

1 September, 2008

Time to Modernize

By Joanna Glasner, Senior Editor

Sophisticated portfolio management systems are flooding the market, but many VCs remain stuck in their old-fashioned ways

It's an old cliché that professionals rarely apply their expertise on their own behalf. The accountant is hopelessly behind on her bills, the doctor won't take his own medicine, and the credit counselor can't qualify for a loan.

So it is with venture capitalists. The people who fund the next generation of software are still more than likely using decade-old technology to track those investments. "You would be amazed at the number of people still using Excel as their key day-to-day tool," says **Guillaume Tissot**, product marketing director for **eFront**, which makes software for venture and private equity firms.

That's changing. As top-tier venture firms get bigger and more globally diversified, they're deploying sophisticated systems to track deal flow, keep tabs on promising entrepreneurs and evaluate ROI prospects at prevailing valuations. Meanwhile, smaller firms looking to establish their brands, particularly in the crowded Web 2.0 space, are tailoring applications for venture deal-tracking built on Salesforce.com, an on-demand software platform.

Time management pressures are driving much of the adoption. Venture-backed startups are taking longer to generate exits compared to a few years ago, leaving VCs with larger active portfolios to manage. With more resources devoted to existing investments—not to mention LP relations, fund-raising, auditing compliance and so forth—there's less time for VCs to pursue their core job: identify the next 100x investment.

"There's so much data and so many business plans floating around," says **Steven Massicotte**, general partner and chief operating officer at **Village Ventures**, which is upgrading a system it developed a few years ago to track both potential and existing investments. "It's really trying to filter through all of that."

Tool time

There's no shortage of software for VCs and private equity managers looking for a spreadsheet replacement. At least a half-dozen companies market portfolio management systems for the sector. For venture investors accustomed to applying the rigors of due diligence to new technologies, the plethora of options can make for drawn-out decision-making.

At Battery Ventures, reports General Partner **Morgan Jones**, "The choice of technology here has consumed far more of our mental time than you can imagine." After scouring the market for every competitive offering, the 62-person firm last year settled on Salesforce.com.

"It's our third platform in five years," says Battery GP **Tom Crotty**. "Over the next three to four years, I think you'll see a lot of VCs adopt it." Battery had previously used software from **TheNextRound**, which it spent a lot of time customizing, and before that it used a database product from **4D**, which it ran on Macintosh computers, Crotty says.

Salesforce's popularity with the private equity set hasn't gone unnoticed by developers. For those looking for something a bit more customized, there's Navatar Private Equity Solution, a year-old application built on the Salesforce platform that firms can use to disperse information about their companies to staff and partners. Another developer, App-X, offers a pre-packaged deal-sourcing application aimed at expediting the process of finding investments.

In addition to Salesforce, there are a host of other applications, many of which combine deal-tracking features with tools for accounting, investor relations and publishing reports. They include:

- **AnalytX**, which makes a Web-based product called Private Equity Office for managing investments from due diligence to exit. Its system handles tasks such as investor distributions, asset monitoring, IRR analysis and investor capital reconciliation.
- **EFront**, whose primary private equity product, FrontInvest, includes modules for customer resource management, accounting and portfolio management across the lifecycle of an investment. EFront, which is based in Paris, recently opened a New York office to focus on the U.S. market.
- **IntraLinks**, whose portfolio management system classifies investors in groups with varying levels of access. It's popular for storing and distributing business-critical documents for tasks such as fund-raising, due diligence on potential portfolio companies or exploring asset sales.
- **Investran**, which offers a private equity portfolio management system with three components: a "relationship management" tool, an accounting module and a Web-based application for investor relations and portfolio monitoring. The company is a unit of Sungard.
- **Navatar Group**, which sells CRM for Private Equity, a Web-based application for private equity and venture capital firms to manage the capitalization process, investor reporting and partnership operations.
- And **TheNextRound**, whose product integrates with all Microsoft products, such as Outlook, Word and Excel. It includes features for contact management, fund-raising, deal management, reporting and ledger accounting.

Dashboard evolution

It's telling that VCs commonly refer to their portfolio tracking interface as a dashboard. Just as drivers expect to glean at a glance the state of their fuel tank, speed and mileage, investors want immediate access to data about everything from portfolio companies to quarterly performance to promising new entrepreneurs.

