HARVARD | BUSINESS | SCHOOL

9-898-154

REV: MARCH 18, 2005

MICHAEL J. ROBERTS

NICOLE TEMPEST

ONSET Ventures

Terry Opdendyk scooped a stack of files off his desk and loaded them into his briefcase. As he did so, he was careful to include materials he would need to think through several significant issues that faced ONSET Ventures, the venture capital firm of which he was a founding partner. It was a Friday afternoon in July 1997, and ONSET was in the midst of raising an $80 million fund—its fourth and largest to date. Terry was proud of what ONSET had achieved over the past 13 years, since its initial $5 million fund. The firm had become known as a top-tier seed investor in the major leagues of Silicon Valley Venture Capital (VC) firms. It had an enviable deal flow, and its limited partners had "re-upped" for the new fund in only nine days. Indeed, they had made commitments for $140 million, significantly more than the partners wanted to raise.

ONSET had been founded on a well-thought-out analysis of the VC industry and operated according to strict principles that its partners had articulated and refined over the years. But, the VC business was changing, and Terry wanted to be sure that ONSET's strategy evolved in an intelligent manner along with the industry. Thus, one of the issues he and his partners had to resolve related to whether the fund should raise more money than they had originally decided upon.

Finally ONSET's partners faced an additional issue related to investing some of the funds that remained in ONSET II, the previous fund. ONSET had been "incubating" an interesting investment opportunity: a team of entrepreneurs had been working to develop a new software product for managing sales force compensation. This company— TallyUp—had been in incubation for about a year, under the sponsorship of ONSET partner Darlene Mann. The team and business model had come together during this time, but the Company had not achieved all of the objectives ONSET had set when the original seed financing of $1 million had been provided. Specifically, TallyUp had not yet developed a "beta" version of the software product. Thus, the partners at ONSET needed to decide whether to invest an additional $1 million round of seed-level financing in TallyUp or to bring the company—in its current state of development—to more traditional VCs for follow-on first round funding.

Opdendyk waved to Mann as he walked through ONSET's offices and headed home for the weekend. "See you Monday," he said, looking forward to the partners' meeting where they would discuss both how much money they should accept for ONSET's latest fund, and what financing approach they should advocate for TallyUp.

Senior Researcher Nicole Tempest and Lecturer Michael J. Roberts prepared this case at the HBS California Research Center as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Background

ONSET was founded in 1984 as a seed stage venture fund. The first fund—simply called ONSET—had been raised by Opdendyk and David Kelley in 1984. This was a $5 million "feeder" fund that had been financed by three later-stage venture capital firms and 31 CEOs and entrepreneurs. The purpose of the "feeder" fund was to make seed stage investments that would move up the "food chain" to the three later-stage VC firms for follow-on financing. From 1984 through 1989, Terry, David Kelley and later, Rob Kuhling honed the seed stage strategies that were to become the basis for later funds.

Following this first fund, a $30 million fund—ONSET I—was raised in 1989. ONSET II, a $67 million fund, was raised in 1994. By mid-1997, two-thirds of that capital had been invested in seed and follow-on investments, and the principals were reserving the remainder of the funds in ONSET II for follow-on investments in businesses already funded. Thus, ONSET was seeking to raise its fourth fund—and its largest fund to date. The partners had decided to seek a minimum of $80 million of capital and a maximum of $95 million.

(See **Exhibit 1** for excerpts from ONSET III offering memorandum that describe the investment history and performance of ONSET I and II, as well as a more detailed description of ONSET III.)

ONSET Ventures: Strategic Foundation

Opdendyk had a masters degree in computer science and had joined Hewlett-Packard as a software engineer in 1970. Three years later he left to join Intel, and after seven years there, he became president of Visicorp, one of the early successes in the personal software industry (e.g., "Visicalc," one of the first spreadsheet programs). Upon leaving Visicorp in 1984, Opdendyk was intrigued with the process of starting and growing a new business. Thus, he decided to undertake a systematic study of how this process worked, at least as practiced by venture capitalists.

> We knew that only 1% of the businesses that sought VC funding actually obtained it. And, of those companies that did get funded, less than 25% succeeded in getting to a future financing event that valued the company above the valuation in the first financing. We wanted to see if we could figure out if there were any principles that explained which companies were successful.

