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Berkeley, California

REID DENNIS

EARLY BAY AREA VENTURE CAPITALISTS: SHAPING THE ECONOMIC AND BUSINESS LANDSCAPE

Interviews conducted by
Sally Smith Hughes
in 2009

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Reid Dennis

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In 1974, backed by a $5 million commitment from American Express (his former employer), Reid formed Institutional Venture Associates (IVA) and raised $19 million from six institutions. That was roughly half of all the capital raised in the United States that year by private venture capital partnerships. Over the life of IVA, the original $19 million grew to over $180 million. In 1980, Reid then formed Institutional Venture Partners (IVP) and the firm has grown into one of the most successful venture capital and growth equity firms in the industry.

With more than a quarter century of investment history, IVP has backed many well-known companies such as Altera, Ask Jeeves, Aspect, Atmel, Borland, Cirrus Logic, Clarify, ComScore, Concur, Exabyte, FormFactor, Foundry Networks, Juniper Networks, LSI Corporation, Netflix, Polycom, Seagate, Synchronoss and Tivo. The firm's recent exits include ArcSight (ARST), Business.com (RHD), ComScore (SCOR), Danger (MSFT), MySQL (JAVA) and Quigo (TWX). We are constantly seeking market leaders in emerging growth markets and look forward to helping talented management teams build the next generation of global technology leaders.

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01-00:00:00
Hughes: It's January 13, 2009!

01-00:00:04
Dennis: Right.

01-00:00:05
Hughes: Happy New Year. Let's start back with your family.

01-00:00:11
Dennis: One week from a major change in our country's well-being.

01-00:00:14
Hughes: That's right. I know. That's quite a historic transition.

01-00:00:18
Dennis: Yeah, and it is. All right.

01-00:00:22
Hughes: Tell me about your parents and where you lived and what it was like growing up in that family.

01-00:00:30
Dennis: Family background. Well, starting with my grandparents—my grandfather's name was Chester Weaver, and he came to California, I think, in 1898. They lived in La Porte, Indiana. My mother was eleven at the time of the San Francisco Earthquake in 1906, so that would indicate that she was four or five years old at the time that he first came out here—five or six years old. They came out to visit, and his brother worked for the Studebaker Company in San Francisco. Studebaker had factory branches that were owned by the factory. Of course they were selling horse-drawn wagons, and Studebaker's big business, which grew up during World War I, was in military wagons drawn by horses. A lot of people don't know that John Studebaker actually started in Placerville, California. Did you know that?

01-00:01:49
Hughes: No. I certainly didn't.

01-00:01:50
Dennis: He started in Placerville making wheelbarrows for the miners! And he did better than a lot of the miners did looking for gold. They all needed wheelbarrows, and so that's what got John Studebaker started, and then he went back to South Bend, Indiana and got into the wagon business, and so forth.

Well, my grandfather's brother said, "Chester—how long are you going to be here? You're just visiting." And Chester allowed that they might stay two or

three months. “Well, what are you going to do, Chester? You can’t just sit around the house for two or three months. We’re going to put you to work!” So he put him to work in the wagon business while he was here and then later on they moved to California. I don’t know just exactly when they moved, but shortly thereafter.

And then the brother got sent up to Portland, Oregon, and Chester Weaver found that he was in charge of the Studebaker branch in San Francisco. He used to tell me a story which was really sort of a very interesting story. He had a friend back in La Porte who was starting a business. The friend said, “Chester, you know I really need some financing and I’d like to sell you half of my business.” And Chester said, “Well, how much money is half of your business going to take—how much would it take to buy half your business?” And his friend said, “Well, how much do you have?” And he allowed that he’d saved $13,000 working in his father’s bank. And $13,000 in the mid-1890s was a lot of money. And his friend said, “Well, that would be enough. That would be enough.”

Well, the friend’s name was Harvey Firestone. But my grandfather didn’t do it. And he decided not to do it, and he used to tell me later on, he said, “You know, Reid, if I’d done that we would have had to live in Akron and instead we came to California and I’ve had a wonderful life out here and just have loved California. So he and Harvey Firestone remained very, very close friends as long as they were both alive. But I remember that $13,000 number because it’s sort of critical.

Then my mother and father were married, I think, in 1916. My father had worked for General Electric; he was an electrical engineer. But after he married my mother he left General Electric and went into the automobile business. My grandfather said the biggest decision he ever had to make was when Studebaker divided the highly profitable wagon business and the highly unprofitable automobile business into two sections, and you had to decide which one you were going to go with. He wrestled with that and finally decided he was going to go with automobiles.

01-00:05:27
Hughes: Do you know why?

01-00:05:30
Dennis: Well, I think he went with automobiles primarily because it was the new thing. And he had maybe more vision than some others. If you take a look—I have some interesting tapes that are the words of Harvey Firestone but narrated by somebody else. Harvey Firestone talks about the fact that the New York bankers thought that the automobile was a fad that came over from Europe—that the automobile was really not going to survive in the United States—that the horse and buggy was a much more reliable proposition. So these companies had a lot of trouble getting financing back in those days.

Firestone had a tremendous amount of trouble getting financing. And it's hard—we're so married to the automobile today, it's hard to imagine it.

But at any rate—and then as Studebaker got more and more involved with World War I and the wagon manufacturing for that, they decided to get rid of their factory branches, so they sold—I don't know what the arrangement was, but at any rate, my grandfather ended up buying the Studebaker distributorship for California, Oregon, Washington, and Honolulu—the Hawaiian Islands and the Far East—so he had a big territory. My father died when I was seven. I really do not have any recollection of my father at all.

01-00:07:26
Hughes: But he was an engineer?

01-00:07:30
Dennis: He was an electrical engineer. And my grandfather, who did not go to college, sort of took me under his wing and we were very, very close. They lived about seven blocks away from us in San Francisco. I was born in San Francisco; I was raised in San Francisco and we lived close by. They had an Irish cook who made absolutely wonderful pancakes on Sunday morning. So I would get on my bicycle on Saturday, late afternoon, and run over to their house, stay overnight, so I could join them for pancakes the next morning and then we often would go driving on Sunday, down the peninsula here. He loved to keep track of things that were going on. But he sort of drilled into me that I was going to go to college and I was going to become an engineer. This was back in the days when you did what your parents and grandparents told you to do.

01-00:08:48
Hughes: And why did he pick engineering? Was it because his son had done that?

01-00:08:53
Dennis: No, no, it would be his son-in-law that was an engineer.

01-00:09:01
Hughes: Oh that's right.

01-00:09:01
Dennis: Sure, it'd be his son-in-law that was the engineer. No—he was a very conservative individual, as a lot of people were at that time. He was scared to death of Franklin Roosevelt and the New Deal, and he said, "Reid, about the only thing that we can leave you that they can't take away is a good education." He said, "I want you to go to college and I want you to become an engineer and then I don't care what you do. You do whatever you want with your life, but you always will have your engineering to fall back on and they can't ever take it away from you. That was the philosophy at the time.

Well, you know, I got my first electric train when I was seven years old and I loved playing with electric trains. I liked modifying them; I liked coming up with new circuits. I would take them apart, and I can remember they came out

with a new reversing mechanism for Lionel trains. I had some old engines that didn't have this automatic reversing in them, so I went down and I can still remember—I think it cost me $2 to buy the little relay mechanism that was installed in the newer models. So I bought one of these things—I went home and took a couple of trains apart, took the one apart that had this in it and took the one apart that didn't have it in it and was able to match up the wires and put it all back together again, and by God it worked!

And I can remember in high school I used to sit in—well, I was heavily influenced by the San Francisco World's Fair in 1939-1940 because the Santa Fe Railroad had an absolutely magnificent display of model trains going around and around in one of these—it was much nicer than the Southern Pacific display, but the SP display was all right too—but the Santa Fe display was huge. And in these day, I was now—what, thirteen years old or so, and in those days you could—I could walk down to the street car, take the street car down to the Ferry Building as a thirteen-year old and get on the ferry boat. My mother would say, "Just be back by six." And I'd go over and spend the whole day at the World's Fair all by myself. There was no concern about safety of young people or anything like that.

I would spend most of my day alongside the Santa Fe exhibit watching these trains go by. It was a panorama of the western scenery that you might run into in New Mexico and stuff. These trains went around and around and around, and I watched the little three-color light signals change from green to red and then back to yellow and then back to green, and then the next train would come by and it would go to red.

Once I got into high school I spent a lot of my time in study hall sitting there with a pencil designing new signaling circuits for electric trains. So I always had this sort of—

01-00:12:45
Hughes: I can see that. Let me ask you—with your father dead at a young age—what happened to your mother in terms of supporting the family?

01-00:12:56
Dennis: Well, my grandfather took very good care of us, and she owned a building in downtown San Francisco called the Physicians Building on Sutter Street that gave her some income and it was primarily—I think the family was very fortunate to have the financial resources to get through the Depression without any serious problems. I had an older brother and an older sister, so there were three of us in the family. My mother never remarried, but really it was, I'd say, the automobile business and my grandfather's work at that that supported us through the Depression.

One of my favorite keepsakes or mementos is a pocket watch that I have with a very nice chain that I only get to wear when I'm all dressed up in black-tie

or something. Just before my grandfather died, when I was over at his apartment and he called me and he was in bed, he called me in and he was perfectly lucid, but he said, "Reid—I've got two watches here, and I'm going to give you your choice of them, and I'll give the other one to your cousin. And one of these," he said, "this one came from the Studebaker Company after twenty-five years of service." And he says, "It's probably the better watch. But the other one came to me from the motorcar dealer's association and it's inscribed in the back 'in 1922, upon his completion of ten years of active service as an officer of the association.'" He said, "This one was given to me by my competitors and it's always meant a great deal to me." So I have hung onto that watch. [with emotion]

So obviously, as you can tell, I was very close to him, and as we say, we did, in those days we did, generally, what our parents and grandparents told us to do most of the time.

01-00:15:55
Hughes: You said you have an older brother and sister. Had your grandfather more or less picked you out as the one to try to inspire?

01-00:16:07
Dennis: Right. Well, my older brother was a little bit more of a loose cannon and he did go to Stanford. I think he may be the only person in history that's been kicked out of Stanford three times in a row! [chuckling] He either bowled his way out twice and skied his way out once or else he skied his way out twice and bowled his way out once. He loved the sports and stuff, but he was not a very good student, but he was a very charming guy. My sister did go to Stanford and completed the four years and was happily married right at the end of the war and happily married for a long, long time. But they are all gone now.

I think that my grandfather took a special interest in me—number one because I was there at what he considered to be an impressionable age. And I loved those pancakes, so I'd get over there frequently. It freed up my mother to do whatever she wanted to on Saturday night and Sunday and stuff, so she liked the idea. She spent a lot of time working for things like the infant shelter in San Francisco and other good works like that.

01-00:17:52
Hughes: Where did you live in San Francisco?

01-00:17:56
Dennis: Well, we lived on Locust Street in San Francisco and just very near Laurel Village, but over the hill so I could look out over the San Francisco Presidio and see the Bay and Alcatraz, and I could watch the ships come and go in and out of the Golden Gate. We had a house that was four stories and my playroom was on the fourth floor, so I had this big, huge window looking out

the room—it was a very large room and it was filled with electric trains, but one end had this big window.

But my grandfather would call me and sometimes on the weekends the dirigible [USS] Macon, which was stationed down here at Moffett Field would be floating over the city, and so he'd come over and grab a hold of me and we'd get in the car and we'd go chase the Macon around from hilltop to hilltop, watching this wonderful, wonderful dirigible fly over the city.

And then his friend—Moore, I can't remember—Moore Dry Dock Company—I'll think of it—I'll call you at about midnight tonight and tell you his first name! But at any rate, a friend ran the Moore Dry Dock Company and he'd call him when they were building the Bay Bridge and he'd say, "Chester, we're going to be lifting sections up off the barges this afternoon," at such and such a time. They pre-fabbed a lot of these big sections of the Bay Bridge at Moore Dry Dock over in Alameda and Oakland and then would float them out there at slack tide or ebb tide, whenever it was when the tide wasn't moving very much, they'd send cables down and hoist these things up in to position on the Bay Bride.

Well, we would—my grandfather would grab me and we'd go down and we'd go up to the top of that hill by the bridge where the big apartment house now stands. It used to be—well, it used to be just a vacant hill and then Union 76 put up a big tower; for a long, long time it was there, just an advertising tower. Well, we'd go sit up on top of that hill and watch this process.

So he just—sometimes we'd come down the peninsula to see how much water was coming into the Spring Valley lakes because they'd just opened the aqueduct from Hetch Hetchy, and I think we were there for the opening ceremony at the Pulgas Water Temple. He just was interested in those sorts of things, and so he would get me involved in it.

01-00:20:57
Hughes: Was it a given, with two siblings, that you would go to Stanford?

01-00:21:03
Dennis: Almost—it really was, in that my mother's two closest friends were Don [Donald B.] and Mary Tresidder, and Don Tresidder was president of Stanford. Mary Tresidder was Mary Curry of the Yosemite Park and Curry Company and Don Tresidder was president of the Yosemite Park and Curry Company.

During the war, 1942 and '43, the summers of '42 and '43, all of the eighteen year olds were off to war and it was the first time Yosemite Park and Curry Company had allowed sixteen year olds to work during the summer. They needed summer help up there, obviously. And so, in effect, I got my first job from Don Tresidder, and I worked at the stables during the summer. I worked on the burro picnic. It was a wonderful division of labor—there was a young

woman there that—her job was to take of the kids on the burro picnic and my job was to take care of the burros on the burro picnic. And so that's the way we worked, but rode a horse and took them down the valley to this picnic place and then—it was a great summer. And the same happened both in '42 and '43.

And then in May of '44, I became eighteen and the navy—this carries on part of the training—the navy—I wanted to volunteer for the navy and you had to volunteer before you were eighteen, or else once you turned eighteen you were subject to the draft. But if you were going to volunteer for one of the other services, you had to do it before you turned eighteen. The navy had a test called the Eddy Test. They badly needed radio technicians and radar technicians, although we didn't really even know about the existence of radar in those days, but they called us radio techs. You could take this test before you turned eighteen, and if you passed it, the navy would say, "Young man, if you volunteer for the navy, we will, number one, we'll let you finish high school, so you can go back and graduate," which was only about three or four weeks in my case. But "Number two, we will guarantee you that if you come into the navy you will go into radio technician training." And we went in with the rank of, I think, first class seaman, which was a step up. Anyway, I passed that test and so I went—

01-00:24:27
Hughes: What was it? Physics and mathematics? That sort of thing?

01-00:24:31
Dennis: Yeah, physics, mathematics, and particular spatial relations. I rate very, very high in spatial relations. If you give me a whole train of gears and you tell me you're going to turn this one one way, I can tell you which way this one is going to go. I can figure it out. I'm not clairvoyant, but—

01-00:24:48
Hughes: Do you think that's from your railroad {unclear}—

01-00:24:52
Dennis: It's from interest in mechanical things. It's interest in mechanical things, and I have a very good friend in the venture business who said, "Reid, you really should have been a mechanical engineer, not an electrical engineer." Well, I don't know about that, but I love, not mechanical things—I love innovation! You know, and I love—it's absolutely fascinating to study the whole field of innovation. In some of my talks when I talk to young people I say, "Number one, you should realize that innovation is nothing new." And I wait for that to sink in for a while, because of course innovation is something new! It is and it isn't, but there's a wonderful double entendre there—but I've often claimed that innovation goes back a long, long way. I think that Adam was the first innovator, when he picked up the fig leaf.

01-00:26:03
Hughes: Maybe Eve handed it to him.

01-00:26:05
Dennis: Well, I don't know—I wasn't there. [laughter]

01-00:26:08
Hughes: Just a thought.

01-00:26:11
Dennis: But at any rate—could be, but nevertheless, it became Adam's innovation, I think. And it's wonderful to go back and study the innovations of George and Robert Stephenson in England, as steam came along. It's absolutely amazing to me that with the first steam engines that were developed in England, they used to heat up the boiler and get the steam to get the piston moving in one direction and then they would spray cold water in there in order to get it to move in the opposite direction. Well, if you can think of a more inefficient thermal situation than that, I can't imagine what it is. And then Stephenson came up with this idea of putting a valve on the outside that would allow you to introduce some new steam on the other side of the piston. So there are all sorts of innovations and it really is sort of fun to try to explore these things and figure out is there a newer and better—is there a different and better way of doing it? So it's—no matter what it is.

01-00:27:38
Hughes: I would think that your grandfather had something to do with this, by taking you places where new things were happening.

01-00:27:44
Dennis: Well, he—he did. He took me to Detroit. He became a Ford dealer in 1935, and 1939 or 1940 on our way to the New York World's Fair we went to Detroit. He was a very—at one stage of the game he was the largest Ford dealer, prior to the war, he was the largest Ford dealer on the Pacific Coast. So he was well received at the factory and [brief interruption]. Okay—anyway, where was I—what was the last thing I said?

01-00:29:00
Hughes: Oh, you were talking about innovation and then your grandfather, the large—

01-00:29:18
Dennis: Oh yeah, and when we traveled—yeah—we went back with him to Dearborn and visited the Ford factory. They gave us an escort and a car and, God—we went all over the River Rouge Plant, including the steel mill and everything else—you know, you go down into the steel mill and see these huge hot ingots. It's things you couldn't do today—there's just no way you can do them today.

But he loved that sort of thing and he had a couple of good friends back there that were—Carl Breer and Fred Zeder, who were two partners with Walter Chrysler, and the three of them had started the Chrysler Motor Company.

