Starting a company is like going to war

Mary Beth Grover, Forbes Global, 11.02.98

Audrey MacLean sits with a couple of young engineers at Il Fornaio, Silicon Valley's latest hot spot for cutting deals. They're trying to raise $1.5 million for their new E-commerce company. Suddenly MacLean wants to know: "What's your Mario Andretti strategy?"

Meaning: What in your deal will put you so far ahead of the competition that they can never close the distance -- as in the famous racing driver's technique. MacLean listens to their spiel and promises to get back to them soon.

A week later she decides to pass. Why? Not Mario Andretti enough.

"They'd licensed someone else's technology. What if that licensing deal falls apart? The problem with the Web is it's so frigging easy to whip something out that you get this false sense of comfort." Something else was missing, too. "Two partners and no visible chief executive," MacLean grouses.

MacLean, 46, is one of Silicon Valley's angels -- so called because they dig into their own pockets to give entrepreneurs their first financial lift. In this they differ from traditional venture capitalists, who usually are agents for other people's money and who rarely finance brand-new companies these days.

Angels have been around at least since Ferdinand and Isabella grubstaked a Genoese sailor named Christopher Columbus five centuries ago. But today's angels don't just sit around waiting for people with ideas to come to them. With good ideas a lot scarcer than money these days, many angels do the seeking out. Jeffrey Sohl of the University of New Hampshire's Center for Venture Research, one of the nation's leading authorities on angels, says there are about 300,000 people in the U.S. today on the prowl for deals, checkbook in hand, pen at the ready. He says they put $10 billion into startups last year alone. This year?

They'll probably put in more.

Congress gave these folks a jolt of adrenaline in 1997 when it decreed that profits made from financing brand-new businesses are tax- deferred so long as they are rolled into new startups within 60 days.

Angels typically get into business formation earlier in the feeding chain than venture capitalists, who usually want to see some kind of a functioning business. Angels, as their name implies, will put money -- anywhere from a few hundred thousand up to a few million -- into an idea, into a dream. When the dream starts to come true, the venture capitalists are willing to take a look.

MacLean is regarded as one of the smartest and best-connected of the angels. Of six companies she has seeded, two went public, three were acquired (one by Microsoft), one went sour. FORBES GLOBAL estimates she has made at least $20 million on an investment of $1.2 million. She has six more deals in various stages.

With that success record, venture capitalists are happy to look carefully at MacLean companies. "Angel, nothing!" exclaims Tim Draper, a third-generation venture capitalist and partner at Silicon Valley's red- hot Draper, Fisher, Jurvetson. "Audrey MacLean walks on water."

Reed Hastings, a promising engineer whom MacLean backed, puts it in plainer language: "Audrey is a hard-ass coach who draws the best out of people," he says. "She's brutally honest but in a productive way."

Hastings has reason to be pleased: His company, Pure Software, was "angeled" by MacLean. It went public in 1995, making Hastings $75 million richer. As Hastings indicates, MacLean brings more than cash to a deal. Taking a seat on the board, she challenges business plans, helps turn ideas into prototypes, recruits experienced executives, finds customers.

What does MacLean look for in a potential investment? A promising idea, of course. But personality counts for a lot, too. "If they get defensive when I ask challenging questions, that's a red flag," she says. "I back people who I think will be seeking help and advice. These are the best entrepreneurs."

They also have to be very tough competitors: "Starting a company is like going to war. You can't do anything else but be fully engaged. You have to be insanely, passionately, nothing-can-stop-me committed."

She saw that kind of entrepreneurial fanaticism in Hastings, a young engineer who worked for her at Adaptive, a networking company she founded in 1988. When Hastings, then 30, approached MacLean in 1990, his idea had already been rejected by several venture capitalists. He wanted to create tools to help software designers debug programs faster, thus getting their products to market more quickly. MacLean was intrigued; in software, those who get to market first often win.

MacLean tossed in a token $20,000 and watched Hastings. As her confidence in him increased, she and some venture capitalist friends raised an additional $6.4 million. Smooth sailing it wasn't. Hastings' product was ready to go in six months, but he was having trouble moving it. The company went through four vice presidents of sales in as many years. MacLean, Hastings says, would demand, "When are you gonna get this right -- if ever?" In the end, she helped hire the right sales vice president and Pure Software took off. MacLean's investment -- $245,000 in total -- was worth $5 million at the time of the 1995 IPO.

While MacLean is best known for high-tech deals, back in 1987 she seeded Pete's Brewing Co. (see box, p. 73). The microbrewery's founder, Pete Slosberg, then 37, had worked with MacLean's husband at Rolm, then a maker of corporate telephone systems. Slosberg's hobby was making beer, and he had just won the silver medal at the Great American Beer Festival in Colorado. MacLean thought she could help turn Slosberg's brew, Pete's Wicked Ale, into a national brand and ultimately put in $215,000.