Opdendyk and his partners interested several large and successful VC firms in an investigation of these issues. These firms opened their records for a confidential study of 300 separate investments that were included in their portfolios. Opdendyk explained the principles that were distilled from the analysis:

> First, if you had a full-time mentor who was not part of the company's management team, and who had actually run both a start-up *and* a larger business, the success rate increased from less than 25% to over 80%. Genentech, Compaq, Lotus, all fit this model. Certain venture capitalists had this skill set, and were willing to invest the time to add this level of value. It was clear that if VC partners defined their relationship with a company as a personal commitment rather than simply as a portfolio investment they simply did not let most failures happen.

> The second principle related to whether or not the business continued operating on its initial business model. It turned out that this was a good way to fail. The successful companies almost always *changed* their business model as they progressed; a business plan is

great, but only the market will tell you if you have a business model that really works. You need to be sensitive to what the market is telling you, and adapt. And you have to do this continuously.

Third, it makes sense to wait until the business model is validated before hiring the CEO. If the CEO is hired before the business model is refined, you will get the business model that the individual used in their last job. If you wait until you have refined the business model through several iterations, you have a much better shot at choosing a person who can really execute that model.

Fourth, you spend money *only* to add value as perceived by those individuals providing the next round of investment capital. Once you get to cash flow positive, you have the luxury of focusing solely on the operating tasks of the business—those activities that generate revenues and profits. But, until you get there, you are dependent upon the next set of investors to survive. So, also you need to focus as well on what will add value in *their* eyes.

Fifth, there has to be a want, not just a need, for the product. The company needs to have a unique reason to succeed. During the early years of a business, it is very difficult to change the way that potential customers think. You need to find an immediate source of pain that people will pay to eliminate. For example, when Lotus 123 came out, it was a more sophisticated product than Visicalc—it integrated database, graphic, and spreadsheet tools. But the reason it was successful was that the product had variable column widths. Financial analysts were screaming for variable column width, and Lotus had it; they made the pain disappear.

Finally, only special people make a special business. You simply cannot compete successfully with larger, established companies if you have ordinary people.

ONSET in 1997

Based on these ideas, ONSET was founded in 1984. The firm evolved over the next dozen years, and refined the principles articulated above. As of mid-1997, ONSET had offices in both Silicon Valley and Austin, Texas. It had 4 partners and had invested in 47 companies. Given the importance of experienced mentors in the ONSET model, the firm had no junior-level personnel (see **Exhibit 1, Appendix C** for ONSET partners' resumes). Opdendyk observed: "When you look at what we are doing during the incubation process, we are often serving as the CEO. You need people who have actually run a business to do this effectively and credibly."

The process of refining ONSET's business principles had led to the development of the firm's incubation process. This was a series of steps through which business ideas were developed, refined and ultimately pursued—or alternatively, rejected. There were two distinct phases to the incubation—process: "pre-seed," which referred to the stage prior to a funding commitment, and "seed," after a financing.

The Incubation Process: Pre-Seed Phase

The pre-seed stage referred to the phase during which a partner from ONSET worked with an entrepreneur or team, trying to decide if their business concept could be the basis of an attractive investment. During this phase, ONSET attempted to discern the assumptions that lay behind the business proposition, as well as the analysis that could be done to determine the merit of those assumptions. The issue was whether ONSET could spend a "reasonable" amount of money—

approximately $1 million—to substantially reduce the risk. As Rob Kuhling, an ONSET partner, described it:

> The basic principle of what we do is to take as much risk out of the equation for as little money as possible in as short a period of time as we can. This means something different each time, depending on the business model and the industry. In medical devices, the early risk reduction points are proving that the technology works in animals, proving it works in humans, and then demonstrating that it can obtain FDA approval.

Another dimension of the pre-seed analysis concerned the people involved: were the entrepreneur and the team up to the task? Opdendyk described how ONSET addressed this issue:

> We work with the founders, trying to gauge their skills and temperament. One of the key hurdles is the "would you rather be rich, or would you rather be king?" test. When we start working with an entrepreneur, they are in the selling mode. But, usually, after a few meetings, they get more comfortable talking about the problems they see, rather than simply trying to convince us to invest. This is a key step. They have to demonstrate that they are willing to learn and adapt, not just take our money and charge ahead with their original business plan.
>
> We also assume that we may need a new CEO. Fifteen years ago, we took for granted the ability to find the person we wanted. Now, talent is so scarce in the Valley that we need to be more confident of getting the right person. Now, before we are willing to go into the seed stage, we need to have some sense of who the individual is, and also that we will be able to get a headhunter to sign up for the job.
>
> You might ask, "What about the entrepreneur who comes through the door with the business idea—isn't he or she the CEO?" Well, we have learned that they are often not the right person. We are up-front with everyone who comes to us about the process. Most people think that they will be the exception to the rule, and there *are* exceptions. What usually happens is that we ask the founding team to do some piece of analysis to help refine the business model—to pull apart the value chain and see what elements of the business are really crucial. Well, the team comes back a few days later and asks for help; they haven't made much progress. So, we help them do it. And then, there is another assignment, and they ask for more help. And after a few iterations, they ask, "Can you get someone full-time to help us—this is just what we need." And we say, "That person would be a CEO." And they get the idea. Often, we will push them to wait beyond that point, because we want the business model better defined; this helps us articulate exactly the kind of CEO we need. And this is a luxury we can afford because of the role that we are willing to play in the process. The key to playing this role credibly is to add value in every single meeting we have with the entrepreneurs. Sometimes, we get part way down this path, and it is clear that it is not working. And we have to be willing to walk away.

In addition to the work described above, ONSET also talked to both potential customers and other venture capitalists during this phase. In discussions with customers, ONSET was trying to get a feel for whether "the dogs will eat the dogfood." And, meetings with VCs were aimed at discerning what would be required to add value in the eyes of those who would be providing the next round of financing, assuming ONSET decided to fund the seed stage. The output of a successful pre-seed analysis was an incubation plan that described the analysis that would be undertaken during the seed stage, as well as the milestones the team would meet.

The Incubation Process: Seed Phase

Opdendyk described how the process unfolded once ONSET made a financing commitment:

> Once we write the check—usually about $1 million—we are in the seed stage. We start to work on the incubation plan that was the output of the pre-seed process. We attack the issues where the business model seems most vulnerable.
>
> We have developed a process to ensure that we are adding real value during this process called "projection and reflection." We go to the venture funds whom we think would make good first or second round investors and tell them what we plan on accomplishing during incubation. We ask them what the business would be worth in a financing if we actually reach those objectives, and then we do the math. Simply put, we know what kind of step-up in value we need to make our internal hurdle rates. On a classic seed stage investment it is 2.5x. So, if the VCs will value it at $5 million pre-money at our milestone, and if it will take $1 million of capital to get there, then we know how much we can pay in the seed stage. Almost every time we do this with a potential investment, the initial answer is that you can't get there from here. We need to reengineer the model, either make it worth more, or get there with less money.
>
> As an example of what can go wrong when we do not think carefully about this, we had a seed stage company whose plan included spending $500,000 to get an ASIC (chip design) done. Well, all the potential VC investors believed that this was an easily accomplished task—they never saw any risk in it. So the fact that we did it did not raise the value of the company in their eyes.
>
> By going to other VCs early, we quickly validate what the most significant risk is. It's usually one of five issues: the technical risk (will the technology work?); market risk (are there enough customers?); operating risk (can we actually build it for the required cost?); distribution and pricing (is there a distribution channel that will get the product to the customer cost effectively?); and, finally, the team (can they execute?).

Rob Kuhling described the lessons he'd gleaned from years of going through ONSET's incubation process:

> Initially, when I started looking at venture investments, I thought that a solid "business strategy" was the most important determinant of success. Maybe this isn't surprising, given my background at BCG. Later, I thought the key was proprietary technology, because it gave you time to make the inevitable mistakes and fix the strategy that was often off the mark. Now, I think it is people. The skills and energy of the entrepreneur can make even a mediocre idea a success, but average people will ruin even a good idea. If a team walks through the door, and it is populated with second-rate people, I have learned that it is just too much work to drag them up the hill. My time has a significant opportunity cost, given the number of deals we can do. Unless the idea is so big and so powerful that it could be an absolutely huge hit, it just isn't worth the sacrifice of committing the time and energy to a mediocre team.