Chrysler was dead and gone, and I don't think that my grandfather was ever a close friend of Walter Chrysler, but he was close friends with the Zeders and the Breers, and they had these absolutely magnificent houses out at Grosse Pointe with huge lawns that went down to the Detroit River and a dock and a boat sitting there. It was a pretty heady life and I know—I can still remember that after that visit there, my grandfather said, "Well, Reid I have some friends who've made a lot more money than I have made in my life, but they have to live in Detroit." [laughter]

01-00:31:02
Hughes: And that's all right with me.

01-00:31:05
Dennis: And that's okay with me—and they lived quite well out here.

But at any rate, Don Tresidder having given me my first job when I—I think it was Don Tresidder's recommendation that I go to the Thacher School down in the Ojai Valley when they were looking for a prep school. Don took me down and delivered me there, as a matter of fact, because the Tresidders flew a small airplane in the thirties, they had a Waco [Aircraft Corporation], a cabin-class Waco. My mother was scared to death of flying, but any time the Tresidders asked me to fly with them, she'd let me go. And so I loved flying and sitting in the back seat of that airplane.

So I went to Thacher; I was there for four years. There were only seventy-five kids in the school when I was there, so it was a small school. But I think that got me on my feet and focused me on studying in a way that I probably wouldn't have if I'd gone to a larger public high school. There were no girls there, which meant there were fewer distractions at that time. We'd have dances occasionally, where they'd import the girls, but nevertheless, Thacher taught me how to study, how to meet deadlines—a paper is due when it's due, and things like that. I did very well in the math and the physics and the chemistry courses. Those were my strong suits. French was my weak suit.

I did all right in Latin, and it's interesting that at the time I can remember thinking, My God, this is a waste of time. Why are we studying Latin? And yet today—there are still times when you think about sentence structure and things like that, and it is such a structured language. In terms of business things—I know when I worked for American Express I had one fund manager working for me who was a very good investor and a very good manager of the fund, but he'd write a report to be presented to the executive committee and it'd be three pages long, and I'd go through and I'd strike out unnecessary words and redundancies and stuff, and I could boil it down to about less than a page and it'd still mean the same thing.

01-00:34:14
Hughes: So you learned how to write.

01-00:34:17
Dennis: So I learned something about how to write and how to express yourself in the English language, although I may not be doing as great a job today as sometimes.

01-00:34:26
Hughes: No, you're fine. Well, tell me about Stanford. You majored in engineering?

01-00:34:33
Dennis: Well, I applied for Stanford—I graduated from Thacher in '44 so I applied to Stanford to be admitted in the fall of '44, you know, because you didn't know when the war was going to end, but of course, I went in the navy for two years instead. But nevertheless—and Don Tresidder said, "I want to write one of your letters of recommendation." He was then president of Stanford and—[chuckling]

01-00:35:04
Hughes: It probably helped!

01-00:35:06
Dennis: I said, Gee, I'm not at all—I didn't say this, but I think maybe my mother was not at all sure that was appropriate, and she said—and Tresidder's attitude was, "Well, I gave him his first job!" [laughter] And it was very, very important in those summer jobs that you stay through Labor Day—that you not quit a week or two early and leave them in the lurch. And I stayed until the last dying gasps, so to speak, before I had to go back to school. And I was conscientious about what I was doing up there, so—anyway, he wrote a letter of recommendation and I was accepted at Stanford. Of course Stanford was desperate, as all colleges were, for students in the fall of '44. In the fall of '46 when I came back from the navy, Stanford honored that acceptance, so it was just sort of a natural thing for me to do now.

01-00:36:18
Hughes: And then was there a flood of applicants because of the G.I. Bill?

01-00:36:24
Dennis: Oh sure. It started up—but it wasn't an uncontrollable flood. But you know, I think that it'd be interesting to take a look at college enrollments after World War II, because I think that from a philosophical point of view, when you think about government policy and education policy, and you think about investments, I don't think this nation has ever made a better investment than the one they made with the G.I. Bill. After World War II, we educated all sorts of kids at the college level, all sorts of kids from—particularly from the Midwest who never in their wildest dreams thought they were going to ever go to college. But a lot of them passed through California on their way to the Pacific and they never went back to the Midwest, except to visit. [chuckling] But you mean, Gee, you don't have to shovel snow out here? It's pretty good! It's not bad.

But I think that was a tremendous boost to the United States in terms of our economic development because of the way we educated kids. And we're faced with a major problem today in terms of how do we solve that problem. I hope we do it with enough imagination and courage that we do something similar.

01-00:38:05
Hughes: Well, Obama has made a lot out of doing something about improving education so everybody has a chance.

01-00:38:12
Dennis: Well, you know—and he stands, in my mind, he stands as the most outstanding example of the fact that we should educate our kids to the maximum of their ability rather than to the maximum of their financial ability. To the maximum of their intellectual ability rather than to the maximum of their financial ability. I think that's the way we ought to educate kids. If they can get into—I'll have to say, UC Berkeley or Stanford or Princeton or Yale or Harvard—if they can meet the entrance requirements and have the intellectual capacity to do well at those schools, we ought to get them in there and we'll get the best return on our investment.

01-00:39:07
Hughes: I agree.

01-00:39:07
Dennis: It's—being very calloused—it will be a return on investment.

01-00:39:10
Hughes: All right. So Stanford—and your grandfather had pointed you towards engineering.

01-00:39:18
Dennis: Absolutely, yeah—and my interest in electric trains pointed me towards—and then my radio technician training pointed me towards electrical engineering.

Now at Stanford I took a course in wave theory once, I can remember, because that's fairly important in electrical work. I and I can remember I got absolutely lost as to which way the waves were going, so if you can't figure out which way the waves are going, you probably don't have the kind of abilities to be a really creative engineer. So that's what sort of led me in—I knew I wasn't going to be a creative engineer—so that's what sort of led me to the business school after engineering. My whole plan was I was going to learn something about the field of finance, and then I was going to go to work for an electronics company down on the peninsula here and act as the liaison between the financial world and the technical world.

01-00:40:37
Hughes: And was that a new way of thinking? Were there people doing that kind of thing?

01-00:40:45
Dennis: Not really, because after I got out of business school I went to work in San Francisco for the Fireman's Fund Insurance Company. When I interviewed the man that was in charge of the investment department up there, he said, "Reid, we think there's a lot that's going to happen in fields related to engineering, and we think it'd be easier to take somebody who knows something about engineering and teach him something about investments than it would be to take a typical liberal arts major and teach him how to understand engineering."

01-00:41:29
Hughes: Yes.

01-00:41:29
Dennis: And it was interesting at the time—this is 1952 that I got out of school, and I went to work for Fireman's Fund in the fall of '52. If you were a liberal arts major from a good business school, the starting salary was $325 a month. If you were an engineering student with a business school degree and you went to work for one of the companies here on the peninsula, or elsewhere, the starting salary would be $425 a month. That's a big spread. He said, "We're willing to pay you a starting engineer's wage to come and work for us at Fireman's Fund." So for a hundred bucks a month, that extra hundred bucks a month they got *me*!

I can still remember the interview—he said, "If we give you this job, do you think you will still be here three years from now?" Boy that sounded like a long time. That sounded like half of the rest of my life, and I wasn't at all sure that it was going to take me three years to learn about investments and then go get a good job somewhere else. But I sort of bit my tongue and said, "Oh yeah, I'm sure, yes sir, I'll be here for three years." Well, I ended up staying twenty-one years and Fireman's Fund became part of American Express.

But the fellow I worked for named Fred [H.] Merrill, who was—Fred was one of these wonderful guys who would leave piles of responsibility lying around on the floor of his office, and if you wanted to go in and pick up one of those piles of responsibility and go run with it, he couldn't be more pleased. "Be my guest. Take it and do what you can." And the thing that really propelled me into the venture business happened—well, it really sort of came to a climax about a month or so before I went to work for Fireman's Fund.

01-00:43:50
Hughes: But step back a minute, though—what were you hired to do at Fireman's Fund?

01-00:43:57
Dennis: I was hired to become a security analyst trainee.

01-00:43:59
Hughes: I see. And so that's why he wanted this, at least a three-year commitment. He didn't want to train you and have you disappear.

01-00:44:06
Dennis: Sure, but security analysis in those days was quite different than what it later became. But nevertheless, he just wanted, whatever training I got, it was primarily field trips. At that time I would say more than almost anything else it was—we made an awful lot of investment decisions based on our appraisals of the management of these companies and whether we thought they were doing a good job as well as, of course, the markets for their products. You wanted to have good sales and so forth. But it wasn't a really very formal training program. It was more or less on-the-job training—you know, you know, you're going to go make some mistakes and you're going to do some things right and we hope there'll be more of the latter than the former.

01-00:45:09
Hughes: Was this what we would now call today the venture capital branch of Fireman's Fund?

01-00:45:18
Dennis: No, no.

01-00:45:19
Hughes: What was this unit?

01-00:45:20
Dennis: No—this was just strictly investing in industrial stocks. This was—do you hang on to your Westinghouse? Or do you invest in both GE and Westinghouse and Dupont, and going to security analyst meetings and listening to management programs and stuff. But he said, "You know, if you—we're not going to invest in these little dinky companies."

Let me back up for a minute—and get this point across again—because just before I joined Fireman's Fund, I had seen when I was at Stanford in engineering, I'd seen an Ampex tape recorder in an engineering seminar. It was a very early, very crude tape recorder. And I said, "You know—I think—I don't know anything about tape recording but I think that technology is going to be useful for a lot more things than just recording Bing Crosby's voice." And that's what got Ampex started, was Bing Crosby wanted to play golf on Sunday afternoon rather than having to go on the radio, and he had a very popular Sunday afternoon radio program.

Well, none of the recording systems up to that time had enough fidelity to allow him to go play golf on Sunday afternoon. He had to be there in person, so the magnetic tape recording came along and Crosby Enterprises gave Ampex, I think, the order for their first ten machines, just so Bing could play golf. They never became investors in the company, but they did give them the order that got them going. And I said, "I think it's going to be used for more

things than that." I didn't know what all they were going to be used for, but there were some hints that it would be used for some other things.

Well, as I had a chance—about a month before, and that happened while I was in engineering, but about a month before I went to work for Fireman's Fund, I ran into a friend of my brother's in one of the offices on Montgomery Street, and he knew I had been interested in Ampex and he said, "Reid, we're doing a little financing for Ampex." He and his family were heavily involved with Ampex as a private company. And he said, "We're doing a little financing and maybe you'd be—." Well, actually, he thought the man I worked for at the time might be interested in putting some money into it, and as a result of that conversation, I ended up putting the amount that I could afford at the time—it turned out to be $13,000, and I said, "Oh, I recognize that number—$13,000. That was an opportunity missed once before and I'm not going to let it happen this time."

01-00:48:47
Hughes: How had you acquired $13,000?

01-00:48:50
Dennis: It was left over from my college education. My grandparents had helped me get through college and had given me a little bit of a trust fund, and I had—there was $13,000 in there that I could sell some Southern California Edison preferred stock. I didn't control the trust fund, my mother was trustee, but she talked to her investment counselor and they knew some of the people that were involved with Ampex and they said, "Oh that's a good company, now if he's going to—."

At any rate, so I ended up—this financing had a minimum of $25,000 units, but you could split a unit. So I looked at it for my boss and he said, "Reid, I don't care whether I take half a unit or if you want fifteen or whatever, I'll—." He was very gracious and I said, "Well, I think in ninety days I can come up with another $2,000, so I'd like to take 15 out of this $25,000 unit. Well, that $15,000, in a period of about three-and-a-half years turned into something between $800,000 and $900,000. And I just took the whole pile of everything I had and pushed it out on the table.

01-00:50:36
Hughes: How old were you at this point?

01-00:50:39
Dennis: Oh, let's see—in 1952 I had to be twenty-six.

01-00:50:44
Hughes: You were doing all right.

01-00:50:49
Dennis: But I had—twenty-six—by that time I guess I had three kids or four kids. I can't remember which! I got married in the second quarter of my sophomore

year. And we had two kids before I graduated—well, that would be ’52, so—yeah, ’52 and two kids. But at any rate—but that really was my first, what would now qualify as a venture capital investment. [interruption to comment on room logistics]

01-00:51:37
Hughes: But you told me off tape today that there was not that term.

01-00:51:45
Dennis: No, no, no—I’m just saying that—no, it was just an investment in a privately held company, but it was—no that term did not apply in those days, but nevertheless, in today’s lingo that would qualify as my first venture capital investment.

01-00:52:08
Hughes: Yes.

01-00:52:09
Dennis: And it sort of said, “God, this is better than working!” But I still didn’t want to leave Fireman’s Fund. I was having too much fun, you know. And my boss said you know, frankly, he knew I was interested in looking at these small high-tech companies and he said, “If you go on a business trip and you want to go visit the xyz company or the abc company, that’s all right. Be our guest. You can do that. If you visit some of these small companies while you’re traveling, you will learn things that will probably affect our investment in General Electric or Westinghouse, or one of the bigger companies—RCA,” something like that.

It was interesting—there was a lot of common wisdom that said RCA ought to control the magnetic tape-recording business. They never did, you know, Ampex controlled that. And you know, just wait until RCA catches up to them. Well, they never caught up to them. But my objective was still, for some time I was thinking that I’d eventually go back to work on the peninsula, but Fireman’s Fund was very good to me.

What we did was—and I went to work there in 1952—it was 1960 before I finally got—eight years later—that I finally got Fireman’s Fund to make its first, what you would now call, a venture capital investment, and in a privately held venture deal. In those days it was called special situations, and I think that we had, at Fireman’s Fund we had six members of the board of directors [who] were on the investment committee. None of them had an investment background. They were all heads of big corporations and the only one that really understood investments was A. Crawford Greene, who was a lawyer in San Francisco who was very close to one of the big banks in New York and he would opine that this particular bank thought well of something or didn’t think well of something. And that carried a lot of weight.

I can remember one of the officers was—I think he was a senior vice president of the Bank of America, a big guy—I can't remember his name right now {add name? }. He had a fist like a ham hock and he'd come down on the table, "Well, at the bank we're doing this," or that or something else. Well, by talking to the analysts at the lower levels in the bank, we would know damn well that the bank wasn't doing that at all! But nevertheless, the investment committee was a gentleman's club, and if they hadn't heard of—if you presented something to them and they had never heard the name before—

01-00:55:44
Hughes: You mean a company?

01-00:55:46
Dennis: A company, a company name, and they had never heard the name of this company before, it by definition became what was called "a special situation." And special situations were things that nobody knew anything about except maybe some of us at the lower level. And that is what eventually became known as venture capital.

01-00:56:13
Hughes: Meaning special being kind of exceptional situations.

01-00:56:19
Dennis: Exceptional, yeah—exception to the standard practice, because here was this fancy investment committee and none of them knew anything about it other than what they got from the junior analysts who were sitting around the table.

01-00:56:33
Hughes: And was there also the connotation that this was risky?

01-00:56:38
Dennis: Oh yeah. There was—it was risky but it's—the first such investment the Fireman's Fund made was in a company called Recognition Equipment, down in Dallas, Texas. Recognition Equipment was developing a new optical character reader, and they were developing something that was called a page reader. My boss, Fred Merrill, said, "This new device has some real application in the insurance business. It could read claims forms."

And I got all steamed up—well, I heard about this company from somebody in New York, a broker, who said, "Look, Reid, I would like to meet with you after hours because I don't want to take your time during the day. This doesn't really apply to Fireman's Fund, but I'd like to talk to you about how we finance this company," because we'd done a number of other financings in the fifties, in the late fifties. I'll get back to that, but he told me what it was and gave me this big report. I brought it back here; it was Thanksgiving Day weekend.

I took it down to the fellow who was in charge of our data-processing at Fireman's Fund, and he took it home and read it, digested this thing over the Thanksgiving weekend, and came in Monday morning and he said, "Reid, if these guys have half of what they claim they have, this is better than sliced bread." I recognized that sliced bread was pretty good. So with that, the two of us went together and Fred Merrill told the investment committee, "We are going to give this company an order for the first machine that they will produce. And that is going to have such a dramatic impact on the financial condition of this company that we ought to take advantage of it by investing in it at the same time." And that's what carried the day.

01-00:58:59
Hughes: And did Fred Merrill have the pull where these concerned the board members?

01-00:59:06
Dennis: Oh yes, oh yes, sure.

01-00:59:06
Hughes: So what he said went?

01-00:59:08
Dennis: Absolutely, yeah.

01-00:59:09
Hughes: Because would they have resisted without—

01-00:59:11
Dennis: No, no, no, no. They understood the argument and we were only talking about investing, I think, $650,000 was a modest amount, or $600,000, something like that. But we were going to be giving them an order for this big machine, so we might as well put some more money out in the form of investment and we got behind it. Well, that—we later—[technical interruption to switch tapes]

[End Audio File 1]

Begin Audio File 2 01-13-2009.mp3

02-00:00:01
Dennis: Recognition Equipment, in 1960, became the first special situation that Fireman's Fund got involved in.

02-00:00:13
Hughes: Now are you painting the board of directors as not necessarily averse to investment in innovative ideas, but more just untutored? Not knowing enough to decide one way or the other?

02-00:00:29
Dennis: Yeah, I think this board of directors operated in a certain circle, and it was very much of a club and they knew other members of the club. Then here suddenly we were recommending companies that they didn't know anything about. So they were not opposed to the idea—they were perfectly willing to take a chance and they did. It was interesting a couple of years later; Recognition Equipment went public and the stock went up to the point where we had doubled our money.

02-00:01:05
Hughes: So they couldn't deny that!

02-00:01:08
Dennis: Well, no, but they suggested at a meeting—I used to go to these meetings. There was a suggestion at one meeting that, "Well, Mr. Dennis, you've doubled your money in this investment, don't you think you should sell half of it and get our money back?" And I said, "Well, sir, I think it still has more to go." Well, it tripled and—"Shouldn't you sell a third of it and get our money back?" "Well, it still has more to go."