While there's no industry standard dashboard for the venture industry, firms that have evolved beyond the spreadsheet tend to incorporate similar features. On the deal-tracking side, there's typically an archive of companies that partners have met with or are following, contact information for entrepreneurs and diligence information. The idea is to ensure that a firm's partners are working through the deal pipeline efficiently and sharing information so that they're not duplicating efforts or stepping on each others' toes.

For example, Battery has 14 people that it classifies as "deal doers" that need access to deal information. "In our organization, we're in Boston, Sand Hill Road, India and Israel, and we have a large group of people who are tracking a very diverse set of technologies," Jones says. "This system helps us to have one unified face, so you don't end up having two different guys calling the same entrepreneur or being confused."

Firm size dictates some specifications. Battery's partners, for instance, look at something on the order of 5,000 investments each year, says Jones. They need a platform that can run detailed internal analyses and be easily accessed by all partners.

Smaller firms have a different set of worries, such as staying competitive in scouting deals with a small group of partners. **Emergence Capital Partners**, a three-partner software investor in San Mateo, Calif., incorporated a "hall of shame" dashboard feature. It lists how long deals have been in the pipeline without a response. Whichever partner has the longest list gets "shamed" at the Monday meeting, says Partner **Jason Green**.

By and large, the VCs who recently implemented new systems or are considering upgrades cited similar priorities. Mobility was paramount, particularly among investors with disagreeable memories of legacy systems tethered to a central server. Another sought-after feature is the ability to restrict access depending on a person's relationship to the firm. For example, a firm would want to give all partners access to deal pipeline information, while limited partners might be restricted to quarterly reports or fund-raising information.

Simplicity was also a top priority, given the challenges of getting partners to adopt a new technology. "People get into work habits and it's hard to change that," observes Village Ventures' Massicotte. He says he's avoiding systems that require partners to spend a lot of time inputting and updating records.

Commitment required

Still, no system functions well on its own. “The system is only as good as the commitment to it and the rigorous inputting,” says Green of Emergence. “Otherwise it’s going to be a frustrating experience.”

Emergence, which invested in Salesforce before it went public, has been using its on-demand software for deal-tracking since the firm’s launch in 2004. Every investment opportunity partners see gets entered into the system and tagged with appropriate information. Green estimates that it takes 20 or 30 minutes a day for him to make updates. Then, partners spend a few hours every Monday going through it.

Why bother? The main benefit of a detailed tracking system, Green says, is that it focuses partners’ attention on what matters most—finding the next deal. Given that the firm’s three general partners consider 60 to 70 new investments in a typical month (and invest in five or six per year), it’s easy for a startup to fall through the cracks.

The Salesforce software allows partners to “track” a company to ensure they follow up with founders at least quarterly. Also, it lets them know how well they’re working through the pipeline. “There’s not a lot of feedback in venture, since it’s such a long-term business,” says Green “This gives a sense along the way of how we’re doing.”

Maintenance fees

Though spreadsheets get a lot of flak from purveyors of portfolio management software, they do have advantages. Chiefly, they’re cheap and don’t require much maintenance.

Dedicated systems, on the other hand, can get pricey. It’s not uncommon for a system to cost in the neighborhood of \$100,000 a year, says **Michael Gorman**, operator of **Venture Back Office**, which provides accounting and support services for venture firms.

Implementing a new system can be pricier. Private equity fund [Oak Hill Capital Management](#) set a budget of \$250,000 to \$300,000 to revamp its back-office system about three years ago. Oak adopted a system provided by Westborough, Mass.-based TheNextRound.

A firm’s willingness to adopt high-end systems varies largely based on its size and operating budget. “If you’re a venture firm with a couple billion under management, you may want to go with one of the larger systems,” Gorman says.

But for smaller firms, he says: “If they have the option of spending \$100,000 on a package, but they can get away with one for \$10,000, you see a lot of firms really skimp in this area.”

Cost and flexibility are two key reasons Salesforce is getting a new look by VCs. Customers pay between \$9 and \$65 per user per month, and can integrate applications designed for private equity usage as they become available.

Exactly how much dedicated portfolio management software providers charge is unclear. None posts prices on its website. We’re told that prices are based on several factors, such as the number of users, a firm’s size, the length of the license and customization requirements.

At eFront, for example, customers can license a feature that triggers accounting entries following business events, such as draw-down calls or dividend payments, says Tissot, the company’s product marketing director.

At Intralinks, pricing varies depending on the user type, the number of general partners, or the number of pages posted to the system. For fund-raising, the company charges a fee to post documents to its secured site for LPs to peruse. “It’s whatever makes sense for that particular business process,” says **Tara Roesch**, Intralinks’ account manager for alternative investment products.