The Venture Capital Industry in 1997

In July 1997, as ONSET was raising the capital for ONSET III, the venture capital industry was in the midst of an extraordinary year. High returns on VC investments had caused limited partners to put more and more money into venture capital and private equity investments. Venture capital firms with reputations for high returns were in the best position to compete for these funds, and the economics of the business provided a significant incentive to create larger and larger funds. Thus, by mid-1997, the size of the average VC fund had increased 40%, from $50 million in 1996 to $71 million (source: *Venture Capital Journal*, February 1997). There were several consequences to this infusion of money. The VC firms were forced to bring new employees into the business to do some of the work. In 1997, for instance, 72 graduating MBAs from HBS—8% of the graduating class—found jobs at VC/private equity firms. For other summary statistics on the venture capital industry, see **Exhibit 2.**

The active state of the IPO market from 1995 to 1997 was a further boost to the VC market, as investments became liquid more quickly and at high multiples, improving returns to investors. Thus, by many measures the timing of ONSET's entry into the market for ONSET III could hardly have been better.

Economics of ONSET's Business

Over time, ONSET refined its incubation process in order to build on practices that were most likely to generate the high returns (generally measured by limited partner investors as internal rate of return, or IRR) that would attract investors for future rounds, as well as reward the ONSET partners themselves. Opdendyk described some of the key economic dimensions of the business:

> Our bare minimum target rate of return—at the fund level—is a 30% IRR over a 12-year cycle. This translates into higher numbers for individual investments, in order to cover fees, expenses, and the General Partners' carried interest. Given standard investment liquidity cycle times, this implies a 2.5x step-up in the seed to first round, a 2.0x step up from the first to second round, and a 1.5x step up in the second to third round. We assume about a year between these "steps." If you look at our last fund, we invested in 18 companies. We have four partners, and the "investing" life of a fund is about four years. So, we are basically incubating one company per year per partner. With the kind of intensive work we do with a company, it is hard to do more. On average, we put in about $4.5 million per company: $1 million in the seed round, $1.5 in the second, $2 million in the third. Even though we are putting in more money per round, valuation is going up by a sufficient amount that we are not staying even with our original ownership position. Interestingly, people have looked hard at the numbers in terms of what you need to do to get the full benefits of "diversification" in a portfolio. It turns out that once you get to 10 companies, you have almost all of the diversification you can get. Any more, and you really have very little benefit to show for it.
>
> When you look at the economics, you will understand a fatal flaw of our first fund. We teamed up with three of the premier VC firms in the Valley. We had a $5 million fund, and we did the seed round, and they had the right to do the future rounds. They had no obligation to let us put any money in on anything but the seed round. At their option, we could invest in follow-on rounds. But we only got this opportunity when they didn't fully subscribe for the company's financing. Well, they did 100% of the A and B level deals, and we only got to do the C & D level deals. This skewed our returns badly, and we gave up on that strategy and went out on our own.
>
> Now, the fact that we control deal flow is a huge plus for us. We usually do 100% of the seed stage for any company we back. This is a hard round to share. We like to say, "It's tough having more than one chef in the kitchen when you don't know what the recipe is yet." Once you know the recipe, you get some leverage from multiple chefs, but before that all you get is confusion.

Yet, because we are so dependent on the seed round—and because of our philosophy—we are vulnerable to local "irrationality" in deal pricing. We believe that each round has to stand on its own. You can't do a bad deal in the seed round and hope to fix the problem in later rounds. If a big venture fund decides that they don't have the deal flow they want, they can decide to pay what we think of as an "uneconomic price" in the seed round, and hope to make it up in later stages. This is one of the reasons why we opened an office in Austin. We decided that having a presence in multiple markets would diversify the risk of pricing abnormalities in a single market.

ONSET had developed some "rules of thumb" which the partners believed would help the firm meet its return targets. Opdendyk explained:

- We will not lead a start-up in an industry where we don't have the ability to reinvent a business model. If we haven't led a deal in a segment before, we won't try to learn that segment by leading a start-up.
- We will only invest in a deal where we have a local presence. We've learned that if we are not in close touch with the company, it is much harder to add value.
- In general, if a company needs more than $30 million of private capital then it is not an opportunity for us. We will simply suffer too much dilution at the back end to make it worth our while.
- We will not invest in a deal that is "under the spotlights." There are certain industry segments that everyone is chasing, where—we believe—other investors are likely to make irrational decisions about valuations and financing size. We'd rather play off to the side a bit, and give ourselves a chance to make a few mistakes.

ONSET's returns were, of course, influenced by its strategy of focusing on seed stage investments. The table below describes private equity returns by type of investment.

