Funding a Startup after the Bubble

Rafi Holtzman, CEO of Silicon Valley-based Luidia, Inc. and formerly an industrial designer for Scitex and Electronics for Imaging, describes his difficult capital raising experiences and urges investors to move beyond old, ineffective approaches that may no longer be applicable to investment selection.

In the fall of 2002, I began the process of courting venture capital with more than a little trepidation. I had read the daily casualty reports of start-ups that perished when "the Bubble" burst in 2000. Industry publications were suggesting that VCs were paralyzed by two competing and mutually exclusive investment goals – the huge potential returns of the late nineties and very low risk. I believed that I had something different to offer, though – a proven team, a proven product, and a business that clearly was about to become profitable.

My initial meetings confirmed the gloomy reports that I had been reading. VCs were perplexed that I was seeking only a few million dollars in capital and seemed to spend most of the meeting trying to put our proposal in various boxes that didn't fit. They recognized that my plan for spinning off an existing business unit from a large company represented low risk with moderate returns in the short term, but they criticized the proposal for not providing a $100 million upside within five years. They couldn't look past the existing business to see the new market opportunities for which we were seeking funding.

After several months of meeting with typical VC firms, I found Globespan Capital and Silicom Ventures. Globespan was a spin-off itself from an established venture capital firm and had a strong track record in atypical venture deals. Silicom was a creature that I'd never seen before – angel investors loosely affiliated to support investments in a wide range of deal sizes and industries. After I met with them, the model and methodology for funding made so much sense to me, that I couldn't understand why similar organizations hadn't sprouted up through Silicon Valley.

But what I got from Globespan and Silicom Ventures was much more than just money. I hired one of the Silicom investors as CTO, and other investors from Silicom have proven invaluable in helping guide our company with sound business advice, industry contacts, and suggestions for new products.

Six months later, the spin-off was complete, and Luidia was born. Some might say that Luidia's experience represents that antithesis of VC conventional wisdom of the 90s – a hardware company, instead of an Internet play – a proven product in its 2nd generation of development, not just a cool idea.

I would argue, though, that "the more things change, the more they stay the same." What ultimately convinced Globespan and Silicom to invest were the team and the vision, and these two factors are almost always listed as the critical ingredients for any successful venture deal.

Over the next few years, I believe the primary challenge for VCs and angel investors will be to recognize the key criteria for success in potential companies without relying upon cookie-cutter formulae to do the work for them. Those investors who do this well will continue to find successful investments, even during an economic downturn. Those who fail to discard broken models, though, will be paralyzed or, worse, misguided in their investments.

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To move forward, Israel and its venture industry must more firmly embrace the global marketplace. Israel needs to promote itself in a more positive light to attract foreign investment and partners. The Israeli government must act to accommodate an easier flow of technology, investment and professional services across its borders to encourage commercial growth. Israeli venture investors need to reach out to quality US investors and others to find new means of cooperation and to leverage the reach of Israeli venture funds. Israeli companies operating in the US should be encouraged to adopt corporate compliance, governance and management standards which will attract high quality funding and advance successful exit opportunities. Finally, Israeli venture investors would be wise to actively pursue opportunities in China and elsewhere in Asia – either with US partners or on their own – to take advantage of those emerging markets.

From my perspective, Israel can and should be more than a supplier of new technology solutions. Israel should strive for leadership in the global technology marketplace.

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