

Cross-Regional Venture Capital Investment is Good for Everybody

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There are a limited number of regions in the United States where venture capital firms are congregated in big numbers. Silicon Valley, New York, Boston, Atlanta, Research Triangle, Austin, and Metro DC (including Northern Virginia, where I practice) top the list.

In each region, the VCs represent a large, but limited pool of money. More than any other target, they direct their investments toward technology companies. Not coincidentally, those are the regions where the most technology enterprises are started and grown. Traditionally, VCs have invested in companies where they have their offices.

The approach VCs take to investing in tech companies has morphed over the past decade. Most of us recall the dotcom frenzy of the late '90s when money poured into "pre-revenue" companies that investors predicted would eventually make money because their websites had lots of "eyeballs" – i.e., unique visitors. We all learned the hard way that those investments weren't good ones. In the second wave of online commerce, however, VCs brought with them a more sober attitude, resulting in fewer startup financings, but vigorous investment in companies that evidenced sound management and an early track record of real success.

In efforts to be cautious, VCs spent the last several years being very demanding, asking for larger chunks of equity and larger roles in day-to-day management of their portfolio companies. Investment has often come at the expense of entrepreneurs' control over the very companies they founded.

The trouble was that the pendulum's swing from 1999's speculative investing to 2009's highly cautious investment

might have gone too far. Those of us who work every day in the world of emerging tech companies have witnessed over and over that entrepreneurs are often reluctant to give up too much equity and/or control. Good ideas go unfunded, and promising companies fail as a result. We must also reluctantly admit that venture investors and corporate lawyers are not always the best persons to control the management of tech companies. Someone who understands the particular technology and its particular marketplace is often better suited for that job. Overly demanding requirements imposed by venture investors has sometimes actually stifled success.

Surely there is a middle ground between speculatively throwing cash at companies and cautiously micromanaging and smothering the vision of talented entrepreneurs. In the changed economic reality of 2009, on the heels of America's deepest recession in decades, I expect the market will gradually move investors and companies closer to a happy medium. Here's why:

Among the trends I see is the trend for good companies to have an ability to seek investment from a wider pool of VCs. Even if lots of money is currently sitting on the sidelines awaiting an economic uptick, good companies still don't have to accept the first offer of funding they find, so they don't have to give away the farm. In my practice, I witness this trend because regional restrictions on VC investment are fading away. My clients have received VC investment from around the country, not just from VCs nearby. Why shouldn't that be the case? One of my clients, for example, is located in Research Triangle Park, NC, but its VC investors are located in the Mid-Atlantic. Another client is managed from multiple locations in addition to having headquarters in Northern Virginia, with C-Level executives in each location. Why would we expect that company to seek investment only from VCs in one region?

It should come as no surprise that truly promising companies can be a bit choosy about the VC firms from whom they accept funding, and about the terms they are willing to accept in exchange for investment dollars. This isn't new logic, but it is a newly emerging reality because companies no longer

operate with local funding alone. They force VCs to compete for the opportunity to invest fairly, and they are more willing to accept VC funding if it's fair.

At the same time, the increasingly competitive venture capital marketplace is good for venture capital firms, too. If a sluggish economy requires prudence and if market trends prevent them from making unreasonable demands about company valuations (i.e., the equity stake they get for their money) and board participation, VCs had better find just the right company. Casting a net beyond their traditional regional focus permits VCs to identify companies who are just the right fit. As evidence, in my practice I am able to introduce Mid-Atlantic VCs to interesting tech companies from Atlanta


or Research Triangle, both of which, frankly, are regions comparatively underserved by the VC communities. Having the ability to work with companies from both the Mid-Atlantic and the Southeast only increases the likelihood that VC firms will find a winner.

The last decade has seen two periods of significant VC investment in emerging technology companies, the first overly speculative, the second perhaps overly cautious. As the U.S. economy re-emerges from the current downturn, VCs and entrepreneurs will be wiser from those experiences. In the next era of the tech economy, both VCs and companies will benefit from more cross-regional investments.

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