Limited Partner Returns by Stage of VC Investment

Year	Seed	Early	Balanced	Later	All Venture
1981	5.60%	33.70%	16.40%	17.40%	19.00%
1982	-18.70	57.00	27.40	25.50	32.20
1983	20.50	61.40	35.30	37.50	40.00
1984	-9.50	-6.20	-2.70	-3.50	-3.40
1985	-9.10	-5.60	2.50	2.00	1.20
1986	5.10	5.20	8.90	1.70	8.00
1987	4.30	8.80	6.20	15.70	7.20
1988	-1.00	-2.00	3.10	4.10	2.60
1989	7.10	-0.30	6.10	7.80	5.40
1990	6.60	5.90	0.00	5.80	1.20
1991	15.70	29.70	17.10	47.10	22.10
1992	8.10	5.30	12.80	19.40	12.70
1993	17.30	12.20	17.60	43.90	18.90
1994	14.70	13.10	13.50	12.40	14.60
1995	46.30	62.60	43.70	51.00	49.50
1996	46.70	43.60	41.00	33.70	42.10

Source: Venture Economics

Note: Returns are calculated on a year-by-year basis using year-end appraisals of investment values. Returns are net of fees, expenses, and carried interest. These are not fund IRRs or "class year" IRRs.

ONSET: Deciding How Much Money To Raise

As ONSET II entered its third year of existence, approximately $22 million of capital remained in the fund, which the principals anticipated using primarily for later-round investments in companies already in the portfolio. Thus, thoughts turned to raising a new fund—ONSET III. Opdendyk described the thought process:

> As we thought about ONSET III, we naturally did some calculations. We have four partners, and we do one seed stage deal per partner per year. The average number of dollars per deal has increased over the past several years. In ONSET I it was $2.5 million, in ONSET II it was $3.5 to $4 million, and in ONSET III we anticipate $4.5 to $5 million. In part, this is due to the fact that it costs a little more just to get into business, so the seed stage investment is somewhat larger. This has also been a result of our getting more disciplined in our own approach, and doing the seed round increasingly on our own. But, for ONSET I and II, we have gone back and analyzed the data, and found that we under-invest in our winners. Our returns would have increased if we had put more money in the follow-on rounds of all of our deals. So, we anticipate that the average company in ONSET III will take a little more capital than in the past—say $5 million. If you look at the time cycle of the fund, it is 10 to 12 years. Because we are a seed fund, it takes—on average—6 years from initial investment to liquidity. (Lately, due to the cycle we are in, it has taken only four years to get from seed to liquidity, but it would be unwise to count on this going forward.) Thus, if we want to shoot to close out the fund in 10 years, we can make our last seed investment in Year 4. So, four partners times one deal per partner times $5 million per deal times 4 years is $80 million. If you add $10 [million] to $15 million in expenses and fees, you get to $95 million or so. This was the upper end of the target for the amount of money we set out to raise.
>
> When we bring new VCs in during follow-on financings, we want to add top-tier players to the deal. To do this, we have to be willing to let them invest the amount of money that makes their economics work. So, if we are doing a $5 million round, we might like to split it equally with a large venture fund. But they need to put more money in simply because their funds are so big. Some of these funds, for example, are trying to put out over $400 million per year.
>
> When we called on our limited partners to make our pitch for $80 million for ONSET III (see excerpts, **Exhibit 1**), it only took two weeks before we had commitments for $140 million. So, now we have a decision to make. If you look around, you can certainly conclude that times are unusually good—that we should take the money because you can't be sure it will be there in four years when we go out to raise another fund. But, that raises the question of what we actually do with the money. We have thought hard about the business model we have built, and how it fits into the basic economics of the venture business. We like the niche we have staked out, and we are doing well in it. We don't want to be just another "diversified balanced" venture fund. And, it is clear that our limited partners behave like rational institutions—they all want to put their money in "top quartile" funds.

Rob Kuhling offered his perspective on the decision confronting the partners:

> Seed stage is where we want to play. While there are periods during a business cycle where seed stage investments perform less well than other stages, generally, over time, seed stage provides a better return. The other round that historically does very well is the round closest to the liquidity event, and this is driven more by the short time horizon to liquidity as it is by the multiple you are getting on your investment. But, it is very tough to just play in *just* this round—you usually need to be in the deal earlier to have the opportunity to invest in this round.

