

## **SOMETHING VENTURED: More Startups Try Bootstrapping**

**By Mark Boslet**

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PALO ALTO, Calif. (Dow Jones)--A new crop of technology startups is growing up the way companies did before the Internet boom: on a shoestring.

Robert Robinett's Modulus Video is one of them. "For two years, there were no salaries. We were paying for the privilege of coming to work," says Chief Technology Officer Robinett of nursing his Sunnyvale, Calif., company through its first 2 1/2 years. "That's the way startups used to be done."

It's also the way they are being done again. Entrepreneurs and venture capitalists across this high-tech Mecca say they are seeing a resurgence of companies "bootstrapping" their way into existence.

Many live on a founder's bank account or an over-used credit card. They buy second-hand servers, operate out of home offices and defer paying salaries. By some observations, they are more numerous than 10 years ago, before the boom years lowered the cost of capital.

Whether these independent entrepreneurs will change the landscape here, no one can say. But already they are providing fertile investment opportunities for venture capitalists who have been reluctant to put money in the youngest, most risky of companies.

"It's a definite change" in the landscape, says Philip Korn, senior relationship manager at SVB Financial Group in Silicon Valley. "Many of these companies are launching for under \$100,000. (And) a good portion of them are VC allergic."

SVB Financial Group says it now has banking relationships with 1,500 bootstrapping companies in the San Francisco Bay Area, up from 1,100 at the end of 2002. Korn's own office opened accounts for 215 in 2004, a 43% increase from 150 in 2003. He expects to do more than 200 again this year.

"I think there are a lot of companies that are trying to hold off venture funding and look to bootstrap," agrees Brian Zanghi, chief executive of Pragmatech Software, a company founded in 1994 and funded by VCs nine years later in 2003. "I think it's a control issue."

By avoiding an initial round of funding, such as a seed round, entrepreneurs can hold onto more of their companies' stock. "You build some value on your own," says Heidi Roizen, managing director of Mobius Venture Capital, and avoid some of the dilution venture money brings. However, the growth in bootstrapping has as much to do with the ability of startups to do more with less. Money goes further now with the availability of cheap hardware, affordable office space, the Internet, new communications technology, freely distributed open-source software and the cost savings of outsourcing software and chip development to less expensive labor markets overseas.

It's not uncommon for a startup to spend \$10,000 to \$15,000 on servers - back office computers that host database and business programs - instead of the \$100,000 it would have forked over not that many years ago. Good-size offices in Silicon Valley can go for \$2,000 a month, one tenth of what they would have cost at the height of the dot-com bubble. Frugal entrepreneurs hold teleconferences and conduct virtual meetings on the Web instead of travel.

Many founders who grew up in other countries or who have ties to engineers in other countries also outsource. Software work can be done for \$10,000 to \$20,000 offshore in places such as India, China, Russia, Israel and Sri Lanka.

In addition, entrepreneurs are taking advantage of a more mature Internet. Avail Inc., for instance, is using the Web to distribute its software at a lower cost. Potential customers download the product, evaluate it for a few weeks and even receive online support. When customers want to purchase, they fork over money for a license.

"Leveraging the Internet allows people to take less money in the early stages," says Chief Financial Officer Craig Randall. This was "not possible a few years ago."

While startups have been better able to stretch their resources, they also have faced a difficult funding environment. In 2002, 2003 and 2004, venture investors had little appetite for early-stage companies, struggling instead to keep existing portfolio businesses alive.

Even when the economy began picking up last year, early stage investing continued to lag. VCs had better choices in front of them. Instead of investing in startups with a year or two of product development ahead, partners could put similar sums in companies that had weathered the downturn and now needed money. In many cases, the businesses had products and, sometimes, revenue or \$10 million or more.

That kept seed- and first-stage investing to 21% of dollars placed in 2004, similar to where it has been since 2002, according to VentureOne, a division of Dow Jones & Co. (DJ), the publisher of this newswire. Seed and first-stage deals were more than 33% of annual investments in 2000. Venture capitalists say that in reaction to the runaway spending of the late 1990s, they are demanding more of young companies. "VCs ask entrepreneurs to show more of what they've got," says Bart Schachter, managing director of **Blueprint Ventures**.

Schachter led a \$6.5 million round of funding for Irvine, Calif.-based WiSpry Inc. in February after the company had bootstrapped itself for a year. The wireless semiconductor company had been existing on Chief Executive Jeff Hilbert's bank account and \$119,000 from customers. It had not paid salaries to its seven employees.

Schachter said the year of bootstrapping made investing easier by validating the technology and customer demand.

Appealing to VCs was equally challenging for Modulus Video. "We couldn't find funding," says Robinett. Bootstrapping was the alternative. For months, the company was a part-time effort, then an operation run from home. Only in 2003, the year the firm incorporated, did Modulus Video move with eight employees into an office rented for \$100 a month.

"We brought in old chairs from home" and spent about \$10,000 on computers, tables and phones, he says. After more than three years of effort, Robinett secured \$8.5 million in a round of funding led by Trinity Ventures and now is looking for a series B. The company needed the money to begin manufacturing its hardware, which allows high-definition video to move faster over phone lines and satellite networks.

Avail's Randall says the idea of seeking venture money is "something we constantly kick around. The longer we can go without negatively impacting our growth, the better the financing terms will be."

So far, the extra cash has been unnecessary. Avail has been living on less than \$1 million put up by a group of founders, including Randall, Chief Executive Chuck Shavit and Ron Lachman, who isn't an employee. It launched its first product six months after being formed in 2002 - the software keeps documents up to date and had been under development before the company's founding - and now has more than 300 customers and revenue growth of 50%.

"Bootstrapping forces you to get a product out quickly," says Randall. With no money to spare, "you have to."

"There's some very creative bootstrapping going on," says Roizen. The Internet boom generated a lot of wealth in Silicon Valley. "People have money," and experienced entrepreneurs are putting it to work, she says.