momentum
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Investors Bypassing Budding Ventures

By Brian Deagon, Investor's Business Daily
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Almost every company starts with an idea and a handful of people willing to take a risk.

Getting big, however, requires lots of money and some good advice. That's how the venture capital industry got started. But times have changed, says Matt Ridenour, managing director of Momentum Venture Management. The business model of most venture capital firms is shifting upward and the traditional garage startup is being passed over, Ridenour says.

IBD: What changed?
Ridenour: The venture capital industry started as guys who were mentors, seasoned executives who would provide seed funding and follow the company through to an exit. Over time it got more specialized, with larger funds and larger management fees. With the Internet bubble, they lost an appetite for small deals. Garage startups are not getting focused on. It doesn't make sense for VCs to make a bunch of $1 million bets.

IBD: But aren't there lots of conferences that target startups?
Ridenour: They call them early-stage conferences and you have 150 entrepreneurs lined out the door and all the seats filled. These guys are looking for capital and advice. The panelists would introduce themselves and each one would say, "We're a growth-stage investor." We'd like to see $5 million in annual revenue, and you could literally see the people in the room kind of deflate because they weren't at that stage. The majority of them just never get the money or their idea off the ground. A big chunk of them bootstrap more than ever before and rely on credit cards, home equity loans, friends and family.

IBD: And you also think part of the problem is that VC funds have become too large?
Ridenour: If you have a typical $250 million venture fund, it's virtually impossible for them to put just $1 million or $2 million into a company. The average investment has to be about $25 million for the model to work. Ironically, it's actually a lot easier to raise a $250 million fund than it is a $50 million fund.

IBD: Why is that?
Ridenour: The large pension funds that provide VCs a lot of their money invest in $50 million chunks. But they can't represent a large percentage of the overall VC fund. For a VC to raise $250 million or larger, it's a matter of just stopping by and talking to all the pension funds. If you want to raise a $50 million fund, it's hard because you have to raise that from individuals. There's just a natural incentive to get larger and larger.

IBD: What needs to change?
Ridenour: A lot of that might need to come from pension funds. A lot of them have a rule of not investing in first-time funds. Maybe they should also think about making smaller investments and changing the rewards structure.

Momentum Venture Management is a Los Angeles-based firm that helps early-stage companies achieve early business results and develop credibility in order to get funding and transform their ideas, technologies and products into sustainable, successful businesses. For more information, please visit www.mvmpartners.com.

IBD: Are there other reasons we don't see smaller venture capital funds?
Ridenour: A $50 million fund, with a 2% management fee, generates a million a year in management fees. Now you have five partners to feed, so maybe it's $200,000 a year for each of those guys, but not really because you also need four or five associates, rent and all the rest of it. So the bottom line is the management fees to support a $50 million fund don't work. So you naturally raise a $250 million fund, but now you're no longer in the same business you used to be.

IBD: How is Momentum Venture Management different?
Ridenour: Our firm steps in and brings the products that are missing. We bring the team and surround the entrepreneur with that team. We basically take care of everything other than the technology and we also can provide bridge funding. So if capital is needed in those early stages, we can always put that capital in.

We developed a core team of three partners, and just added another partner. We have two full- time analysts and an administrative person. What we're looking for are early-stage situations. The patterns that you see and experience in an early-stage firm are completely different from what you experience even after $5 million or $10 million in sales. The problems are all different.

IBD: What do you do when a company starts to take flight?
Ridenour: We tap resources outside - the lawyers, marketing, sales and accounting people. We have a Rolodex of good folks who want to step up. We can then take the company to the venture capital guys where they can look at the dynamics of a company and its exit characteristics. They don't all have to be a Google.