ONSET II: The TallyUp Decision

In addition to deciding how much capital to raise in ONSET III, the partners at ONSET needed to make a decision about one of the companies that had been seeded in ONSET II—TallyUp. Darlene Mann, a partner at ONSET, had been working closely with TallyUp since August 1996. She described the issues that ONSET and the TallyUp management team faced:

> TallyUp is developing a new software product for use in managing complex compensation systems, like those used for a commissioned sales force. Our original incubation plan called for them to hit a number of key milestones, and then go out and raise a first round of traditional VC money. Well, we've spent the seed round capital and hit many of the key milestones, but we still do not have a product in the beta stage yet. The issue we face is whether ONSET should invest an additional $1,000,000 to enable TallyUp to develop its beta product, and hold off on raising the first round of venture funding from traditional VCs until the product is ready in mid-1998, or go out to the market now to raise $3 [million]-$4 million and use the money for both product development and sales and marketing. And, if we do proceed now with a round of outside financing, what is the appropriate valuation for TallyUp?

TallyUp Company Background

Andy Swett, the co-founder of TallyUp, was introduced to Mann, a partner at ONSET, through a mutual friend in August 1996. Mann reflected on their early meetings:

> When Andy first came to ONSET, he described his business idea as a billing system for service and content providers on the Internet. With the rapid growth of small companies doing business over the Internet, he believed there was a real need for an inexpensive billing system since the existing systems in the market cost on the order of $500,000. Based on my experience in the software industry I didn't think there was a sufficient market for the product, but I was very impressed by Andy's technical background, determined entrepreneurial personality, and his willingness to accept help. I felt that even if this was not a great product, Andy was an entrepreneur who possessed all the traits necessary for success. I suggested that Andy work with a consultant, Scott Kitayama—who later joined Andy as co-founder of TallyUp—to validate his business idea, using a loan from ONSET to pay the consulting fees. This study quickly concluded that there was not yet a sufficient market for an Internet billing system. However, I was still very intrigued by the settlements technology which was at the core of Andy's product and we brainstormed about the various business opportunities which could leverage this technology.

Swett reflected on this period:

> I thought ONSET was going to bail out after the Internet billing system idea didn't work out. That's what I expected from a venture capital firm. But, ONSET was different—they really stuck with us through this period while we came up with the next idea.

Mann continued:

> Based on these brainstorming sessions, Andy came up with the idea for a sales force compensation system. Having previously been a VP of Sales, I knew there was a real need for a product like this. However, to better understand the level of market demand, we interviewed over 25 companies to determine what systems they were currently using and what issues they were facing. We found that these companies were spending $100,000 to $200,000 per year on managing the administration of sales force compensation, and would be willing to

pay hundreds of thousands of dollars for a sales force compensation system without blinking. We were very encouraged and decided to move ahead with the idea.

Collectively, Andy, Scott and I sat down to determine what questions needed to be answered and what issues needed to be addressed before ONSET would invest the seed capital required to get started. Two critical issues quickly surfaced.

First, we needed an expert in the compensation field to work with us on product design, to set up and lead discussions with potential users, and to give TallyUp credibility with customers. However, we were not prepared to bring someone on full time at this stage, so the person had to be willing to serve in a consulting role. We interviewed about 30 people and identified one, Jim Finkelstein, who would be an excellent fit for the company. Jim had been the director of compensation at Pepsi-Cola and a compensation consultant at Towers Perrin before starting his own compensation consulting practice. The fact that he had his own practice worked well for us because he could work with us on a part-time basis and with his own clients the rest of the time. We negotiated a deal with Jim where he would be paid partly in cash and partly with both participation-based and milestone-driven equity. ONSET's role in the interviewing process was critical since we lent credibility to the team and the business model.

The second question we had to answer was whether we could design a sales force compensation system that could be an off-the-shelf product. Many of the potential customers we interviewed expressed the view that compensation plans were too complex and varied too widely between companies to be supported by a standardized product. However, as we dug deeper, we learned that in reality there were only so many different compensation methods, with the real variability revolving around the percentage commission, the number and type of distribution channels used, the complexity of products offered, and overall size of the sales force. So, using the latest rules-based technology, we could capture this in an off-the-shelf product.