We played this game for a couple of years until the point—and we were supposed to get prior approval from the committee before we sold anything, but one day I came into the office and the price of Recognition stock had gone up to the point where we'd made ten times our money. And I said, "I'm going to sell 10 percent of it and get our money back," [chuckling] which I did! And then I just—without authorization, I sold the 10 percent, got the money back, and then at the next meeting of the committee I reported that I had moved ahead and had gotten our money back out of Recognition Equipment.

Well, that stock went on to become the largest tangible asset the Fireman's Fund had. At the height of the market we owned over $40 million worth of the stock, with a cost basis of a little over a million dollars. By the time we were through, we took out about $15 million in profits, which was pretty good.

02-00:02:45
Hughes: Pretty impressive. Were you making decisions all along? You were watching what was happening to the stock—was it mainly on the basis of share price? Or were you looking at the company in greater depth than that?

02-00:03:03
Dennis: Well, it was interesting, because I actually went on the board. The investment became so important to Fireman's Fund that I actually went on the board of directors of Recognition Equipment, so I was very well informed as to what was going on.

02-00:03:20
Hughes: And when that happens—how did that work? Did Fireman's Fund say, "We've got x dollars of investment in you—you'd better take this young guy and put him on your board?" Was that the way it went?

02-00:03:32
Dennis: Oh no. No, no, no. I was close enough to the company that they wanted me to go on the board.

02-00:03:38
Hughes: Okay, all right. So it was not pressure from them.

02-00:03:40
Dennis: No, no pressure at all, no. No—and I wasn't that young anymore. Remember, this is 1960. I was in my thirties. [laughter] Yeah, I was an old man!

02-00:03:56
Hughes: Old man.

02-00:03:55
Dennis: An old man in the latter half of my thirties. So it's—something like that.

02-00:04:01
Hughes: So that was your first board membership, presumably.

02-00:04:03
Dennis: Yes, it was.

02-00:04:06
Hughes: Did you know what to do as a director?

02-00:04:09
Dennis: Oh I think so, yeah, I think so. It was a great learning experience and I was on that board for nineteen years. I went on the board early on before the thing became a successful investment. They wanted my input.

02-00:04:37
Hughes: So they presumably were relying on you for investment—or were they more for management of the company?

02-00:04:48
Dennis: No, it's a wavy line between those two. It's a fairly porous border. I think that it's one of the reasons why I think it's important for young people who want to go into the venture business to not be in a hurry. I think the venture business is a better business to enter after you've been doing something else for ten years, working at what I call an honest job somewhere else and learning something about management of an enterprise, and learning a specialty, whether it be marketing or finance or something else—or manufacturing. But at any rate that's—

02-00:05:39
Hughes: Well, did you indeed find that your years of membership on that board did have great application for what you were going to do later?

02-00:05:49
Dennis: Oh gosh, yes. [chuckling] It certainly did, because at one stage of the game, we had to look for a new chief executive officer for Recognition Equipment and we formed a three-man executive committee. We didn't have a candidate to become the new CEO, but we knew we had to get rid of the old CEO, so in the interim period, the founding CEO of Recognition Equipment was one of these guys who would, two months before the end of the fiscal year, the company would be in terrible trouble and then through heroic efforts on his part in the last two months of the year, he'd go pull out the whole fiscal year and everybody would be giving him a pat on the back. Well, there's no reason in the world why it had to get into all that trouble anyway, in the first place.

Recognition Equipment was a company that was more interested in trying to solve virtually impossible engineering problems than it was in making money. So we had to get rid of this guy and go on an executive search for a new CEO, and by this time I was—they had made me chairman of the board at REI, and Trammell Crow, the real estate developer, lived, lives—still lives in Dallas, but he [telephone ringing] was on the board. [Trammell Crow died January 14, 2009.]

So it was a great learning experience; it was a fabulous learning experience. Serving for nineteen years, serving on a board of directors, you'd better learn something. But I ended up as I say, chairman of the board, and then when we decided we had to make a change in the CEO, we decided to form an executive committee as an interim committee to run the company and keep the CEO from going wild while we were looking for a new CEO.

At any rate—so we formed a three-man executive committee to run the company. It was—the CEO, Trammell Crow, who was in the real estate business, and myself. And I was made chairman of the executive committee. So I was chairman of the board and chairman of the executive committee. And after the meeting broke up and we walked out into the hall, Trammell put his arm around me and said, "Reid, I don't have time to fuss with this. You've got two votes on this committee." [chuckling] So I was back and forth to Dallas twice a month for quite a long period of time until we found a new CEO who was good for a while and really pulled the company out and got it going, got it going up and up and up, but it went right over the top and back down again, so it was—

02-00:09:22
Hughes: What do you mean by that? Because of his mismanagement?

02-00:09:25
Dennis: He was more interested in growing sales than he was in building a profitable company.

02-00:09:32
Hughes: I see, I see. And were you trying to advise him otherwise?

02-00:09:36
Dennis: Well, this was a pretty strong character. It was pretty hard to do, but at any rate—that's sort of a diversion, but I do think it taught me a lot about—I don't want to get into the personalities on that, but I think it taught me a lot about—I learned a lot about being a board member in that particular experience. I think the other thing that you should know is that having gotten Fireman's Fund into the venture business, and having gotten them into the venture business on a successful basis, REI was—you know, this is probably one of the cardinal rules that anybody thinking about venture investing or special situation investing should always follow and that is to always make your first such investment a very successful one. If you can do that, then—

02-00:10:45
Hughes: And are you going to tell us how to do that? [laughter]

02-00:10:48
Dennis: Well, I don't know how to do it—it was—you've got to be lucky, but obviously my first investment in Ampex was a very successful one. The Fireman's Fund's first investment in Recognition Equipment was a very successful one.

02-00:11:08
Hughes: Did anything surprise you?

02-00:11:09
Dennis: Not really. No, not really.

02-00:11:15
Hughes: You expected it?

02-00:11:17
Dennis: Look—there was a lot of opportunity at the time and there were not a lot of people in this business. There was not a lot of competition in this business. There was not a lot of competition in terms of people funding small little privately held companies. And my arrangement with Fred Merrill was pretty interesting because he knew that I liked to invest in these little dinky things, but he said, "Reid,"—at that time I had gotten to the point where I could invest maybe $25,000, maybe even $50,000 at a crack at that time because of my success with Ampex, and he said, "we're not going to look at investments that small. So anything that's $50,000 or less, you can feel free to invest in."

02-00:12:17
Hughes: Meaning you personally, Reid Dennis.

02-00:12:20
Dennis: Meaning me, Reid Dennis, personally. "And anything that's $250,000 or more as an opportunity, we, Fireman's Fund, want to have a look at it." So we got sort of a $200,000 no man's land in between here, which is the way we avoided the conflict of interest.

02-00:12:40
Hughes: That was smart.

02-00:12:39
Dennis: Yeah, and it worked very, very well. And I made, personally, I made a lot more money than Fred Merrill did in my personal investments, and yet he had an investment background. And some senior officers would be very jealous of that sort of thing and resentful of this—

02-00:13:09
Hughes: Young punk.

02-00:13:09
Dennis: Young punk out here in the investment department who's doing so well, and yet he took a great deal of pleasure in it and said, "You know, I'd rather have a successful investor running my investment department—

02-00:13:21
Hughes: [chuckling] I would think!

02-00:13:22
Dennis: —than an unsuccessful investor. And that's what I heard from visitors who had come to visit him and then he'd send them in to see me.

02-00:13:30
Hughes: So I imagine your reputation as an astute investor was spreading, or was it maybe still {unclear}.

02-00:13:40
Dennis: No, it was pretty good. It was pretty good because we have to, somewhere along the line here we have to back up and talk about what happened in the fifties and sixties on the personal side, because—

02-00:13:52
Hughes: All right. Well, let's do that now.

02-00:13:55
Dennis: Because at that time, from roughly 1955 to 1965, there was a group of us in San Francisco, and we called ourselves The Group, as a matter of fact, for the lack of a better name. It consisted of Bill Bowes, who was then at Blyth & Company, and John Bryan was at Blyth & Company. Bill Bowes later went on to form U.S. Venture Partners. John Bryan became a partner with Bill Edwards in a company called Bryan and Edwards, but Bryan and Edwards was primarily investing their own money and their own financial resources. Bill Bowes went out to U.S. Venture Partners and raised a lot of money from the outside.

02-00:14:54
Hughes: Now how did that group come together?

02-00:14:57
Dennis: Well, we just knew each other. We were all about the same age; we all worked in the financial district. I was the only one that had a EE background, and so I could understand what some of these—

02-00:15:24
Hughes: They had business and investment backgrounds?

02-00:15:26
Dennis: Yeah, they had investment backgrounds; they were working for investment companies, but we were about the same age.

02-00:15:32
Hughes: I see, but they didn't have the science.

02-00:15:34
Dennis: But they didn't have the technical training. When I went to work for Fireman's Fund in '52, I was really the only young person, the only young person in the financial community up there, just out of school, who did have an engineering background and an engineering degree. So I'd get calls from brokers and other people along Montgomery Street there and [they'd] say, "Reid, we've had a visit from some guy. He's got a black box and I can't tell you what this black box does, but he's looking for financing. Would you mind talking to him?" So I'd say, "No. I don't mind talking to him."

So we ended up with a group of us—there were five in The Group: Dan [Daniel J.] McGanney at Lionel D. Edie was also part of it—that was an investment counsel firm. And we had some other people that participated alongside of us. But we would get four or five members of this group together, and the group consisted of five members, and we'd get four of us or five of us together and we'd invite the entrepreneur to come have lunch at Jack's or Sam's.

02-00:16:57
Hughes: Now did you, the group, invite the entrepreneurs?

02-00:17:03
Dennis: Oh sure.

02-00:17:03
Hughes: You were known and people were {unclear}.

02-00:17:06
Dennis: Well, the broker would call us and say, "Would you talk to so and so." And then one of us would talk to him and get a preliminary idea and then we'd say, "Well, we'll call the group together. Can you join us for lunch on this or that or some other day?"

02-00:17:24
Hughes: Well, do you want to just finish with The Group? And then we'll take a break?

02-00:17:34
Dennis: Yeah, we'll get interrupted here for a minute.

02-00:17:35
Hughes: So there was a little bit of vetting, it sounds like—the person who was first contacted would look over this proposition, right?

02-00:17:44
Dennis: Absolutely, yeah. [brief interruption] Okay. Anyhow—where was I—oh, we would call The Group together, get the entrepreneur to come in and have lunch with us. Eventually one of our members got to become a member of the University Club and sometimes we'd go up there and have a fancy lunch. But we liked Sam's, which was—I think on Bush Street or Pine—Pine [it's on Bush Street], I think, because they had little booths, plywood booths and the plywood was about an eighth of an inch thick so you could hear everything going on in the next booth, but nevertheless, we felt as though we had a little privacy.

We'd call the entrepreneur in and we'd have lunch with him. He would tell us his story and after lunch was over—and it was always a he—he didn't get much to eat, but nevertheless, he'd get the story out. We'd excuse him and say, "Go stand outside on the sidewalk for ten minutes and let us talk about this and we'll come out and tell you what our decision is." And we'd talk around the table—"Do you like it? Who has questions?" And so forth and so on. "Who's going to be on his board?" We'd assign one of The Group to be the leader and then we would go out and—both John Bryan and Bill Edwards had some inherited wealth and they could invest, oh, $30,000 or $40,000 if they wanted to, but they could invest $25,000 or $30,000 quite easily. I was about a $10,000 or $15,000 investor at the time. But if we liked the deal, we'd go out and we'd tell the ent[repreneur].

At that time—in the late fifties into the middle sixties—you could start a company down here on the peninsula for anywhere from $250,000 to $350,000 dollars. And that's what they needed as startup capital.

02-00:20:20
Hughes: And that's because everything's lower—rent, salary, {unclear}.

02-00:20:27
Dennis: Sure, sure, everything, yeah. Everything was lower—but that's all you needed to get up to the point where you could get going and prove things would work. So we'd go out and we'd tell the entrepreneur, "Well, we like your deal. We've got $80,000 raised around the table from the five of us. Give us ten days and we'll raise the rest of the money and we're going to do your deal." So all five of us would go back to our offices that afternoon and we'd call various hangers-on and camp-followers that worked in these brokerage firms.

I can remember—we started what became the medical-electronics division of Smith, Kline & French this way. [chuckling] Two entrepreneurs who really

worked their hearts out, and we grew that thing on the Stanford campus to the point where Smith, Kline—

02-00:21:35
Hughes: It was at Stanford!

02-00:21:35
Dennis: That one was just in a rental building—not on the campus. It was over in the industrial park, yeah, just in a rental building. Just in a warehouse. Well, actually when I first saw Corbin-Farnsworth they were in a little dinky shack just off of Page Mill Road, but once the financing is done then they rented the warehouse.

02-00:21:58
Hughes: So is that fairly typical? That these entrepreneurs were pretty local?

02-00:22:04
Dennis: Oh yeah, yeah.

02-00:22:05
Hughes: And Silicon Valley types?

02-00:22:08
Dennis: Most of it—Silicon Valley. Well, we did a couple of deals in San Diego or Southern California. But the main thing is that it had to be relatively close by.

02-00:22:20
Hughes: Why was that? Because you wanted to be able to {unclear} them.

02-00:22:24
Dennis: We wanted to be able to contact them easily, and we all had full-time jobs working for somebody else.

02-00:22:30
Hughes: I see; you couldn't be hopping on a plane.

02-00:22:32
Dennis: You couldn't be hopping on a plane to go see Joe Blow. We had full-time jobs doing something else and so it had to be nights and weekends and things like that that we got together with these guys.

02-00:22:45
Hughes: How did these entrepreneurs react? Because you must have been just about the only game in town.

02-00:22:56
Dennis: They reacted very well.

02-00:22:59
Hughes: No but I mean from that—I didn't phrase that question very well. I'm just imagining that at that time it was a fairly new phenomenon.

02-00:23:09
Dennis: It was a new phenomenon.

02-00:23:09
Hughes: For anybody to get hold of a group, have lunch, and say, “Okay, we can come up with $800,000 and start your company!

02-00:23:18
Dennis: Well, $800,000 we couldn’t do.

02-00:23:21
Hughes: All right—then $80,000.

02-00:23:23
Dennis: $250,000 to $300,000 of which we would put up $80,000 and eventually that became $100,000 or a little more. But I can remember when we were approached by a fellow named Dave Bossen who’d come out from Ohio. He had worked for a company that made a paper thickness measuring machine.

02-00:23:50
Hughes: Oh—Bill Draper talked about that.

02-00:23:52
Dennis: Yeah, and the—Measurex.

02-00:23:57
Hughes: Right, Measurex.

02-00:24:00
Dennis: Yes, Measurex. And Dave Bossen needed $1,200,000 to start his company. “Holy smokes, Dave! We’ve never seen money like that.” Well, he went back to New York and he got Pete Bancroft and his group at—what’s the name?

02-00:24:23
Hughes: Bessemer.

02-00:24:23
Dennis: At Bessemer Securities—and Bessemer Securities agreed to put up, I think either $400,000 or $450,000, and there were a couple of other investors that came in, so he raised $600,000. Then he came back to see us and we said, “Oh well, $600,000—we can do that!” But 1.2 million, there was no way we could do that, so we trailed along on Pete Bancroft’s coattails on that one. And he was—

02-00:24:53
Hughes: Had you known Pete Bancroft before this?

02-00:24:55
Dennis: Well, I knew Bessemer Securities and that’s when I really got to know Pete Bancroft fairly well.

02-00:25:04
Hughes: You mentioned that part of this discussion around the table after the entrepreneur was standing on the curb was who would go on the board. Were decisions like that made just by who happened to have the free time? Or were there matching of backgrounds?

02-00:25:31
Dennis: I can remember one day when I turned to Bill Edwards and said, "Bill—it's your turn to go on the board." Bill said, "I don't know anything about being on a board." I said, "Well, join the club. Neither did any of the rest of us when we first started doing this, so you're going to learn. But you've got to carry your fair share." So it was an assignment.

We helped one another, but no—it was a great learning experience for all of us. During that probably ten- or twelve-year period, from the middle-fifties to middle-sixties, we invested I think in maybe twenty-five little companies down the peninsula here. Of those twenty-five, I'd say eighteen of them were wildly successful; it was a very high percentage. And a couple of them we got our money back. I think we only had big losses on maybe three.

02-00:26:33
Hughes: Isn't that an incredible record?

02-00:26:36
Dennis: Yeah, yeah. It was—it was—the success ratio was very, very high. And we weren't—later on, this business became one where you sort of expect the—[brief interruption]. Anyhow, later on people would say, "Well, all you need is one or two really good hits out of ten investments." I don't think so. I think that the thing that really made the venture capital business highly successful was having a hit ratio of about 65 to 70 percent were successful investments and your real duds were only about 15 percent.

02-00:27:46
Hughes: You mean from the standpoint of confidence?

02-00:27:48
Dennis: In terms of financial return, just profitability.

02-00:27:53
Hughes: Yes, but I'm also—yes, I understand that.

02-00:27:55
Dennis: It relates to confidence, yeah.

02-00:27:57
Hughes: Yeah, because if you have a percentage like that, people are going to say, "Well, these guys obviously know what they're doing. Let's go to them."

02-00:28:09
Dennis: Sure, yeah, absolutely.

02-00:28:12
Hughes: But you're implying that that isn't true particularly?

02-00:28:15
Dennis: I don't think so.

02-00:28:16
Hughes: You just need one or two really big ones.