While it takes more money and effort, VCs who’ve worked with multiple portfolio management systems generally recommend installing a robust set of features from Day One. There’s also a marked preference for systems that someone else designs and maintains.

“Even simple things are not easy to run if you have some home-grown system where you have to use a consultant to customize it,” says Battery’s Jones. Before moving to Salesforce, “when we decided to run some statistics or reporting or do interesting searches, it seemed like we were using an antiquated technology,” he adds.

Scant in-house technical support presents another constraint. Notes Tissot: "If you take your typical private equity firm, they tend to have small teams, and they don't have an IT culture." Among venture firms, it's reasonably common to have a chief operating officer, but a chief technology officer is virtually nonexistent.

Wish list

Despite the plethora of offerings, VCs and vendors say there are still several desirable features missing from the current portfolio management product lineup. Chiefly, they'd like to see full integration with a wider range of devices, more venture-specific analysis tools and applications updated to match changes in accounting standards.

"One of the challenges in the venture industry is that it's pretty small compared to, say, pension funds or mutual funds," says **Jim Anderson**, president of **SVB Analytics**, the majority owner of **eProsper**, an equity management software provider that is developing a private equity portfolio offering. "Accounting software firms really haven't developed a lot of tools for that sector."

Anderson would like to see better applications for venture partners to analyze what's needed to maintain an equity stake over several investment rounds. Firms could also use some help in estimating expected returns over the life of a portfolio company, he says. And they need an easier way to aggregate data over a number of measures, such as looking at how the performance of portfolio companies in a particular sector compares to an overall industry.

Finally, there's going to be great demand for tools to comply with new accounting standard FAS 157, which most venture capitalists had hoped would quietly go away. Under the new rule, venture firms have to value portfolio holdings based on market value. Currently, auditors have yet to weigh in on the metrics that venture firms are using to set these valuations. Once they do, however, there ought to be plenty of interest in venture circles for tools that help to automate the task, Anderson says.

Besides seeking out new analytics tools, venture firms are also concerned that new systems integrate with the gadgets and applications their partners already use.

Emergence's Green, for one, says he craves better integration with his iPhone to enable truly mobile deal tracking. At Village Ventures, Massicotte says he's looking for a system that will work with Microsoft Outlook, as well as preferred desktop applications.

"If someone is a general partner and they've used spreadsheets for the past 15 years, it's hard to break them of that habit," he observes. Getting them to switch e-mail platforms would be a downright Herculean endeavor.

SIDEBAR: No tools to automate FAS 157 compliance

With the exception of highly paid valuation consultants, few people in Silicon Valley have welcomed this year's enactment of the accounting standard known as FAS 157.

The new rule, which requires private equity investors to account for portfolio holdings at a fair value based on current market prices, has caused particular consternation in venture capital circles. Investors are finding the "mark to market" approach leads to valuations markedly at odds with the ones used in funding rounds.

What's more, it's a difficult accounting standard to implement. There are few tools on the market to streamline the process. "Right now most firms have an army of analysts crunching through spreadsheets to evaluate the existing portfolio," says **Jim Anderson**, president of **SVB Analytics**, adding that "there's a fair amount of activity that people are trying to automate."

Waiting game

Automation, however, is hard, because there's little feedback on how FAS 157 should be applied. For funds with calendar year ends, disclosures will first be required in 2008 financial statements. That means auditors have not yet weighed in on how accurately the standard is being implemented. Until there's more data on what's compliant, software vendors are refraining from introducing programs to automate the process.

Still, there are a few applications available to help set valuations:

- **BNY Mellon Asset Servicing** has introduced a system to help calculate fair value that's available to clients through the company's Workbench technology platform.
- **CCH**, a tax and accounting software provider, has rolled out a service called FAS 157 Manager that uses a Q&A format to walk users through issues related to the valuation.
- And **Peach**, a U.K.-based provider of compliance products, offers its Compliance Mapping & Proof service, which uses templates to help companies adhere to the new accounting standard.

Venture assets, however, promise to pose particular challenges that are difficult to automate away. The most obvious is that unprofitable, entrepreneurial companies developing world-changing technologies don't lend themselves to market-rate valuations.

Moreover, since venture represents such a tiny sliver of assets covered by the new accounting standard, vendors aren't exactly rushing to cater products to the industry. Says Anderson: "If someone's going around saying we have the golden tool to solve the 157 problem, I'd be pretty skeptical."