

The Web: Founder sales flourishing

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During the late 1990s and into 2000, every Internet entrepreneur had the same dream: Start an online company and launch an Initial Public Offering on Wall Street a year or two later, becoming fabulously wealthy in the process.

Fast-forward five years and though the dream remains, parts have changed, experts told UPI's The Web.

Venture-capital spending remains flat, expected to be \$21 billion this year, the same as last year, according to a joint survey by PricewaterhouseCoopers, Thomson Venture Economics and the National Venture Capital Association, and IPOs have not yet returned to their past peaks.

So, many online entrepreneurs have found a new way to cash in on their projects. The founders of companies such as eHarmony.com, the online dating service, and others, such as Fastclick.com and OptionsXpress.com, are selling stakes in their firms for cash. Because the sales add capital, not only to the firm's coffers, but also to the pockets of the founders, these transactions are called founder sales in the technology-investment trade.

"What we're seeing is founders reaching out for 'partial liquidity,'" said C.J. Fitzgerald, with Summit Partners, a venture-cap firm in Palo Alto, Calif., with about \$9 billion in technology investments. "This is for companies that have been bootstrapped, and have been very successful, but the entrepreneurs are taking some money off the table now."

This is good for the companies, Fitzgerald said. They and their founding employees often invest 100 percent of their savings at startup. By giving up a share of their firm for cash, some of which they retain, they generally can feel more confident and perform better in their jobs -- and take the company to the next level of performance, experts said. It enables tech-firm founders to wait for the IPO market to recover, but still get rich in the interim.

"The idea of paying out founders from venture investment is a rapidly growing trend, but only makes sense for companies that used relatively little money to build their business," said Javier Rojas, managing director of Kennet Venture Partners in Menlo Park, Calif. "Most of these deals still leave the founder with a big stake if they are active with the business. Founders that are no longer active often can sell their whole stake in these deals."

OptionsXpress.com in Chicago, which Fitzgerald called the "eTrade of options" -- specialized financial derivatives used to minimize risk by institutional investors -- held a founder sale about a year ago, and the extra money "helps the executives make better decisions for the company," he explained.

Earlier this year, after a seemingly long wait, OptionsXpress.com went public with a spectacular IPO on Wall Street and now is reporting about \$100 million in annual sales.

Another firm that followed a similar strategy is called mAudio, a maker of digital audio products for musicians who create virtual studios at home. Investors took a minority share of the firm and provided cash to the founders, in addition to working funds.

"This was one of the fastest growing companies in the music business," said Fitzgerald.

Eventually, the firm was purchased by Avid, the TV editing software and hardware company.

Another expert in these types of investments is attorney Dirk Michels, a partner in the San Francisco office of Kirkpatrick & Lockhart Nicholson Graham, whose practice focuses on technology companies here and in Europe.

Michels said he did not see this trend at the early stage investment, where so called "angel investors" come in to small startup firms. Rather, it appears to be one for latter-stage technology companies. In many ways, Michels, a native of Germany, sees the founder sales as an "investment buyout."

That is not the case, however, Rojas argued.

"For these companies, the founder owns much of the equity," he said. "When the company becomes valuable, they can raise capital, for the company, and at the same time, get some liquidity and reduce their risk."

It is the new way to get rich for technology entrepreneurs today.

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