02-00:28:20
Dennis: Well, no, no. I don't think it's a question of need. I think it's a question of attitude towards the business. That's what a lot of venture capitalists *think* they need to do. I don't think that is the way to really be successful in the venture capital business.

02-00:28:38
Hughes: You need something else.

02-00:28:41
Dennis: I think you need a bigger percentage of winners. You're better off not making the investment than having a mediocre one.

02-00:28:48
Hughes: I see, yeah. Well maybe we can talk about this after the break. [interruption in recording] I had just one more question, I think, about that subject and then I wanted to go back to Fireman's Fund and talk about the SBIC.

02-00:29:12
Dennis: Okay. SBIC—the legislation about that?

02-00:29:17
Hughes: Yeah, and in fact, I thought that Fireman's Fund actually had an SBIC.

02-00:29:24
Dennis: No, we never did.

02-00:29:25
Hughes: Oh you didn't. That was misinformation then. Well, is it worth saying something about—because I looked upon that as kind of an interim phase of what became venture capital.

02-00:29:38
Dennis: Well, it—

02-00:29:40
Hughes: We're not on—anyway. Oh we are.

02-00:29:44
Dennis: We're on! Then we have to apologize for this recent diversion. [laughter] Well, we can talk about the SBIC movement and why we never had an SBIC.

02-00:29:59
Hughes: Yes, that's what—

02-00:30:04
Dennis: Because the SBIC legislation came along in order to get some government money into the hands of investors who would invest it in small companies. Small Business Investment Company is what an SBIC stands for—Small Business Investment Company. It was, in effect, a government loan to those companies, but along with it came a number of restrictions. And along with it also came a different kind of a tax consequence. It was, I think, harder to generate capital gains through an SBIC. I can't remember because we never went into the SBIC field because we had, within Fireman's Fund and American Express, we had plenty of capital ourselves, so we didn't need the government help on capital and we didn't really want the government red tape that went along with the regulations.

02-00:31:08
Hughes: Yeah, which apparently was considerable.

02-00:31:11
Dennis: It was considerable. But for people who did not have sufficient capital, and wanted to put up some capital and then leverage it with government money on top of that, the SBIC form worked out very well. However, there were two very separate branches of what became the venture business.

02-00:31:36
Hughes: I see.

02-00:31:38
Dennis: And I have no exposure, really at all, to SBICs.

02-00:31:41
Hughes: Do you know when the SBIC became the less-favored way, when it began to die out, why that might have been?

02-00:31:50
Dennis: I think it was to the end of the sixties, but I think that it was again because of the regulation and the fact that—more than anything else.

02-00:32:01
Hughes: And probably also {unclear} that there was a better way of doing it.

02-00:32:04
Dennis: Well, that's true—but I think—at least there certainly was a different way of doing it that was less burdensome. But I think that you really need to talk to somebody who had had one.

02-00:32:16
Hughes: Had had one.

02-00:32:17
Dennis: Or more familiar with it and why did they get out of it and so forth. For instance, one of the things that's interesting—and we'll have to get into this later—when we started our independent venture funds after—it was 1973-74—we avoided pension funds. In the huge bull market of venture capital and fundraising, pension funds have become a major source of capital, and it's one of the things that has flooded the industry with so much capital that it doesn't know what to do with it. But we avoided pension funds because of the so-called Prudent Man Rule that the pension funds were bound by. If you had more than 25 percent of your capital came from pension funds, then the whole fund was subject to the—I think it was 25 percent; I believe that's right—the whole fund became subject to those Prudent Man regulations.

Well, the Prudent Man Rule on one side and venture capital on the other are really two diametrically opposed propositions to invest in a company that doesn't exist in the present time and bet on managers who you can't see them actually doing their management job in that environment. But you expect that they can do it or else you wouldn't invest in them. But nevertheless, it's hard—is it prudent to—I suppose you could say, "Look, the returns in venture capital have been so good that it's imprudent not to at least have a part of your fund in that area." [laughter]

02-00:34:25
Hughes: And the whole—putting it very simplistically—was the burden of the Prudent Man Rules to reduce the risk of investment?

02-00:34:35
Dennis: Oh it was a way of—for instance—it was a way of sheltering a finance committee or a board of directors from liability. You didn't ever want anybody to come back and say, you know, take you to court because you made some stupid decision, some stupid investment decision. I think that in our current situation, you can say that Bernie [Bernard L.] Madoff did not really follow the Prudent Man Rule. He was at the opposite end of that spectrum. Now—was it prudent for his investors to invest in it? Was it prudent for investment counselors to recommend that their clients invest with Madoff? Probably not, because as some people have said, the constant return of 8 percent should have been a red flag that nobody can—

02-00:35:43
Hughes: Keep doing that.

02-00:35:44
Dennis: Keep doing that, year after year after year after year. But we'll have to let the courts decide that.

But that did affect it, and in effect, you see, when we started our first venture capital fund in '73 and '74, we ended up with—with seven investors, six of them were insurance companies. Six of them were insurance companies just

like Fireman's Fund was, you know, and because I had worked for an insurance company and knew what their filing requirements were and what they had to do in January with respect to filing their investments—in our meetings I could talk like I was one of them, and they thought I was a member of the family. I think that helped us a great deal in our fundraising, because I understood their problems. And so we ended up with six insurance companies plus the Ford Foundation. Those were our first seven investors in 1974.

And at that time—it's hard to believe it now—but in that time, 1974, the fund we raised, which was $19 million, was 45% of all of the private venture capital funding that was raised that year. The whole industry raised about $45 million, of which we raised $19 [million] and we were the only fund that raised $10 million or more.

02-00:37:18
Hughes: Well, who else was there?

02-00:37:23
Dennis: Kleiner Perkins, I think, started in '72 and they raised $7 million. And there were some other funds around too. Mayfield was around, Tommy Davis and Mayfield. Tommy Davis used to work at Kern County Land Company, and Tommy and I used to get—when I was with Fireman's Fund, we'd get together and we'd talk about maybe we'd ought to set up an independent company to do these kinds of investments. We couldn't figure out whether we were going to call it Davis, Dennis or Dennis, Davis, so we never did get together.

02-00:38:01
Hughes: [chuckling] Was that really the only reason?

02-00:38:03
Dennis: Oh—no, I think we just were both a little timid too. But then he ran into Arthur Rock and Davis and Rock—he, Tommy, he clearly got first billing the way the alphabet works, so that was that.

02-00:38:21
Hughes: Now that Prudent Man law—or is it a law? What is it?

02-00:38:27
Dennis: Well, it's a rule that—it's called the Prudent Man Rule, but it in effect it gets interpreted by the courts and therefore—

02-00:38:36
Hughes: Yeah, and that was legislated—and wasn't that one of the changes that came in in the late seventies?

02-00:38:40
Dennis: Well, I don't know, because we were never subject to it. So you've really got to—

02-00:38:47
Hughes: What I was trying to—

02-00:38:49
Dennis: I was just subject to a finance committee that decided whether we were making money or not.

02-00:38:55
Hughes: Well, you had said over lunch, and I know this is jumping ahead a bit, but that 1980 was probably the best year for venture capital, ever.

02-00:39:08
Dennis: Sure.

02-00:39:08
Hughes: And I know there was some legislation in the late-seventies and in 1980 that definitely gave a stimulus to venture capital.

02-00:39:18
Dennis: Certainly, and the two things that did it, and I was very, very much involved along with David Morgenthaler of Morgenthaler Associates from Cleveland. The two of us were both officers of the National Venture Capital Association [NVCA]. And we spent a lot of time in Washington, DC talking to congresspeople.

But 1978 was the—we were back there in late-'77 and I know that we talked to, in the fall of '77, we talked to the chairman of the Ways and Means Committee [Wilbur Mills?]. Just David and myself were in his office talking to him and he said, "Gentlemen, I understand your arguments and your proposition, and I agree with you and I think that that is something that needs to be taken care of." But he says, "Quite frankly, I don't think that capital gains will even come up as a subject of discussion in this session of the legislature." Now this is in the fall of '77, and in May of '78 [telephone ringing] we had a law. [interruption for telephone call and short pause in recording].

02-00:41:16
Hughes: Okay. You were starting—or are you not finished?

02-00:41:17
Dennis: Well, what I was going to do—yeah, I'm not quite finished. I was talking about '77 and '78 and—[leafing through some documents?] where the hell is '78? Well, I don't seem to—I don't have the right one here, but—at any rate, I'll find it. I've got it somewhere and I'll get it organized by next time. But this was back in the days before we had Palm Pilots.

02-00:41:54
Hughes: [chuckling] It looks that way!

02-00:41:59
Dennis: This was the predecessor to the Palm Pilot.

02-00:42:03
Hughes: Is it? I'm still using a system like that! [chuckling]

02-00:42:17
Dennis: Well, I'm looking here to see—I know I had it in here. Just a minute—you're not rolling now, are you? I hope not.

02-00:43:09
Hughes: What are you looking for?

02-00:43:10
Dennis: I was looking for the date of our meeting with the chairman of Ways and Means—and in terms of the really, the big boom in—the big boom in venture capital—it got—you have to give Jimmy Carter the credit for this because early in '77—first off, Nixon was the one who really jacked up the capital gains rate at one stage of the game, to the point where it practically killed the venture business. That was Nixon's problem. And then Jimmy Carter came along and said, early in '77 he said we should get rid of all of the distinction, all of the differences between ordinary income and capital gains. He said we just should wipe it out completely.

Well, that so incensed the venture capital industry on the one hand and the American Electronics Association on the other, which was very active here on the peninsula—and it got them galvanized into action in a way that nobody else had ever been galvanized before, to get together and do something about this thing. If it hadn't been for Carter's statement that we should get rid of all of the distinction between ordinary income and capital gains, I think we would have drifted along, and they would have nickeled and dimed us to death by making small changes all along the line until the industry was wiped out.

But as a result of Carter's statement, the American Electronics Association—and this is an important part of the venture capital story on the peninsula; it galvanized them into action. They did a survey of their members—they had some 600 and some odd members, and I think they got 400 responses to this survey. But they sent out a survey that required the financial officers of each of their member companies to go back into their archives and come up with the tax returns from the previous five years, and who do they pay the taxes to and so forth and so on. That was all put together in the form of a testimony. I wish I had a copy of this testimony—I'll try and get a—we should try and get a hold of a copy of it—but testimony that Ed [Edwin Van Wyck] Zschau made before Ways and Means in March of 1978.

In that testimony—we had been talking to enough congresspeople, and the [American] Electronics Association and the [National] Venture Capital Association worked very closely together, but we'd been talking to enough people in Congress and they said, "We, the Congress, we can create a job at

government expense at a cost of about $25,000 a year." That's how much it cost us at that time to put somebody to work. And that would be a job like sweeping the sand off Ocean Beach, or something. As soon as the $25,000 a year funding stopped, the sand would roll back in and the job would be over and done with and the guy would be out of work.

We proved—Zschau and the Electronics Association, I should say, proved that if you encouraged the venture capital community to invest $13,000 in one of the electronics companies in their association, that you created—not only did you create a permanent job, but within five years, the various taxing authorities, the city, county, state, and federal taxing authorities, would be getting a 30 percent return on our investment. We sat in front of these congressmen and said, "Gentlemen—we would love to get a 30 percent return on our investment. But if I can get a 30 percent return on *your* investment—that's even better! That's even better!" And it was that argument and that survey put together by the Electronics Association with the support of the Venture Association that really turned the tide.

It was an absolutely fascinating process because we got to some congressmen who really believed us. And Ed Zschau's testimony before Ways and Means—I was there; I testified on the same day, different testimony—I can't find a copy of that either, but nevertheless, it was that that caused this thing to happen.

So I can remember when David Morgenthaler and I visited an undersecretary of the treasury one day in his office, and he totally stonewalled us on this thing because he worked for the Carter administration. He didn't have any sympathy for us at all. But, as I walked out of his office I noticed there was a *New Yorker* cartoon on the back of his door, so I went over and I looked at it and a little cutout of a typical *New Yorker* cocktail party with two men talking to one another and one of them says, "Venture capital—do you remember venture capital?" This industry was essentially dead and gone as far as these people were concerned.

And yet—that was in the spring of '78. We had this testimony in March, and in May we had a bill passed that reduced the capital gains rate from 48 percent down to 28 percent. And then in 1980 there was another bill passed that took it from 28 down to 20.

Now the first bill in '78 was sponsored by Bill [William A.] Steiger from Wisconsin, a congressman who died a few years after he did this, but it was called the Steiger Amendment. And he, in effect, spearheaded it through the House. He needed somebody in the Senate to carry the torch, and he got a hold of Hansen—Senator Clifford [P.] Hansen. Clifford Hansen was a senator from Wyoming. He had already announced that he was going to retire and he was not going to run for reelection, so he was a lame duck. But Clifford Hansen was one of these people who was extremely well-liked in the Senate,

and he was somebody who a number of people over the years had asked him for this or that or some favor, or help me to support this bill or that bill. He was very, very helpful to a huge number of people and he had never asked for anything in return. So Steiger got him convinced that this was the right thing to do.

Alan Cranston, who was our senator from California at the time and who was the Democratic whip in the Senate—he supported us in spite of the fact that Carter was on the other side of the table. I can remember meeting with Cranston and I said—I'd known Alan Cranston from some previous activities and I said, "Alan—the electronics industry in California is the second largest employer of people other than agriculture—and these are your constituents." So Cranston, as the whip, signed up and was supporting us.

Well, Hansen took the bill, which became known as the Steiger-Hansen Bill, and he hand-carried that around the Senate. And before he was through, he had sixty co-sponsors and there's just no way the Carter Administration could fight it. So that's what got the first reduction; the second reduction came in 1980. That's why I say 1980 was the best year to start a company, because managers just came pouring out of big companies to start their own—there were more startups started in 1980 than I think almost any year in the history of the business until recently.

02-00:52:33
Hughes: And there was also increasing worry at the national level about America's competitiveness. We were worried about the Japanese and—there was a feeling that we were slipping, whereas since the war we had prided ourselves on—

02-00:52:52
Dennis: On being ahead.

02-00:52:53
Hughes: Yeah.

02-00:52:53
Dennis: Being the leader. No, there's no question about that. There's no question about it, and I think that concern has grown in recent years, continued to grow, but nevertheless, that's what in effect what got us off the—

02-00:53:09
Hughes: All right. Well, we kind of skipped into Institutional Venture Associates, which then becomes Institutional Venture Partners.

02-00:53:18
Dennis: Venture Partners in 1980.

02-00:53:20
Hughes: {unclear} which means, does it not, that you had come to a decision to leave Fireman's [Fund]/American Express?

02-00:53:32
Dennis: American Express. Yes.

02-00:53:34
Hughes: Why was that?

02-00:53:38
Dennis: Well, in 19—what year did we start this thing—'74.

02-00:53:47
Hughes: '74.

02-00:53:48
Dennis: So in 1973, actually—no, in 1972—it was in, I think, May of 1972. At that time I was—my official title was I was president of the American Express group of mutual funds headquartered in San Francisco. I was writing more letters to shareholders than the chairman of American Express was. We had a very successful group of mutual funds and I was president of it, but I realized that the handwriting was on the wall, and if I kept my nose clean and got one more promotion, I got to move to New York. And they didn't tell me what first prize was, but I didn't consider that to be first prize.

And so I went to my boss and said—Fred Merrill was then chairman of all of the mutual funds, but he was a very inactive chairman, and I went to him and I said, "Fred, what I think we ought to do is you ought to retire as chairman. Let me become chairman, you bring in a new president and CEO, whoever you want to to run the mutual funds, and I'll get out of the fancy office and move down in behind accounting somewhere in a smaller office. I will chair the meetings and I'll do whatever I can to help your new president through the transition, and I'll run the board meetings and so forth and so on. And when you tell me you no longer need me, I'd like to get out of here. I really want to go into the venture business full-time." I said, "I had 125 people working for me; I'm a lousy administrator; I'd much rather make investment decisions and I don't want to move to New York. I really don't want to be part of that big social hierarchy at a major American corporation."

So that's in effect what we did, and I stayed on for fifteen months after I'd told him that I wanted to leave, and continued to operate out of that smaller office and bide my time until we were pretty well established with a new CEO on board, and it didn't look as though—there was no management upheaval, which was—we had so many public shareholders in all the mutual funds I didn't want it to look like a big management turnover. So it was a very friendly departure.

I was in New York a few months before I was scheduled to leave, and the president of American Express then was a fellow named Bill [William H.] Morton, and he—I was walking down the hall one afternoon a little after 5:00 and his door was open and he saw me and he yelled at me and said, "Reid! Come in here for a minute." So I went in and he said, "Are you sure this is what you want to do?" And I said, "Bill, I've never been so sure of anything in all my life." And he said, "Well, we don't want you to go, but if you're determined to go, you should take some of our money with you." And so we sat down that afternoon and on the back of an envelope sketched out about four or five conditions under which they would put up the first $5 million of a fund that would be $15 [million] to $20 million in size. And that's what—because American Express was putting in $5 million, it's what allowed us, really, to call it *Institutional* Venture Partners.

02-00:57:42
Hughes: Oh I see. I was wondering about that.

02-00:57:45
Dennis: And then we went out and all we talked to were other insurance companies and other institutions and foundations—but not pension funds. So that's how we ended up—knowing—we knew who the other insurance companies were that were possibilities, and that's how we did all of that.

02-00:58:07
Hughes: How much did your reputation precede you? The fact that you had an impressive record in terms of your past investments?

02-00:58:19
Dennis: Well, I think they—[pause for tape change]

[End Audio File 2]

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03-00:00:11
Hughes: All right. What I asked was how much, if at all, did your reputation as an investor precede you, now that you were throwing your net wider trying to get other institutions involved.

