeting last November, Micali chatted about the pros and cons of the open-source operating system with Levine, who has become something of an expert on Linux from his experience deploying it in his data center. Intrigued by the idea of using it in his own data center, Micali and three staff members later visited E-Trade's headquarters in Manhattan to huddle with Levine and his crew. "He got me pretty juiced about Linux," Micali says. "Based on those discussions, it is something I am now taking a hard look at."

Wise Counsel for CIO Councils

The VC-CIO link became notorious for the wrong reasons in the late '90s, when reports surfaced that some IT executives received stock or stock options, free or deeply discounted products, and other perks from startup companies they purchased from. In the current ethical and regulatory environment that's placing greater scrutiny on financial moves of all corporate executives, however, even a whiff of impropriety can be damaging.

New Enterprise Associates (NEA) partner Harry Weller says selling isn't an issue during his group's council meetings because the company doesn't use that time to trot out its portfolio companies to CIOs. "We generally keep the discussion at a higher level than that," Weller says. "We don't do an NEA companies pageant."

Gary King, CIO of Barnes & Noble and a member of Apax's CIO council since April 2002, hasn't had a negative experience with a venture capital firm. "Apax doesn't push stuff on us," he says. For instance, King is running a Wi-Fi hotspot trial in Seattle with wireless startup Cometa Networks. Apax is an investor in Cometa—but Barnes & Noble came across the startup on its own while investigating wireless companies, not because someone at Apax foisted the company on them. Besides, he says, all buying decisions at Barnes & Noble go through a formal vendor solicitation process, which doesn't allow much room for side deals with startups. King says that if he is unsure about a deal, he gets an opinion on it from the company's legal department.

There are no fees to join VC-sponsored CIO councils. Membership in JPMP's Technology Council is purely voluntary, French says. Like other VC firms, JPMP covers costs related to CIO group meetings, but the CIOs pay their own travel expenses.

It's up to the CIOs themselves to decide how much information they share about their companies at meetings—especially if they end up sitting next to a rival, which can happen on some of the councils. But Intel CIO Doug Busch, who sits on several advisory councils, says, "CIOs are pretty open about sharing their challenges. We're all cautious about the competitive strategies of our companies, but there's an enormous willingness to share issues and be candid."

Busch says that for CIO councils to work well, the VCs need to be willing to spend the time to get to know CIOs and their companies. At big corporations, IT can be a byzantine maze. Busch says that oftentimes VCs and startup companies alike don't quite understand how Intel operates, which prevents them from effectively forging the right relationships and getting their technology in front of the right people. As a

result, all sides lose.

Scott Russell, a partner at Diamondhead Ventures, says he understands the importance of speaking CIOs' language—perhaps because he was a worldwide technology manager before he became a VC. "A lot of VCs talk to CIOs, but if you don't have an appreciation for their job, it's sometimes a hard conversation," he says. "Most VCs throw a new company over and say, 'Why don't you take a look at this?' But the CIOs get swamped." To use a VC-sponsored CIO council effectively, "you really have to understand their business," says Russell, who says he has run CIO councils in the past and plans to start one up again.

Not all CIOs are convinced of the usefulness of VC-sponsored CIO councils. "It's too early to tell how successful the [JPMP Technology Council] will be," says Mark Laughlin, CIO of Guitar Center. "I'm not quite sure if they can provide the information and networking or the exchange of information or workgroups that will make our time valuable." What does Laughlin want? To talk with the "best and brightest" about things that matter to him: vendor consolidation, the economy and Sarbanes-Oxley, which he believes creates a big problem for CIOs. Laughlin, who holds an MBA and an accounting degree, is more interested in solving the business problems related to his job than finding the latest whiz-bang technology. "I don't have time to mess around," he says. "I want to get value for my time invested."

Nonetheless, Laughlin has thawed to the occasional VC vendor pitch. J.P. Morgan Partners has a stake in a company named ProfitLogic, which helps retailers optimize product pricing. Laughlin thinks the technology could help Guitar Center do a better job of analyzing profit margins, pricing and modeling so that the company's stores can better manage stock and lead times on orders.

Laughlin met with ProfitLogic in January. For J.P. Morgan Partners, it's another potential match accomplished.