It was hard to find other believers. "I'm the living proof that Audrey is the best salesperson alive,"says Geoff Yang, a partner at Menlo Park, California-based Institutional Venture Partners. Yang says: "She called me on the phone, and I went from saying 'I don't know anything about beer, I'd prefer not to do it,' to 'Okay, I'll send my check in.' I'm just not sure what happened."

Pete's Brewing Co. went public in November 1995, returning to the first investors more than a hundred times what they put in. Pete's wasn't an unqualified success but did well enough to be bought by Gambrinus, a San Antonio, Texas-based beer importer of such brands as Corona, for $69 million.

If MacLean is sometimes tough on her entrepreneurs, it's tough love.

She learned it helping raise nine younger siblings while growing up without much money in the rural town of Warwick, New York. When she was only 8, her Dad said, "Hey Audrey, you want to go to college? Get a scholarship." In 1970 she got a partial one to Columbia University but didn't attend. "My father wouldn't cosign my loan, "she says. "He said no one will ever want to marry you because you'll be in debt." So instead, MacLean took classes at Long Island University, where she had a full scholarship. But she dropped out and went to Paris, where she did some modeling for fashion magazines such as Vogue.

Back home, she decided to get a fresh start and headed for California, where she earned a B.S. in mathematics from the University of Redlands. "Math is the great equalizer," she says. "If you can do the numbers, the boys have to respect you."

They did. Starting out as an engineer at Tymshare, an early networking company, MacLean rose to become a sales executive but left with a couple of co-workers when Tymshare refused to back their idea to create a line of switches for wide area networking products. In the summer of 1982, when she was 30, she cofounded Network Equipment Technologies. MacLean sold a rental property she owned for $70,000, invested it and didn't take a salary for more than a year. She got potential customers on the phone by waiting until their secretaries had gone home for the day and they would have to pick up their own phones.

Getting venture capitalists to listen to her pitch was even tougher.

In those days, Silicon Valley wasn't exactly flooded with institutional money -- or with women entrepreneurs. It took over a year to get the first round of cash, $4.3 million, and only after she recruited a seasoned manager from Comsat as chief executive. MacLean, who was carrying her second child, recalls one of the lead investors asking if she was pregnant. "When I said yes, he said 'We better get an extra half-million in key man insurance.' "

During the next four years MacLean had that baby and also managed to raise an additional $20 million and deliver big corporate accounts like IBM. NET's IPO in February 1987 yielded its backers a sixteenfold return on their investment. MacLean, however, had ended up with less than 1% of the company and made only a bit over $1 million. That taught her a lesson she has never forgotten: Don't give away too much equity.

With that in mind she kept 21% of the common stock of her next startup, Adaptive Corp., a maker of high-speed switches. Adaptive was funded by NET in 1988. Shortly after the two companies merged in 1993, MacLean's stake was worth $6 million.

By then she was tired of 80-hour weeks and eager to spend more time with her two daughters. She decided to live on her capital. She cashed out of NET and Adaptive, deciding to use the money to back other's startups. She also invested in one newly public company. The name of that lone stock: Cisco Systems.

MacLean's husband of 20 years is Michael Clair, a cofounder of LAN switch manufacturer Synoptics and himself an active angel. "Between the two of them, they know everyone in Silicon Valley," says Andrew Rachleff, general partner at Benchmark Capital in Menlo Park, California.

MacLean spends a lot of her time just schmoozing with people like Michael Price, former head of Lazard Frres' telecommunications business, who helped put together the WorldCom-MCI deal. Says Price, "Audrey's a smart, nice, tough businesswoman. But she's also a great mother, a great wife and a great friend. What's really interesting about her is the full package." Together they've invested in several companies, including Avidia, a low-end switch manufacturer that they seeded with $2.5 million in 1997. It was quickly snapped up by fast- growing Pair Gain, a maker of telecommunications equipment, for $94 million. "We made ten times our money in six months," gloats Price.

They also coinvested in Firefly, an Internet upstart from MIT's media lab that was recently acquired by Microsoft. Firefly tracks the interests and purchasing habits of Web surfers for companies like Barnes & Noble.

In addition to high tech, these days MacLean is starting to look at health care. "They're both huge market opportunities," she says. She and Stan Meresman, former chief financial officer of Silicon Graphics, invested $1 million in Healthcare Transaction Systems, a company devoted to making hospital purchasing systems more efficient (see below).

Barbara Paldos, a 27-year-old Stanford Ph.D. in electrical engineering, attended an entrepreneurship class MacLean taught at Stanford. When Paldos started Informed Diagnostics, an advanced laser technology startup, MacLean wrote a check for $100,000 before even seeing a prototype.

Will any of MacLean's startups land on the FORBES GLOBAL's 300 Best Small Companies list? Bet on it.