03-00:00:26
Dennis: Oh there's no question about the fact that that helped a great deal. And it also helped a great deal that somebody like Jim [James S.] Kemper, Jr., who was one of the first people we went to see, could call Fred Merrill and he knew Fred Merrill and talked to him, and Fred would give us a great boost. And for a while, the vice president of the Kemper Insurance Company, who was in charge of the investment department, used to refer to this as Kemper's Folly until our first fund began to turn out pretty damn well. And God, we ended up with somewhere around a 38 or 40 percent return per year to all of the

investors in our first fund, and then it became his brilliant investment rather than Kemper's Folly. But he took ownership of it.

I can remember going into Mutual of New York in New York City with my partners, and the fellow in charge of that particular—a very senior fellow who was very close to retirement, and it was amazing to me that Mutual of New York, this guy would make this kind of an investment decision, a ten-year investment decision a matter of months before he retired from Mutual of New York. But he looked at me and said, "Oh Reid, we know who you are. I want to talk to your partners here and find out who they are." [chuckling]

So there's no question about the fact that—the fact that I'd been in the insurance business, in the investment side of the insurance business from '52 to '73—twenty-one years made it an awful lot easier to get in the door. They all thought they knew exactly who I was and I, at various investment meetings, security analyst annual meetings and things like that, you would naturally come to learn who the investment officers are for New England Mutual or the Penn Mutual, or one of these other companies. So there was sort of a camaraderie there that helped us get over some of those early hurdles. No question about the fact.

03-00:03:10
Hughes: Was this a first-time investment of this nature for most of these institutions?

03-00:03:16
Dennis: Absolutely, yeah. It certainly was for Kemper and it was for Mutual of New York. I think that Penn Mutual may have made one other. It was new for New England Mutual.

03-00:03:39
Hughes: Did you find that there was any difference between the East and West Coast in terms of willingness to participate or familiarity with what you were trying to do? {unintelligible}

03-00:03:53
Dennis: Well, you did not have a lot of other major institutions on the East Coast. Pacific Mutual Life out here—they didn't get the message. I remember we talked to them, but they didn't go—. Fireman's Fund/American Express did not want us to approach Transamerica because they considered Transamerica a competitor in the insurance business, so they said, "Look, you've got to put the fund together, but if you can do it without Transamerica, so much the better." So we sort of avoided—there are more insurance companies that were candidates on the eastern seaboard, and that's why we originally went with—. New England Mutual actually introduced us to New York Mutual. We had a $2 million minimum, and New England Mutual didn't think they could get up to $2 million, because we made it clear from the very beginning that we wanted very few limited partners and we wouldn't take more than $20 million. So we had this $2 million minimum.

Well, Kemper came in for $3 million; that clearly was above the minimum; American Express in for $5 [million]. We went to see New England Mutual and they said, “We don’t think we can get to $2 [million], but we’d like you to go down and talk to our friends at New York Mutual Life, MONY—Mutual of New York, that is. And we did. We went down to see them and we also called on New York Life. I don’t think—New York Life didn’t do it, I don’t think.

But at any rate, we went down to see MONY and MONY had a very interesting reaction and it was largely because of this guy who was about—who was very equity-oriented but who was about to retire as head of their investment department. He went before their finance committee, and their finance committee consisted of a bunch of—like ours really—a group of CEOs of big major corporations. I can remember [Charles C.] Tillinghast from TWA was on their board and a bunch of people like that on their committee.

One of their committee members said, “Well, you know,” and they had gone in with a recommendation that they invest $4 million in this fund. One of the committee members said, “Well, why don’t you invest $5 million and then get control of the documents and you can write the agreement.” [chuckling] And—“All right, that sounds pretty good.” And they came out of that meeting and said to our friends at American Express, “You people are really not arm’s length investors here because of Reid’s prior association with you, so we’ll write the agreement and we’ll represent the investors.”

So I called back New England Mutual to thank them for the introduction to Mutual of New York and said that Mutual of New York was going to put in $5 million and then they said, “Gee, if we invest a million, that means on average we’re in for $3 million apiece with Mutual of New York, so we’re above your minimum! Can we get in?” [chuckling] So we said, “Sure.” So we ended up with $19 million out of the $15-$20 [million] that we were aiming for, and we would not have taken another million dollars from anybody else, so we wanted a small group of investors and that worked out extraordinarily well—very, very well. They all felt as though they had a major ownership interest in our fund and then they participated.

03-00:08:00
Hughes: So it was a wise investment.

03-00:08:01
Dennis: Oh it was a very, very, very wise decision. And it’s too bad—that’s another thing that’s changed in this industry today. We had participants in this fund who—when they’d get a distribution from us—if their original investment was big enough to be a legitimate portfolio holding, if they got a distribution from us from one of our successful investments—it was big enough, in each individual case it was big enough for them to pay some attention to it, put an

analyst on it, understand what it is that they were getting in the way of new stock.

I know that in the case of ROLM [Corporation], which was one of the big successes down here on the peninsula, early entrant into the digital telephone business—in the case of ROLM, Mutual of New York still had something like 60 percent of all of their ROLM stock when IBM finally bought them out. They just made buckets of money on that sort of thing.

And in those days it was legitimate—at least it was possible—for us to call our investors and say, "Look—we're about to distribute some stock in the XYZ company. One of us is on the board. We're going to distribute the stock in kind, but I will tell you that my partners and I are going to continue to hold on to whatever we get as part of this distribution because we think this company has a long ways to go." And as a result of that, we made stockholders out of our limited partners who rode with us for a while.

Today, if you distribute any in kind, all of your limited partners—there are so many limited partners they get a little dinky tiny piece of it. They don't get enough to make it worth their while to spend any time analyzing it. They think of it as a liquidity event and they sell it. They just blow it out. So that is a major change in the industry in the last twenty years, twenty to thirty years.

03-00:10:22
Hughes: You mentioned partners in IVA who stayed.

03-00:10:27
Dennis: IVA, right.

03-00:10:28
Hughes: Who were they and why?

03-00:10:29
Dennis: Burt McMurtry.

03-00:10:33
Hughes: And who is he? Where did he come from? How did you know him?

03-00:10:36
Dennis: Well, Burt worked with Jack Melchor down here—you know, I don't know how we got introduced to one another, but he was in the process of leaving Melchor, or had left him. And we met—Burgess Jamieson worked at Bank of America.

03-00:11:01
Hughes: And you knew him?

03-00:11:04
Dennis: You know, I don't know how I knew him. That's going back a long way—1973. That's longer than I can remember!

03-00:11:15
Hughes: [chuckling] Sorry. I'm just wondering why this particular group of men came together to form this new institution.

03-00:11:30
Dennis: Well, I think we were all sort of interested in it because Jack Melchor had been in the venture business and Burt worked for him, and so somehow we got together. I think Burt may have known Burgess and that is the way it—

03-00:11:47
Hughes: It might have been that way.

03-00:11:49
Dennis: We got together that way.

03-00:11:49
Hughes: And were there just the three of you partners?

03-00:11:52
Dennis: There was a fourth partner in the beginning—Jim Norris who had worked for me at American Express. He came in as the junior partner. Unfortunately, he died a few years later, so it was primarily the three of us.

03-00:12:20
Hughes: Is it relevant to talk about your early investments?

03-00:12:27
Dennis: It is, but I'll have to do some homework on that.

03-00:12:31
Hughes: Okay. Well, maybe—

03-00:12:35
Dennis: Should we call it—

03-00:12:35
Hughes: Should we stop now?

03-00:12:35
Dennis: I think so. We're at a place where we're rambling a little.

03-00:12:39
Hughes: [chuckling] Okay.

03-00:12:41
Dennis: And that's my fault. But is that all right?

[End Audio File 3]

Begin Audio File 4 02-10-2009.mp3

04-00:00:45
Hughes: Today is February 10, 2009 and this is the second interview with Mr. Reid Dennis. We are in a different location this time, which we will talk about as we move up through the chronology. Last time, we ended with your formation of IVA and talked about the first fund, but you mentioned just now off tape, that in the 1970s, which was when, if I'm remembering right—IVA was founded in 1973?

04-00:01:29
Dennis: That's—1973.

04-00:01:32
Hughes: You said that the industry, the venture capital industry, of course, almost died.

04-00:01:40
Dennis: Yes.

04-00:01:41
Hughes: So why? [laughter] And what did that do to you?

04-00:01:47
Dennis: Well, the industry died I think largely because of some changes in the tax laws. President Nixon was the first one to raise the capital gains tax in a dramatic way so that it moved up, and it was essentially up to the point where it didn't make any difference whether you were working for a job and paying income tax or whether you were building an estate and building an asset and then selling it and paying tax on the profit. The tax rates were very, very close to the same. That really depressed anybody's desire to invest in long-term programs, and a venture capital investment is a long-term investment.

These funds were typically—the first ones were set up for seven years. Certainly the first Kleiner Perkins fund was a seven-year fund. I think the first Mayfield fund was a seven-year fund, and I know that Draper, Gaither, and Anderson was a seven-year operation. It was largely not because the people involved thought that seven years was the right period of time—it was that they thought that was about as long as they could get people to sit still for letting them manage their money.

04-00:03:39
Hughes: I was wondering that.

04-00:03:40
Dennis: And really—we've had some funds now go on for fourteen and sixteen years, just because they have some valuable assets in them, there's no liquidity in the asset, and you hate to throw it away.

We have one of our funds that has really one primary asset, and it's a company in the medical equipment business. They got into a bunch of lawsuits over their technology with people like Johnson & Johnson and others. They won those suits because Johnson & Johnson had infringed on their patents and they got so much money that came in as a result of having won the lawsuits that they don't really need to go out and go public and raise money—they have more money than they know what to do with, but it's still a privately held company—a very successful privately held company. But it would be a shame to—and our limited partners really don't want us to just distribute the securities to everybody, and they end up with a non-marketable security.

04-00:05:01
Hughes: Isn't this some sort of marker for the maturation of the venture capital industry and the investor's confidence in it? That they're willing to leave their money in the investment because there's been enough history to show that, in some cases anyway, it pays off?

04-00:05:24
Dennis: Well, the other thing also is that we've already given them back all of the money they invested in that particular fund.

04-00:05:31
Hughes: Oh, all right, I see.

04-00:05:32
Dennis: So they're playing with the house's money, so to speak. And we're down to the last—we've given them back and given them a good return on their investment. So these last few things—troubled, now the word is toxic assets, but the last few troubled investments where you just cannot get liquidity and get marketability, they're willing to leave them with us and let us worry about managing them because we know more about it than they do and they don't want that headache. And when the funds get to be that old, we don't charge them a management fee, we just charge them whatever our expenses are, and our expenses are very minor. So in this one case of this one fairly successful company, the company pays for board expenses and things like that, so there's very little that comes out of the fund. And as I say, it was a fairly successful fund. They got all their money back plus a nice return on it and they're just—they're very relaxed about leaving us with what's left behind.

But the thing that really killed the venture business was the fact that capital gains rates had come up so close to ordinary income rates that it just did not—if you were a senior manager at Hewlett-Packard or one of the other companies up and down the peninsula here, it just didn't seem like taking the risk to go out and start something new which might or might not be successful [made any sense], if you were going to get taxed on the profit at the same rate that you'd get taxed working at your present job. So middle managers did not

want to leave and start new companies, and that's what really killed the process of starting new companies.

I can remember clearly in one of our visits to Washington, DC and visiting with an undersecretary of the treasury, on the back of his door as we walked out of the office I saw a *New Yorker* cartoon, and this was in—probably in 1977, in the spring of '77. I'd moved the door so I could read the cartoon, and it was two people at a typical *New Yorker* cocktail party, two gentlemen talking, and one of them said, "Venture capital. Remember venture capital?" That is about as far gone as you can get!

It wasn't until Jimmy Carter, bless his heart, came along—and with a very unusual result—but he came along and said we should get rid of all of the differential between ordinary income and capital gains. They all ought to be taxed exactly the same. Well, they'd been nickel-and-diming us and taking a little bit away at a time, and Carter came along and wanted to take the whole rest of the pie. And that one statement on his part galvanized the American Electronics Association and the [National] Venture Capital Association into action. That's when we began to really spend some time talking to the Treasury and to Congress and senators and so on in Washington, DC, and started a full-court press to, in effect, tell them that they were killing the goose that was laying these golden eggs.

04-00:09:32
Hughes: Which must have eventually gotten through, and I don't know what the sequence was here—

04-00:09:37
Dennis: I do. [chuckling]

04-00:09:38
Hughes: But in the later years—I'm sure you do—in the later years of the 1970s, the Carter Administration began to be worried about the U.S. losing out competitively, particularly against the Japanese. It would seem to me that it would be a natural that you would try to promote an industry that, after all, was into innovation and new company formation and boosting technology and all of this American technology.

04-00:10:12
Dennis: That's true; I think that is absolutely true. You'd think—once the proposition is explained to people, they can catch it. They catch onto it very, very quickly. And there is no question about the fact that—and we're coming up, right now, to revisit this whole argument, because there is so much static about what is called the private equity business, and they are going to increase the taxes on private equity. In the process of doing that they're probably going to throw the baby out with the bathwater and increase the taxes on venture capital, and they're not the same. That's what almost killed us before and we've got to be sure it doesn't happen again if we can.

I think that the point you make though, about explaining it and aren't we on the same track, was absolutely the correct one, because in the fall of '77 David Morgenthaler and I went to Washington, DC.

04-00:11:38
Hughes: Now you told a little of this last time.

04-00:11:41
Dennis: Did I?

04-00:11:41
Hughes: Yes, you did.

04-00:11:42
Dennis: About Wilbur Mills?

04-00:11:43
Hughes: Yes.

04-00:11:44
Dennis: Okay, well, then that meeting with Wilbur Mills—he agreed with us. He agreed with our arguments. He said, "Absolutely. But this isn't going to come up at this session of the Congress." And yet eight months later we had a bill, and it was that bill reducing capital gains that came through in May of '78 that really opened the floodgates of the venture capital business.

04-00:12:16
Hughes: And do you credit the information that you were sharing? Wilbur Mills was head of the Ways and Means Committee?

04-00:12:26
Dennis: He was chairman of Ways and Means.

04-00:12:27
Hughes: Do you think that it was the education that you and Morgenthaler did that at least were part of the reason that the winds began to change?

04-00:12:39
Dennis: Well, we weren't the only ones, because the American Electronics Association was back there telling the story also. And Ed Zschau, who was head of a small company here on the peninsula and later actually ran for and became a congressman, he was president of the American Electronics Association. He did a magnificent job of testifying before Ways and Means, and I'd say that that testimony, more than anything else, in March of '78, really laid out the reasons in a very logical way. Out of Zschau's testimonial, backed up by—well, I was there representing the venture capital industry and Stan [Stanley C.] Golder was there representing the SBIC industry and Small Business Investment Company industry. So all of these people were there and telling this story, and I think that there is no question about it. We're seeing it again even today with our current financial crisis in 2009, that it's better if the

government can encourage private industry to create jobs, it's better than the government creating jobs that only last as long as the government is paying the salaries.

04-00:14:14
Hughes: And you got that message across.

04-00:14:18
Dennis: And we got that message across.

04-00:14:19
Hughes: Yeah, and of course, in a sense you were helped, and I put that in metaphorical quotes, by the changing culture of the times, namely this worry that the United States was falling behind.

04-00:14:37
Dennis: Oh I think that's true. That's true. An awful lot of innovation was coming from Japan and Germany, and there's no question about the fact that there was some concern about that. But I think that the real question was did we have the incentives in place to motivate people to take risk, and I'm talking about managers getting out of a comfortable job in a big company going out and starting something new because it was a good idea and going with it.

04-00:15:12
Hughes: So talk a little bit about what that spring of 1978 change in the capital gains tax—what was the immediate effect?

04-00:15:22
Dennis: Well, the immediate effect was to create—an awful lot of new companies came into the venture capital business. Had I known how many competitors we were going to create, I don't know that I would have necessarily worked quite so hard on trying to get the bill passed! [Hughes laughs] But clearly it was the best thing to do. And then of course the capital gains rate was reduced again in 1980 and that really opened the floodgates.

04-00:15:50
Hughes: Yeah. I believe you either said or I read that you said that you've believed that 1980, until very recently, was probably the best ever year for IPOs? Or was it for startups?

04-00:16:08
Dennis: It was the best year to start a company.

04-00:16:11
Hughes: Start a company.

04-00:16:11
Dennis: [It] was 1980 because they'd reduced the capital gains tax, and managers were leaving big companies and going off on their own in droves. That is what really opened the floodgates. It was the best year, I think. And it was a

surprise, because when we raised a new fund in 1980, that was the first IVP fund, and that fund—we told our investors that we would only probably do one or two startups because they're so time-consuming. We started off with just a couple of partners and we didn't have time to do a lot of startups.

It turned out that in the next year after we started that fund, instead of doing one or two startups, we did six or seven startups because they were so compelling! We had entrepreneurs coming in and sitting around our conference table and telling us a story that just captured your imagination as to what you could do. And of those—I think we only had one that really didn't work out very well. So most of the others, out of seven, I think six of them were wildly successful. So that was a great fund and that was the first IVP fund in 1980.

04-00:17:53
Hughes: Well, maybe we should go back to IVA/IVP. I'm interested in what the significance is in the change in the names of the partnership.

04-00:18:09
Dennis: Sure, sure. IVA—Institutional Venture Associates was started by Burt McMurty, Burgess Jamieson, and myself. [brief interruption] At any rate, we ran that fund from '74 until 1980, and at that time Burt McMurtry decided he really wanted to go off on his own, start his own fund. I was the guy that was the driving force behind getting IVA going, and so he wanted to start his own fund. Burgess Jamieson wanted to take it easy for a while, and I wanted to keep going. But they didn't want me to continue to use the name IVA because they didn't want it to look like continuity if there was no continuity. So I said, "Fine. I'll change it. We'll call it Institutional Venture Partners." So the first IVP fund was started in 1980 and we're now up to IVP Roman numeral twelve.

04-00:19:40
Hughes: My heavens! And you've been the general partner and manager of all those funds?

04-00:19:46
Dennis: I've been *a* general partner, not *the* general partner. But I've been a general partner of all but IVP XII, IVP XII is the first one in the series that I'm just an advisor, and it's about time for this particular former venture capitalist to retire and get out of the way of the young people that are coming along.

04-00:20:13
Hughes: How do you feel about that?

04-00:20:16
Dennis: I love it! [laughter]

04-00:20:18
Hughes: More time for flying and San Francisco prints?

04-00:20:24
Dennis: And for prints, San Francisco prints, trying to find a home for all of the San Francisco prints that I've amassed over the last thirty-nine years—longer than that, isn't it?

04-00:20:41
Hughes: Yes.

04-00:20:43
Dennis: It's longer than that. Seventy-three, so it's—but anyway—

04-00:20:51
Hughes: There's not a dearth of things to do.

04-00:20:53
Dennis: Well, it's thirty-six years, I guess. It's the twenty-ninth year of IVP, and it's probably the thirty-sixth year, thirty-fifth year of the total thing. So it's been fun and interesting, but I have a lot of knowledge about some of these things that I've collected over the years and I want to get that knowledge documented or written down before it's gone.

04-00:21:23
Hughes: Yeah? Do you think of writing a book?

04-00:21:26
Dennis: No. I'm not up to writing a book, but I have probably—one of my sons gave me—I haven't tried it yet—a machine that you can dictate into and it'll type out on the computer screen what you're talking about. If that works reasonably well then I might start using that. But I've written a number of little things that go around the walls in our offices saying pretty much what I know about certain prints, but there are certain prints that I haven't yet had a chance to deal with.

04-00:22:07
Hughes: Well, would this be a good time to pick up on one or two, or perhaps even three companies that you think might illustrate some of your principles of investment?

04-00:22:28
Dennis: Sure.

04-00:22:28
Hughes: Are they all in the forefront of your mind? Or shall I make some suggestions?

04-00:22:36
Dennis: Well, no, they're not all in the forefront of my mind, but there are certain ones that stand out. You wanted both some successful ones and some unsuccessful ones.

04-00:22:47
Hughes: I would like to hear also about the unsuccessful ones, yes.

04-00:22:54
Dennis: Well, in IVA, probably the one investment that did more for us than almost anything else was our investment in ROLM—R-O-L-M [spells], which was a company that was an early entrant into the digital telephone business. They developed a telephone that was unlike any other, and Burt McMurtry was the lead on that. He knew the people at ROLM and brought them in, and we liked them and we supported them and we made a major investment there. And we stuck with it.

It's really interesting—when ROLM went public, the underwriter required us to sell some of our stock to help make it a true public market, so I think we had to sell 5 or 7 percent of the stock we owned in ROLM, which we didn't want to do because we thought this company had a long way to go. Well, it turned out—I can't remember what year ROLM went public, but as it turned out the stock came out and went down. So it went down and we went into the open market and bought back what stock we had sold and a little bit more—and so we ended up with our position again. And we held onto that stock for a long, long time.

I think that we really had, I'd say a philosophy of looking out—you can only look forward maybe somewhere around eighteen to twenty-four months in a high-tech company. And we'd hope we could look forward two years and get a feeling for what the company was going to do. We would hope that we could look at it a year later and extend our horizon again bit by bit.

04-00:25:07
Hughes: And is that simply because, or not simply, but one of the reasons because technology is just evolving so quickly?

04-00:25:14
Dennis: Because technology is evolving and changing and you've got to keep up with it. And you get competitors and things do change.

04-00:25:21
Hughes: Yeah, so it's different than selling cereal.

04-00:25:25
Dennis: Oh absolutely, yeah, absolutely. But I think in this business, we put an awful lot of stress—in our organization—we put an awful lot of stress on the management team that was going to run the company. We rarely invested in one-man shows. I would say that one we did later, one of the 1980 ones was—I'll get to—we did invest in a one-man show and I'll have to get my mind cranked around to that one. But by and large we liked to invest in a team of three or four or five people, and we liked to have the feeling after interacting with these people that we really would enjoy working with them. You have enough choices in this business that you don't have to work with everybody, and if you don't think you're going to enjoy working with somebody, forget it—life's too short.

Now that philosophy—this is one of the places where I have a very different point of view than Don Valentine at Sequoia, because he says, “If the market’s big enough, I’ll change the people.” Well, changing people is a painful thing for them; it’s a painful thing for you. As far as I’m concerned, I think there are better ways to get along in this life, and you can do very, very well by betting on the best people and people that you’d enjoy working with.

I can remember one company that we did that turned out not to be very successful, and I can’t remember its name now, but Burt McMurtry said, “You know, these people are good enough that if this particular idea doesn’t work out, they’re going to come up with something else that’s going to work out. And that turned out to be true. The business changed quite dramatically as we went down the road, but we continued to work with the people, enjoyed working with the people, and it came out. It was all right. It was a good investment.

There are some other investments that you get involved in because of emotion. I know I was involved at one company that was not terribly successful. [It] was a company called Collagen Corporation, whose original product was going to be an improved burn dressing for burn victims. I think one of the toughest things I ever did in terms of due diligence was to go down to the hospital in Santa Clara and go through the burn unit there. I had to get all scrubbed and gowned and masked and everything else, to see people that had huge burns over—remember this was the time of the Korean War.

The treatment of burn wounds was very much a cottage industry. One hospital would have one way of doing it, another hospital would have another way of doing it. There’s a big army hospital in Texas that had their own way of doing it. The principal material that was used at the time was pig skin, to cover places where there just was no skin at all. The problem was that after a while, after several days, the pig skin would start to get rancid, or not do its job anymore and they’d have to take it off and put on a fresh dressing—extraordinarily painful to the burn victim.

So these people had a great idea of coming up with this burn dressing made out of collagen, which is the major component of skin anyway, and I thought that was going to turn out to be successful. Well, it was never successful as a burn dressing. It turned out to be that it was more successful as something to get rid of wrinkles and divots and—

04-00:30:08
Hughes: Oh really—which was not your motivation.

04-00:30:11
Dennis: Which was not our motivation. We came out all right on it, but not an overwhelming success. I know that for a while my partners used to refer to Collagen as our annual reinvestment opportunity, because the company had a

terrible time trying to get to the point where it could support itself—but it finally did.

04-00:30:40
Hughes: Now did that hold any lessons for you in terms of being motivated by emotion rather than the cold, hard statistics?

04-00:30:49
Dennis: Oh sure, yeah, but on the other hand—no, it's—I think that in my feeling, even today, it was worth taking the risk. Had we been successful with the burn dressing, it would have been a wonderful thing for a huge number of people, and I'm sorry we weren't. I really am sorry we weren't. The management of the company was able to find some other things to do to make enough money to give us a payback and to give us a profit, but I think there are times when you have to say to yourself—it's sad to have to go in to visit one of these things, but at least I got to see what the problem was, and I'm glad we gave it a try. I really am.

04-00:31:51
Hughes: Right. Well, it's a perfect opening, as I see it to ask you whether one of the many things that I presume you consider in regard to a possible investment is the social impact of the company. Does that enter into your thinking?

04-00:32:12
Dennis: Well, the social impact—it rarely comes up, but I would say that there are certain things that we probably wouldn't do just because we wouldn't be very proud of being in that industry. So I would say, yeah, that it does have an impact, I think. We're primarily interested in the high-tech field, but if somebody came along with a new pair of glasses that made everybody's clothes invisible, I would say we probably would not invest in it. [laughter]

04-00:33:09
Hughes: Well, you know, I associate, and I'd like to hear if you correct me, with venture capital and high technology—and of course I know that there are instances where it's not a high-tech company, but as a general rule do you see it as not only in your partnership, but in others, that investments tend to be in high technology?

04-00:33:39
Dennis: Well, it all depends on the firm, obviously, but our focus has been on technology. There's no question about the fact that it's been on high tech.

04-00:33:51
Hughes: Why is that?

04-00:33:55
Dennis: Well, it was a field that we thought we knew. Burt McMurtry got his PhD in engineering; I got a degree in engineering. Burge Jamieson got his degree from—mine came from Stanford, a little school out in the West, and Burge Jamieson got his at MIT. So you had three partners that were all engineers. It

was at a time when there were not a lot of—when we first got started it was a time when there were not a lot of people in the investment business that really understood high tech, who could sit down with a technician or a group of founders of a high-tech company, who could talk about their proposed plan and their proposed product line or product area, where there were not a lot of people in the financial industry that could understand what they were talking about. And yet if you had an engineering background, I think our biggest strength was the fact that we understood what engineers were talking about.

I never thought of myself as being a creative engineer. I'm not somebody who could come out of thin air to create something that would be a gee whiz or wow kind of product, but I think that if I sat down across the table from somebody who had a gee whiz idea, I could appreciate what the market for that product might be, how important it might be, and also how difficult it was going to be for the founding team to actually solve the technological problems. Now sometimes you can get too far ahead. You wanted me to mention something that didn't work out very well.

04-00:36:02
Hughes: What do you mean by too far ahead?

04-00:36:05
Dennis: Well, there's a saying that it's easy to tell the pioneers, because they're the ones that have the arrows in their back! W invested in a company back in Boulder, Colorado called Reference Technology. Reference Technology had this idea of taking the 14-inch Sony videodisc and converting that into a digital storage machine. The idea of taking a videodisc and using it for digital storage was brand new! The problem with Reference Technology is that we were probably five years ahead of the time we should have been, because they were too early but they had a great vision.

They said, "Some day we're even going to distribute software to computer users on discs! Now can you imagine such a wild thing!" I could not. How the devil would you ever—going to distribute software on disc. Well, now we distribute software over the Internet, but for a long, long time we used to go and get one of these little CDs and slip it in your computer and away you went. But we were just too far [ahead], and these 14-inch discs were cumbersome. Then of course they came out later—Seagate came out with an 8-inch hard drive, or I guess a 5-inch hard drive was—Seagate was—the first one was a 5-inch hard drive. And then they kept getting smaller and smaller and smaller.

Reference Technology was not a successful company. It had a great management team, good technology, but they were too far ahead of where the market was.

04-00:38:16
Hughes: Well, unpack that a little bit, because I think you're on to something that's very important—because it's too early in what regard? It could be many things—a supporting system, and then you're mentioning that the later products, I guess you could say, were more convenient, more efficient, because they were—

04-00:38:41
Dennis: And smaller.

04-00:38:41
Hughes: Miniaturized. But what about the people—

04-00:38:45
Dennis: Well, there wasn't enough of a market for people with a 14-inch disk drive. You just couldn't make that market grow fast enough before suddenly IBM came out with the 8-inch and then Seagate came out with a 5-inch.

04-00:39:00
Hughes: I see, so they broke the ice but they couldn't—

04-00:39:02
Dennis: They broke the ice and they sort of pointed the way. Other companies got ahead of them by coming out with smaller units sooner, before you could get a foothold in the industry. And of course, you could go too far the other way, too—because we went on down to smaller and smaller and smaller things, and we finally ended up with a company called {MiniStore?}, that had a little, dinky disk drive—and that didn't work well for us either. So we got snookered on both ends of that technological curve.

04-00:39:35
Hughes: Thinking back to your testimony, if that's the word, your lobbying in Congress where education, to put it simply, was one of the things or maybe the main thing you were trying to do—where does that fit in, if at all, here. If you have a revolutionary new idea and then you're going to pack information on a disk, how much education do you have to do of the public, the supporting industries, maybe your potential competitors—what goes into introducing a break-through product?:

04-00:40:22
Dennis: Oh boy. Can we take a break here? [interruption in recording]

04-00:40:28
Hughes: [resuming recording]—taking a whack at that question I asked you? It will be rephrased and don't be intimidated [Dennis laughs] because I know it's a huge question.

04-00:40:41
Dennis: I can't remember what it was. I just remember that I needed a break when I heard the question.

04-00:40:46
Hughes: I asked you something along the lines of what does it take to introduce a new technology—including the whole infrastructure that has to go around it and also just public receptivity or lack thereof.

04-00:41:07
Dennis: Sure. Well, I think by and large, introducing a new technology—we really don't get involved with technologies that are going to go generally—didn't use to get involved, I should say, with technologies that were going to go straight to the public, to the public market.

Technology really was—the technological innovations usually found their first markets in industry, in other companies—in other high-tech companies who were doing a certain function, such as an IBM or—we used to use tape recorders for recording digital information on an IBM computer. It would have rooms full of tape drives with these things roaring around, and the disk going back and forth. And of course, then when you come up with the hard disk, the first IBM storage disks were big, huge things again.

So they had pioneered the idea of digital disk storage. For companies such as Reference Technology, the reason that they were trying to break into that field was the fact that here was a relatively inexpensive consumer product, meaning the Sony audio disk player that maybe could be adapted. There was already a market because IBM had gone out and sold a great number of machines at fairly fancy prices, and if you could come in with something based on Sony, so much the better. I'm trying to think—there was a company called Exabyte in Boulder, Colorado, which was one that [spells] E-X-A-B-Y-T-E—

04-00:43:46
Hughes: Yes, I've got it here.

04-00:43:48
Dennis: Exabyte—and Exabyte was taking a small Sony recorder—and I'm trying to think what it was, whether it was a disk drive or a tape drive.

04-00:44:10
Hughes: I have magnetic tape data storage products.

04-00:44:18
Dennis: Okay, all right. Well, as tape recorders got smaller and were used mostly for music and voice recording, Exabyte took a fairly small, inexpensive Sony tape recorder and made it into a data recorder. It was really sort of funny, because I ran across this particular company—it was located in Boulder, Colorado and when I described it to my partners, they thought I was absolutely out of my mind. So we all got in an airplane and went back to Boulder, Colorado and it was the first time I think the whole partnership had ever gone anywhere together like that. We all went back and after it was all over, we went back and spent a day at Exabyte, and they shook their head and said, "You know, you're right. This thing has tremendous potential."

And Exabyte was—they thought I was over the hill, or out of my mind or something—I can't remember. But at any rate, they finally decided that, by God, this was a good deal. So we made an investment, and Exabyte turned out to be fabulously successful for one of the early IVP funds. And indeed we put Exabyte into some other funds also, so we helped the Stanford Engineering venture capital fund by putting some over there, and it turned out to be a very successful deal for us.

But by and large it was taking existing technology and changing the application. But rarely—now with the pervasiveness of the Internet, it is possible to distribute something to the public through the Internet in a way that just did not exist early on. We didn't have the Internet. Gee the first time I saw an Apple computer—small, little desktop computer, I couldn't figure out what the heck that would be used for. Who would want one of those? [laughter]

And then, of course, when they got up to the point where gee, you can get a whole megabyte of storage on a disk or—I think—it's hard to believe that we get things that were operating at certain speeds that we thought were very adequate, and the fact that you had to wait five seconds before you brought up the next window, it didn't seem to bother you. But speeds kept getting faster and faster and faster and faster. Now unless you've got umpteen gigabytes of storage and all these things—. It's hard to believe, but the applications today take up so much more memory than we ever in our wildest dreams thought computers would ever use!

04-00:47:54
Hughes: You know, it seems to me that in the way that you chose to work with people with whom you were comfortable—can that also be said of the technology or the business that you are investing in? That, if I'm understanding you right, when you say that in general you did not invest in companies or in products that went straight to the public—was that perhaps because then you'd have to get into a whole new realm of endeavor? Namely creating new markets and dealing with sales forces and all those things that I'm presuming you didn't have experience with?

04-00:48:37
Dennis: Well, we did not want to get into the consumer enterprises or consumer products, because there is a huge risk, not in—does the device work—but there's a huge risk in: Can you get it to the market and will the consumer buy it? But in most of these business to business technologies, you can always find a few customers here in Silicon Valley that will buy one of anything. They'll buy one of anything and just try it and see if it works. And so they're almost taking too much risk not to try it, because if one of their competitors tries it first, then you're in trouble if they like it. But more and more capacity, faster and faster, faster and faster, more and more capacity, that's been—

04-00:49:51
Hughes: Was your technical background, your engineering background, allowing you to keep up with these changes on a technical basis?

04-00:50:01
Dennis: It allowed me to keep up for quite a while. I'll have to admit, maybe in the last ten years, I've fallen pretty far behind. My younger partners today talk about various products on the Internet that I just don't have the slightest idea—creating virtual realities on the Internet and why people want to use them and all those sorts of things beats the dickens out of me. And I never really thought that computer games would do what they've done. There are so many constructive things that you have to do in this world. Who's going to sit around playing—

04-00:50:46
Hughes: The answer is a lot of people! [laughter]

04-00:50:49
Dennis: Yeah, I know! I know! I understand that; I understand that now. I didn't understand it then that people would set aside other things for games, although I must admit that there was an early solitaire game that I loved to play on the computer, but unfortunately the company that made it didn't keep up.

04-00:51:12
Hughes: Well, I notice, I think, that aside from Collagen—was that what it was called? That most of your investments, as far as I can discern, are not biomedical.

04-00:51:33
Dennis: Well, as IVP grew, we went into the biomedical.

04-00:51:42
Hughes: Did you?

04-00:51:42
Dennis: Yeah, and we actually at one stage of the game split IVP into three groups. We had a biomedical group which was headed by Sam [Samuel D.] Colella and Becky [Rebecca B.] Robertson and {add name }—oh my—and another partner.

04-00:52:11
Hughes: You'll get another whack at this.

04-00:52:14
Dennis: That's embarrassing. I can't remember his name.

04-00:52:16
Hughes: You'll come up with it.

04-00:52:18
Dennis: And then we had what I would call a computer and communications group that was looking at startups, and then quite frankly Norm Fogelsong and I and Mary Jane Elmore formed a group to do later-stage and public market.

04-00:52:50
Hughes: Really—later-stage!

04-00:52:54
Dennis: Later-stage and public market.

04-00:52:54
Hughes: Why would that be your predilection?

04-00:52:56
Dennis: Well, partly it was a predilection because all the way back to IVA we always had in our partnership agreement the ability to buy public stocks, but we restricted it to public stocks where we knew something about the company. That would be in the high-tech area. It wouldn't be public stocks that our limited partners would feel comfortable buying on their own. But for instance, I mentioned to you that we had an investment in ROLM as a private company, and when it went public and the stock went down, we bought more. We bought it back again, and more. Well, an awful lot of venture capital partnership agreements do not permit the partners to buy public stocks.

04-00:53:59
Hughes: Really, what is the rationale there?

04-00:54:04
Dennis: Let's talk about what was the rationale. The rationale for allowing us to buy public stocks was the fact that I had spent twenty-one years at Fireman's Fund and American Express managing public stock portfolios. And there were times when we wanted to be able to buy some of these less well known high-tech stocks. We made a lot of money in them at Fireman's Fund, buying little, dinky stocks. But at any rate, we bought some other high-tech stocks when the markets were down the chute. Particularly if we were already an investor in it, had become an investor through the private—

04-00:55:18
Hughes: You mean in the field or in the—

04-00:55:21
Dennis: In that particular company.

04-00:55:22
Hughes: Oh I see.

04-00:55:23
Dennis: If we were a private investor in the company and then it went public and got into trouble or the market got into trouble—it didn't have to be the company getting into trouble—. We knew an awful lot about certain companies.

When Seagate—Seagate was one of our most successful investments in the first IVP fund—we made that investment in 1980 and it went public I think in 1981, in the fall of ’81, we owned a lot of the stock and it came out and the stock went down. And we said, “Gee, this isn’t right.” Actually—I’m wrong on that. What happened is Seagate filed in the fall—and I’m not sure which year it was but I think it was ’81. In the fall of ’81 they filed to go public and the original filing range was $18 to $20. And then we had a terrible decline in the stock market, and the next thing I knew, they reduced the filing range from $15 to $18. And then the next thing I knew, they’d reduced it $12 to $14. It was supposed to come public the next week and then finally the next day.

I called Tommy [Thomas I.] Unterberg at a firm called Unterberg and Towbin, who was one of the underwriters and I said, “Tommy, what’s the Seagate offering look like now? What’s the pricing look like?” And he said, “Reid—would you believe $10 a share?” And I said, “Tommy, would you like an order?” And he said, “Reid—that would be like manna from heaven!” And so I said, “Well, we’ll give you an order to buy 50,000 shares at $10 a share.” And that’s what allowed the company to go public.

04-00:57:38
Hughes: Wow. Isn’t that amazing.

[End Audio File 4]

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05-00:00:01
Hughes: You were telling me about the $10 offering.

05-00:00:14
Dennis: At Seagate.

05-00:00:15
Hughes: Yes.

05-00:00:18
Dennis: Well, it’s—at any rate, so we gave Tommy Unterberg the order to buy 50,000 shares, which is half a million dollars of Seagate stock. Our original investment in Seagate had been—was a half a million dollars. But that was at 50 cents a share. So there are a lot of investors, once they’ve paid 50 cents a share would never think about buying something at $10. We owned this very large block of stock at 50 cents a share, and then in order to help with the public offering and also because we thought it was a good investment, we bought the second tranche at $10. [cell phone ringing] So we held on to our $10 Seagate stock and in less than a year the stock was back up to $17, or something like that. Or I should say it was up to $17, and so we sold it. We sold a high-cost stock and we made 70 percent on our money in less than a year. That’s not a bad return. And we just held on to the low-cost stock.

And then finally on the third anniversary of the fund, we distributed the Seagate stock to all of our limited partners. Now this was the IVP I fund, which I think only had nine limited partners. But the thing that was interesting about it, and it's an interesting contrast with the world of venture capital as we know it today, is at that time, on the third anniversary of the fund, we gave all of our limited partners back three times the amount of money that they had invested in the fund in terms of the value of the Seagate stock. Seagate all by itself gave them three times their money back. And that was extraordinary. And so from thereon out after three years, not only were we playing with the house's money, but they had already gotten a very good return on it. And it's remarkable to be able to do that in such a short time frame.

05-00:03:08
Hughes: Yeah, how *did* that compare to what other venture capital firms were doing in that era?

05-00:03:17
Dennis: Well, I don't know. It has to be one of the more successful investments for the time—1980 to '83. But the thing that's different about today is that our funds are so big and we have so many limited partners that any one investment, even if you'd made umpteen times on your money, by the time you distribute it among all those limited partners, they have such a small holding that it's not worth their time to learn something about it.

05-00:03:53
Hughes: Well, then why don't the general partners limit the number of limited partners?

05-00:04:00
Dennis: Because they want the money to get the management fees to—

05-00:04:02
Hughes: But they could—well, this is naïve, I'm sure, on my part, but couldn't it be set up in such a way that if you want to be part of this you have to invest this much at least?

05-00:04:17
Dennis: Well, that's true, and people do have minimums, but nevertheless, the funds have gotten so big, they've gotten to be multiple hundreds of millions of dollars or over a billion dollars—

05-00:04:30
Hughes: But explain to me why that would be.

05-00:04:34
Dennis: Because so many people want to invest in the venture capital business, and that's different than it used to be. We had to struggle in the first IVA fund to raise $19 million in 1973-'74. It was much easier, but our first IVP fund in 1980 was a $22 million fund. Because of the success with Seagate, we never

took down the whole $22 million; we only took down three quarters of it. But funds were relatively small then.

It was the success of the eighties that got everybody and their brother interested in investing in the venture capital field. And so a whole group of investors—pension funds and state funds and so forth and so on began to get interested in this area, and then of course, there was the change in the Prudent Man Rule that allowed pension funds to invest freely here.

05-00:05:47
Hughes: But I would also think there was your record of success.

05-00:05:50
Dennis: There was a record of success which was great while funds were small—and it was spectacular. And now there are still some funds that have had spectacular records: those that invested in Google were spectacular. There are very few Googles, you know. There are very few really big home runs like that, but if you look at the history of financial bubbles over the centuries, whatever has been very, very rewarding for a good period of time usually attracts too much capital and the returns go down. And that's exactly what's happened to the venture business.

05-00:06:35
Hughes: And also true, would you say, of the roaring nineties?

05-00:06:39
Dennis: That's absolutely true of the roaring nineties, sure. The nineties were a great period up until the very end, till the bubble burst in 2000.

05-00:06:54
Hughes: I have several questions in mind, but would you also say that the orientation of the new venture capitalists coming in, or maybe it wasn't just the new—but instead, as you've made so clear, that part of venture capital is building the company, sticking with it, if you're going on the board making sure as best you can that this company is going to be a success. Has that kind of orientation changed in recent years?

05-00:07:25
Dennis: I think it has in that there are so many people investing today in companies that they are—they're trying to build the companies in order to sell them to somebody else, instead of building the companies to last.

05-00:07:42
Hughes: Getting their money back.

05-00:07:43
Dennis: You know, it's a question of built to last or built to sell. It used to be that we were trying very, very hard to build something that would last and last and last.

05-00:07:58
Hughes: Does that still characterize your philosophy?

05-00:08:02
Dennis: I don't think you can do that today in the same way because there are so many other things that come into play.

05-00:08:06
Hughes: Like what?

05-00:08:09
Dennis: The demand for liquidity on the part of your limited partners and—

05-00:08:14
Hughes: And you can't talk them out of that?

05-00:08:16
Dennis: No, oh no.

05-00:08:18
Hughes: Why, why?

05-00:08:21
Dennis: Because they have their own performance records to show to their finance committee.

05-00:08:25
Hughes: So everything's interlocked. [chuckling]

05-00:08:27
Dennis: And as you get bigger and people's investments are smaller—we gave our limited partners so much Seagate that they had to learn something about it.

05-00:08:43
Hughes: Exactly. There's no incentive.

05-00:08:45
Dennis: If you just give them a little—you give them a little dab—

05-00:08:46
Hughes: They don't care about the company.

05-00:08:47
Dennis: They don't care about the companies. They get a little dab of this and a little dab of that and someone says, "Well, why don't you just sell the stock in the fund instead of distributing in kind." Well, in many cases, because you have a concentrated block in the fund, you're subject to all sorts of restrictions on how much you can sell in any period. You've got to report it all. Somebody sees—Oh they're selling, they're beginning to sell—that means there's going to be pressure on the stock for the next year and a half while they try to liquidate and get out of it. You're much better off distributing it, and

hopefully trying to distribute it in a good market where there'll be receptivity to it. But it's—there's a lot that has changed, so it's anyway—

05-00:09:53
Hughes: All right. Let's see. Would you say, and this is another probably impossible question because you kind of implied it already, that your investment strategy or your investment style, however you want to characterize it, has changed with the times? If that indeed is true, are there certain core principles, core values that you insist on holding on to?

05-00:10:29
Dennis: Well, number one, you've got to remember that I'm not a general partner in the current fund. So I don't want to speak for the current fund.

05-00:10:39
Hughes: No, all right, well, don't bring it up that far, then.

05-00:10:43
Dennis: But I would say that certainly through IVP X, we continued to invest in the same way. [IVP] X and [IVP] XI. We're still looking for the same sorts of things, but it's hard—it's hard to stick with exactly the same rules that you used to apply, when the world around you has changed as much as it has. So you've got to play the game the way the rest of our industry is playing the game.

We used to have a lot of time to make up our mind. We used to have—I mean relatively to what is true today. We used to have more time; we put much more emphasis on knowing the people and being comfortable with the people. We still put a lot of emphasis on the people, so that hasn't changed. But you've got to make up your mind about the people in a hurry because there are so many competing firms now, and if good people started going around raising money, if you don't jump on it and get after it right away, you may lose out.

Plus the fact that the other thing that has changed is that we used to have to do more or less our own due diligence. It was our own thoughts about a technology or an area. Today with the Internet, there is a huge amount of information available on almost any subject that you can think of. It's like—go research this area or that area—it's like opening a fire hydrant. There's a tremendous volume of information that comes at you, and so you've got to have analysts to sort through all of this stuff and summarize it. You're on a much faster timetable, and it's much less of a personal business today than it used to be.

05-00:12:54
Hughes: Yeah, it sounds like [it]—how do you feel about that?

05-00:12:57
Dennis: I'm glad I was in it when it was more of a personal business.

05-00:13:00
Hughes: [chuckling] Right, I bet. What about IVP's reputation, though? Not only have you been around longer than most of your competitors, but you have, as I've said before, a record of success so that when you're competing for investments, investors, doesn't that give you a leg up over many?

05-00:13:24
Dennis: Oh it does, no, no. I think that the fact that IVP is a well known name; it's Institutional Venture Partners; it's been around for a long, long time and they know that. I think the other thing is that IVP raised Roman numeral X in the year 2000. That's nine years ago. Venture capital firms are sort of measured by vintage year—when was the fund started, what's the rate of return been? Well, the year 2000 was the year the bubble burst. IVP X is one of the few funds in the nation that has returned all of its original capital and has a positive result. There are other funds, most of the other high-tech funds lost money for their investors. So to be a partner in a group of funds that has a 2000-vintage year fund that made money, separates you from the pack. So it's an indication that I've done pretty well in selecting my successor partners.

05-00:14:51
Hughes: Yes, it does.

05-00:14:52
Dennis: And that we as an organization have done a good job of bringing younger people into the firm, and they're doing a good job. That's about all you can leave them with is trying to bring bright, young people in and let them have their head and see what happens.

05-00:15:21
Hughes: Again, I think you probably have answered this, [Dennis chuckles] but I'll ask you the questions anyway. Talking as a venture capitalist, or looking at yourself as a venture capitalist—and I know you're many other things—what do you think are your greatest strengths and perhaps your areas of weakness.

05-00:15:51
Dennis: Well, I think that the venture capital business is something that—it's a business that it really pays off to come into it after you've had a fair amount of experience doing something else. I think it's a business that you're probably better off entering in your thirties and forties than you are entering it in your twenties, because you need to build a frame of reference by which to judge people and to judge opportunities and to be able to judge markets and what's going on in the economy. So that I think that—let's see—I was in my, I guess in my forties when we started the first IVA fund as an independent fund. I'd had the experience of working, doing venture capital investing both at Fireman's Fund and in American Express before I came down here.

05-00:17:11
Hughes: And on a personal level in {unclear}.

05-00:17:14
Dennis: And on a personal level. So you have to build that frame of reference that allows you to sit down across the table from somebody.

05-00:17:23
Hughes: I would think so.

05-00:17:26
Dennis: And be able to make some judgments as to whether—is this person really—he's probably telling me the truth. He or she, telling me the truth as they see it. Are they capable of doing what it is they say they're going to do?

05-00:17:42
Hughes: Yeah, now is that intuitive?

05-00:17:46
Dennis: An awful lot of that is intuitive. It's intuitive and it comes about through just experience. You can't build that frame of reference and get that experience unless you've been around for a while. And particularly, I think it's a mistake for people to jump out of college and say, "I want to go into the venture capital business." Because typically the entrepreneurs are going to be slightly older than you are. Not always, but slightly older. If you're dealing with a group of entrepreneurs that are six or eight or ten years older than you are, they're going to say, "I want somebody on my board of directors who has more experience than I have, not less experience." And so—you're a better board member; they're more liable to take your advice and counsel if you see something that they should be doing. I don't think you have to have, necessarily, gray hair, and you don't have to have as little hair as I have, but nevertheless, it's important that you do have some experience.

05-00:19:06
Hughes: Nobody so far, of the people I've interviewed, has talked about the process of taking a company to the public market. Are there some generalities, or would it be easier for you if you talked about a specific company that might be illustrative? I want to know the context, how the decisions are made that this company is ready to take to the market, and what you're looking at to make such a decision, because I imagine it's more than just where the company is.

05-00:19:46
Dennis: Well, it is, yeah, it is. It's usually—the process of going public usually starts with the fact that the company is growing fast enough that it needs to raise some additional capital. We typically will invest in a company for two or three rounds; we like to support our companies. If we get in early, we'll invest in the second round and third round. And as I say, in the case of Collagen, my partners used to refer to it as our annual reinvestment opportunity [Hughes chuckles], but after a while, the company's needs, if it is growing, the company's needs gets beyond the capabilities of the venture capital firm to continue to support it in a meaningful way, and then you should turn to the public.

Plus the fact that if they've done it the way most companies do, you have a great number of stockholders that are within the company, that are actually working in the company, and they want some liquidity. They have wives and children and pets and things that need to be supported. The wife wants to build another wing on the house or buy a new car, so there's a pressure for a free market in the stock or a public market in the stock that would allow employees to get some liquidity.

And then there's also the pressure on the part of the venture capitalists to be able to give a marketable stock out to *their* investors where they can make that decision as to whether they hold it or sell it. It also gives—in some cases, it'll give the venture capitalists the opportunity to say, distribute the stock to all of the partners including the general partners. And the general partners may be so close to the company that they want to hang on to it. And you can do that—

05-00:22:12
Hughes: Really—that's been your experience?

05-00:22:19
Dennis: That's—well, it used to work that way. Now there's so much pressure put on any market, any time a new market is created for a stock it is very, very hard for it to perform well because there is so much pressure for liquidity. Part of that is from investors who—we have many, many limited partners who are invested in a lot of venture capital funds, and they have a lot of capital calls coming periodically. Not all the time, but periodically they have more capital calls because we don't take down all the capital on day one. You take it down over usually over a three- or four-year period. So they have pressure on them to supply new money to funds they are already in; they'd like to get some money back from their current investments and recycle those dollars.

05-00:23:17
Hughes: I see. Excuse me for interrupting. But where, if at all, does the state of the market figure into all this?

05-00:23:28
Dennis: Oh well, it figures very prominently in it, because if the market isn't doing well, you cannot take or you should not take a company public in a market that's about to tank or is very unstable.

One of the problems that we had with the Seagate example that I gave you was we were going to go public in a market that turned out to be under tremendous pressure, and it went down, down, down, down. It was partly because somebody who wrote a market newsletter, who was very, very negative on the market, made a tour around Europe and kept telling everybody that the world was coming to an end and coming to an end and coming to an end. Every time he gave a speech, the market went down just that much further. So it was a terrible time to go public, but they needed the money and so they went public. They ended up selling the stock at a lesser price than they

had hoped to, but nevertheless it was a successful offering. The stock never went down after it came out at $10 a share, so all the public stockholders made money.

I think that's something else that has changed today is that we've had an awful lot, in the recent two years, really, we've had a number of companies go public that have never seen—come out and gone down and have never seen that price again. And that's too bad because what we've done is we've sort of soiled our own nest in that the public gets tired of buying stocks that go down.

05-00:25:23
Hughes: [chuckling] Yes!

05-00:25:24
Dennis: And I don't blame them! I don't blame them. I wouldn't want to do that either. If our industry keeps pushing things out the door, and the public doesn't want to buy them and they go down, they're going to walk away from us. So there has been some of that going on.

05-00:25:43
Hughes: Well, we were going to end with the current state of the market, but it seems to me that there's a segue into that discussion right now if you want to say something briefly about what the current economic downturn is doing to the venture capital industry.

05-00:26:01
Dennis: Well, we're in the beginning of 2009, this is February of 2009, and the market has been very, very volatile. But I think that what really is going on today is the fact that the whole economy is in terrible shape. This is the fastest downturn in the economy that we have ever experienced since the Great Depression. It's the fastest, the sharpest; unemployment is going up faster than it has for a long, long time, and I think it's going to be quite a while before any new high-tech companies can go public and have a good result for the public investors.

Now having said that, we see a number of public stocks—way back in the beginning, way back in the fifties and sixties we used to—when the high-tech market was just beginning to become known—and you have to remember that when I got out of school, there were no publicly held electronics companies on the peninsula, so this whole thing was a relatively new phenomenon. When Hewlett-Packard went public, David Packard recommended that people sell the stock because he thought it was overpriced. And of course here he couldn't have been closer to the company—and he couldn't have been more wrong! People that disregarded his advice and bought the stock and held onto it made a lot of money.

But nevertheless, back in those days, we used to say that if you could buy—you couldn't look at earnings; you couldn't look at price to earnings ratios

because these companies were growing so fast they were out in front of earnings. They were plowing money in and investing money into things at such a rate that it was hard for them to earn money. So you had to relate the value of the company as represented by the stock price to sales, to the revenue of the company. We used to say if a company was growing rapidly, and you could buy it today at one times sales, or maybe 1.2 times sales, or 1.3 times sales, you had a pretty good chance of making money as sales kept going up, if you were convinced sales would go up and you ignored the earnings of the company and just looked at sales.

A couple of years ago I can remember sitting around the table and listening to some of my younger partners say, "Gee, this company looks like a pretty good deal because it's only three times sales, or four times sales, or five times sales." [chuckling] And I'd have to wince and say, "Gee it really looks good at three or four times sales." Well, we now are back to the point where you're looking at price to sales ratios of again we're back to about 1.5 times or 1.2 or 1.3 times sales. I think we're back to the point where there are a lot of high-tech companies that are rapidly growing companies that are pretty attractively priced today. Now can they get overpriced again? Sure, yeah, they can. But I think that when you can buy things at say, say less than 1.5 times sales in today's market, that's a pretty good long term investment if you're right on the future of the company and the growth in sales.

05-00:30:19
Hughes: What do you do in a down market, though, about the momentum that you talked about, to get liquidity?

05-00:30:30
Dennis: You'd better get liquidity on the way up. You've got to have liquidity on the way up and you have to have more capital that you can draw on. You've got to keep some powder dry for times like these. We're glad, my partners are glad they haven't taken down all the capital in IVP XII yet, and we still have some capital to call on and some investments to make at these lower levels.

05-00:30:57
Hughes: So it sounds as though IVP anyway isn't drastically hurting.

05-00:31:04
Dennis: Oh things could get better, but—we're not drastically hurting because we have liquidity. What we really have going on in our country today is an incredible liquidity crisis where people who have gotten used to, during the past twenty or thirty years, they've gotten used to a certain pattern with their banks of—if I have this kind of a deal I can go to my bank and I can get that kind of money and I can carry on my business. Now you go back to the same bank with the same kind of deal, the same sorts of terms, you're in the same business, and the banks say, "We don't want to lend you the money." We've got a liquidity crisis that has frozen up the banks in a way that has never happened before in the fifty-five years that I've been in business.

05-00:32:01
Hughes: Yeah, not since the Depression.

05-00:32:04
Dennis: Not since the Depression.

05-00:32:05
Hughes: Well, switching subjects—or do you want to say more on the current situation? No? Because I'm thinking of you and your colleagues in venture capital as barometers, if you can use that term, of the state of new business, and in your case, anyway, high technology, at least in the region that you consider for investment. In other words, a repository of new knowledge. And what does that really mean? Is that a service or an advantage—I don't know quite the words to use—that should be more widely utilized than simply—okay, deciding that I'm going to invest in this company or that?

05-00:33:11
Dennis: I'm not sure that I understand the question. Try it again.

05-00:33:14
Hughes: Well, it seems to me, because presumably—or maybe I should ask that question—reading business plans must be part of the job, right?

05-00:33:25
Dennis: Oh sure.

05-00:33:28
Hughes: That seems to me a source of knowledge, and a source of knowledge about very specific innovative technologies in a way that I can't imagine quite another parallel source of information. I'm not quite sure where I'm going with this question either, but *you*—with my looking at it very narrow mindedly—you're using that information to decide whether I'm going to invest in this company or I am not. But it seems to me that knowledge, that bulk of knowledge—if you multiply it by the number of venture capital brains that are absorbing this information—that it's a tremendous pool of financial, technical, business information that it seems to me could be used for other purposes.

05-00:34:30
Dennis: Well, let me back up for a minute and say that there have been a number of innovations that have come along that have had a major impact on industry and economies. Certainly, one of the reasons we have steam engine models around here is the fact that the invention of the steam engine and the fact that it allowed people to do more than just muscular work—they could improve on their own muscular strengths and use machines to do work. And then, of course, the development of the electric grid, so to speak, was another step forward in terms of energy for people. Certainly the switch from the horse and buggy to the automobile was a major innovation. It's interesting to take and plot, on a logarithmic scale, the distance that one person can travel in one day versus time. The reason the California Missions are all about thirty-five miles

apart is the fact that that was about as far as a person could ride a horse in one day; that's about the maximum. And then, of course, along comes the automobile.

Now the bankers in New York were very, very skeptical about the automobile, and they thought it was a European fad that would never catch on in this country. You go back and you read or listen to some of the history of Harvey Firestone talking about the development of the automobile and the rubber tire—it was hard to get financing because the New York bankers just felt this was not going to last.

05-00:36:52
Hughes: Because the distances were too great?

05-00:36:54
Dennis: No, because the horse and buggy was so reliable, you know!

05-00:36:58
Hughes: Oh I see, and why would you want to go—

05-00:37:01
Dennis: And we didn't have roads! You didn't have any roads; we didn't have 280 and we didn't have all these—so things relate to one another.

Now in our time, of course, we've had—first you had the development of the vacuum tube in the early part of the last century, and that brought on radios and things like that and eventually television. But then huge innovation came out of World War II, and we developed radar and microwaves and things like that, and frequencies that we'd never dreamed of generating before—higher and higher and higher and higher frequencies. And, of course, in our time, in the time that we've been in the venture business, the biggest innovation has been the development of the microprocessor, and it's gotten faster and faster and faster and smaller and smaller and smaller. But the major hurdle, the major innovative breakthrough has already occurred in that area, and computers will continue to get smaller. Computers will still continue to get more powerful. But it's going to be evolutionary, looking forward, rather than revolutionary. I think probably the next big innovative changes are going to come in the biomedical field rather than the electronics field.

05-00:38:50
Hughes: And why do you say that?

05-00:38:54
Dennis: Well, because we have so many unsolved problems in the biomedical field.

05-00:39:00
Hughes: And you're implying that the others are evolutionary.

05-00:39:08
Dennis: Yeah, and I think we still have unsolved problems in the biomedical field that are available for pioneers and experimenters to still innovate in. I think we're learning more and more and more about the human body all the time. So there's an awful lot to be done in that field in combating disease, whereas I think that what's going on in the electronics industry is going to be much more evolutionary. Sure we'll go faster, and sure it'll broader; everybody will soon be connected to everybody else—and it's going to be terrible! [laughter]

05-00:40:09
Hughes: Well, this is a wonderful discussion, but I think in the interest of time we should move on to such things as the wider context. I'm wondering—you know you spoke very well about how some of the legislative changes at the Washington level had had a huge impact. Are there other things of that nature that—either at the governmental level or I don't know quite what else—that have had a direct shaping effect on the way venture capital has evolved?

05-00:40:54
Dennis: Well, we've talked about capital gains already.

05-00:41:11
Hughes: Yes, we have.

05-00:41:12
Dennis: That's terribly important. I think that one of the things—there are some problems with the tax laws that need to be corrected. I hope in the process of fixing some of the problems that exist today that they don't start raising the capital gains tax again on venture capital firms, because I think that'd be a mistake. Now the current rate is 15 percent. I don't think it makes any difference at all whether that rate is 15 percent or 20 percent. But you get much above 20 percent and then that tax begins to be a tax that prevents transactions from taking place. It becomes a block to transactions; people won't sell something because they don't want to pay the tax, or it becomes a tax on inflation—if we ever get to the point where we have an inflationary economy again. But if people bought a house a long, long time ago, and if they sell it today an awful lot of the profit is just keeping up with inflation—and should that be taxed?

So I think that there are two directions to go here. As I say, I don't think it makes—I think anywhere from 15 to 20 percent is perfectly acceptable, and it's not an economic impediment to the redeployment of capital to its most effective use. And that's what we're really talking about. The capital gains tax is a tax that, if it gets too high, will prevent the redeployment of the capital to its most effective new use.

There's no point in reducing it further, because the capital gains tax—it's interesting—you look at this history. When it was reduced from 48 to 28 and from 28 to 20 [percent], the actual capital gains revenues went up because

there were more transactions! I don't know what happened from 20 to 15, but obviously if you go to zero, revenues are going to go to zero, so there's no justification for taking the capital gains to zero. I think that'd be a big mistake.

05-00:43:57
Hughes: Is there talk of that?

05-00:44:00
Dennis: Well, there's talk about maybe you reduce it to zero for one year. Well, that's terrible! Because that makes everybody short-term investors or something. And there are people in long-term projects who need to sell when the right time is, and you shouldn't have the tax laws determine the timing of the sale of some asset. So I am perfectly happy to see capital gains, long-term capital gains for the venture industry in this range of 15 to 20, and I'm not going to argue whether it's 20 or 22 or 18, but nevertheless, it's in this range. It should not go down to zero.

The other point is that in trying to fix certain problems, the taxing authorities have really fouled up the tax on stock options, and that should be corrected. One of the things that really made Silicon Valley as successful as it has turned out to be was the fact that for a long, long time stock options were available. Stock options are a way of allowing employees all through an organization to become partial owners of that organization.

Well, some big companies—and the worst offender was Chrysler in giving Lee Iacocca options on millions and millions of dollars worth of stock. In order to prevent that and the favorable tax treatment on people like Mr. Iacocca, who was really getting compensated for a job—it wasn't to incentivize him to become an owner of a large block of Chrysler stock.

But in order to correct that problem they changed the rules on stock options so that now instead of being able to exercise your option and hold on to the stock, now if you have an option to buy stock at $10 and it goes to $50 and you exercise the option at $10 and you own the stock at $50, you are liable for the tax on the day you exercise it at the $50 price. If it goes back down to ten, you still owe your tax on the 50 bucks, and you don't have it anymore. So it really forces employees who have stock options to, in effect, sell their stock when they exercise it because they can't afford the risk that it could go down and they would owe the tax at a higher price.

05-00:47:13
Hughes: I see it. When did that tax law come in?

05-00:47:15
Dennis: Oh a couple of years ago.

05-00:47:16
Hughes: Really?

05-00:47:17
Dennis: Yeah, and it's something that really needs to be corrected, because they shouldn't have to pay the tax until they sell the stock and then the tax ought to be due on the price they get when they sell the stock. That's the way it used to be and that's the way it should be, and that's why virtually everybody at Hewlett-Packard was a stockholder. *All* the employees were stockholders, and broad stockholdings in the high-tech companies has been a hallmark of our industry. During the most successful parts of our recent history, it's one of the things that really made it work and people all felt, goddangit, I've got an ownership position here, and this is my company as well as your company and your company and your company.

05-00:48:13
Hughes: Right, yeah, and so all that motivation you had lost.

05-00:48:18
Dennis: Now it's lost. It's absolutely lost. And you're just scared to death that if you don't get out while the getting is good, you're going to end up owing the tax.

05-00:48:29
Hughes: Is the idea that is so prevalent and has been as far as you're saying for so many decades in Silicon Valley—that employees have stock options and hence an incentive to contribute and stay at a company—is that a West Coast idea? I know that the big firms elsewhere used to give their executives [stock options]. But as far as I know it wasn't a policy that every employee in a company got stock options.

05-00:49:09
Dennis: No, and it still isn't. You have to be there a certain period of time; you may have to be at a certain level.

05-00:49:17
Hughes: But if you're a dishwasher? Well, maybe a dishwasher isn't a good—because they're often concessions.

05-00:49:22
Dennis: {Franchises?}, yeah. But no, no, no, there have been requirements that you had to be an employee for a year or a year and a half—

05-00:49:33
Hughes: But it's not—what I'm trying to get at though—it's not a discrimination on the basis of your status in the company.

05-00:49:40
Dennis: It hasn't been, no.

05-00:49:42
Hughes: No, but I believe it has—originally.

05-00:49:46
Dennis: Well, it can be. It all depends on how broadly you want to do it. But Hewlett-Packard did it very broadly, Varian did it very broadly. Varian wanted all of their employees to be stock holders, and that was one of the ways they could do it.

05-00:50:02
Hughes: Yeah, have you been in a position to give new companies advice in that very area?

05-00:50:10
Dennis: Oh well, we usually do, yeah.

05-00:50:12
Hughes: And what do you—

05-00:50:14
Dennis: Well, you know, right now under the tax laws, it's hard to know—

05-00:50:18
Hughes: What to say.

05-00:50:19
Dennis: —what to do, because I think it's become pretty standard in our industry that you get fairly broad distribution of stock among—certainly among key employees, and then push it down as far as you can.

05-00:50:33
Hughes: [to videographer] Ten minutes, period?

05-00:50:42
Dennis: Okay, we've got to wind up.

05-00:50:42
Hughes: We're running out of tape. Sorry about that. Let's say something about California as a setting for at least one, if not the, major center for venture capital in the world, on the planet.

05-00:51:02
Dennis: Sure.

05-00:51:04
Hughes: What influence, if any, has that had?

05-00:51:06
Dennis: Oh I think that a lot of people have come to California and come to the Bay Area and said, "Gee, we'd like to duplicate what you've done out here in some other part of the country or some other part of the world." Well, the first think that they'd have to do is duplicate our weather.

05-00:51:27
Hughes: [chuckling] And they're not going to do that.

05-00:51:31
Dennis: And that's the hard thing to do. But by and large, talking about the technology industry, which is the one I know best, the centers have grown up around MIT and Harvard. They've grown up around University of Michigan in Ann Arbor, and they've grown up around the Golden Triangle down in Raleigh-Durham and—

05-00:52:00
Hughes: Chapel Hill.

05-00:52:03
Dennis: And Chapel Hill. And so they've grown up around universities. In the Bay Area there are two competing centers—there's a small one over in Berkeley and then there's the big one around Stanford, of course. [laughter]

05-00:52:18
Hughes: I don't know that I agree with that!

05-00:52:21
Dennis: Well, I know, I don't expect you to agree with it, but nevertheless—

05-00:52:25
Hughes: There is also UCSF, which is not known as exactly a laggard in this area. [laughter]

05-00:52:32
Dennis: Sure, no, I know. At any rate, but we're so lucky that we're in the Bay Area where by and large we've had fabulous weather. And the weather does play a role here, because during World War II a tremendous number of people went through California on their way to the Pacific, and they determined that they were not going to go back to the Midwest. My gosh, you don't have to shovel snow, and all that sort of thing—you mean you never have to shovel snow? And look at what's happened recently with the ice storms in the East. It's just been miserable, so the weather has had a big impact.

And then it's a question of the university environment and in our case we were blessed to have Fred Terman at Stanford, who really was the father of radioengineering in many respects. He wrote the handbook, he wrote the textbook, he gave lectures on it. He was the one who encouraged Hewlett and Packard to start their company; he was on their board for, I guess, his whole life. He was a charming, energetic, and encouraging kind of person, and he loved to encourage people to start new things. I think that Lee de Forest, who developed the first vacuum tube that had three elements in it, called a triode—his laboratories were down in San Jose. The Varian brothers that really developed the klystron that helped make radar a practical tool during World War II—that was developed here.

So these centers of high-technology development that have attracted venture capital have grown up around universities. I think the same is true in England

where I know at Cambridge there has been some innovation—less at Oxford, I think—a little stuffier. But it's—but I don't think you can necessarily export what we have here.

The other advantage that we have in this country versus the rest of the world is the fact that we have—what is it—230 million people in the United States now? Something like that? And we all speak, almost, the same language. Now there are some people from Texas that don't know how to speak the language, but at least if we're patient with them we can usually understand what it was they meant to say. I'm not thinking of anyone in particular.

05-00:55:53
Hughes: I bet you are! [laughter]

05-00:55:58
Dennis: But some one of the comics said that he was trying to quote George W. Bush and said, "Mr. Bush is alleged to have said—'it's too bad the French don't have a word for entrepreneur.'" [laughter] I'm afraid that that's not a true statement, but nevertheless—

05-00:56:27
Hughes: It's a nice one.

05-00:56:27
Dennis: It's a typical kind of thing that he could do. We have three minutes.

05-00:56:32
Hughes: There's a lot been written and spoken about the so-called unique culture of Silicon Valley in this area. Do you subscribe to that? It's termed in adjectives such as it's not risk-averse and—

05-00:56:51
Dennis: Can do!

05-00:56:51
Hughes: And can do and move on and speed and collegiality.

05-00:56:57
Dennis: Look—we've had just a huge number of success stories here, and so I think that that culture does exist. Plus the fact that this became a mecca for venture capital firms because so many small companies were growing up around here. We started—one of the investments we made was in a company called Corbin-Farnsworth, which now is the medical-electronics division of Smith, Kline & French. And it started in a little dinky warehouse over here off of Page Mill Road; some guys just trying to take technology and apply it to new things. Go down and visit it, like the people—"Sure, we'll get the money." That attitude has pervaded this area—of starting new things. And it feeds on itself because by and large over the last fifty years it has been a very, very successful activity.

05-00:58:03
Hughes: Well, [abrupt end].

[End of Interview]