Incubating TallyUp

By December 1996, the team had developed an operating plan (see **Exhibit 3** for excerpts from the operating plan) and ONSET invested $750,000 to purchase preferred shares (at $1 each), in return for 31.6% of the company, based on a $2,375,000 post-money valuation. The agreement was structured so that ONSET would later invest an additional $250,000—at the same $1 per share price— to further help the company accomplish its key milestones, if needed. The company elected a Board of Directors, which included Mann, Swett and Terry Opdendyk, with the agreement that Terry would turn over his board seat to the new CEO when he or she was hired. In addition, ONSET also required that they play a role in all substantive decisions, such as hiring senior staff and purchasing capital equipment. However, on a day-to-day basis, ONSET's involvement primarily focused on the team's work plan.

Once ONSET invested, the real incubation process began. Mann acted in a day-to-day CEO role for TallyUp, working to achieve the five goals that she and the management team had established:

- Validate, size and segment the market;
- Bring the product to the beta stage;
- Develop the business plan;
- Hire a top-flight CEO; and,

- Bring in 2-3 development partners who would put in money in return for early access to a sales force compensation system designed with their requirements in mind.

Mann reflected on how the plan helped them minimize risk:

> In every new business there's technical risk and market risk. We did not feel that the technical risk centered on *whether* the product could be built, but rather *what* product was built—what customer needs it addressed. We felt the technical risk was really on the execution side. In terms of market risk, our biggest concern was whether the market was large enough. In order to minimize both of these risks, we invested significant time and resources into market research. As we interviewed companies to gain a better understanding of the market and their specific needs, we also marketed our product idea in hopes of attracting at least two corporate partners with whom we could develop a product. We were successful in attracting two paying development partners. This reduced the risk for us; not only were they putting their own capital at risk, but serious, paying customers helped us attract the attention of the venture capital community.

Kitayama, now serving as vice president of marketing, reflected on ONSET's role in the process:

> ONSET kept putting manageable hurdles in front of us—these took the form of questions we needed to answer before proceeding. It made it tough at times, but it also gave us a clear roadmap for what we needed to focus on. For example, ONSET believed that either you develop a $500 product and sell hundreds of thousands of them through the retail channel or you develop a $100,000 product that you sell through a direct sales force. Anything in the middle is purgatory. So we had to prove that our product could be priced at, or above, $100,000.

The team worked on several of the goals in parallel: Kitayama and Mann focused on developing a detailed understanding of the market, while Swett pushed forward on product design. Early on, it became clear that to tackle both these issues they needed to get access to potential customers to understand their needs in detail. They set up 31 one-on-one interviews with potential customers to determine how the sales force compensation function was currently being handled and what a technical solution could possibly look like. Mann reflected on their findings:

> We talked with CFOs, directors of compensation, and sales managers, and the answer came back the same—the administration of compensation plans is a real headache. It's a highly time-consuming and unproductive process. Most companies have one administrative person per 50 sales people and that person spends most of his or her time poring over spreadsheets trying to understand the discrepancies between what the salespeople had been paid and what they thought they should have been paid. Furthermore, many of these companies would rebuild their system each year as the compensation plans changed. There was clearly a need for a system that streamlined this whole process. We discovered that the early adopters would be companies in the high tech and financial services industries since their distribution capabilities created complicated sales environments.

Mann also sounded out four venture capital firms as part of ONSET's projection and reflection process to determine the risks that they perceived. Mann found that the venture capital firms were most concerned with who the CEO would be and whether the market was large enough to justify an investment. Since the market size issue came up several times during their discussions, the TallyUp team dedicated a significant amount of time to studying the market in order to develop a fact-based estimate of its size. The team estimated the market for replacing existing dedicated sales force compensation systems to be around $400 million. However, when the market was expanded to include all variable-based incentive plans, the team estimated the size of this larger market at $1.5-$2.0 billion.

In 1996, 7.6% of all exempt employees in the United States were paid based on variable compensation plans and the trend was accelerating: incentive compensation was becoming popular at more companies and at lower levels of these organizations.[1] This large and growing market had naturally attracted the attention of several major software firms, including Oracle, SAP, and Peoplesoft. Some of these firms were developing applications targeted toward the same market as TallyUp's product. The TallyUp team believed that its product was superior, and that they had a lead in developing an offering for the market which they needed to protect by moving quickly.

Hiring a CEO

In keeping with ONSET's key principles, Mann and TallyUp held off on hiring a CEO until they had completed their extensive market research to validate the attractiveness of the market and understand the nature of the business opportunity. As was frequently the case with start-ups, it was clear early on that TallyUp would need to bring in a CEO from the outside. Mann described how ONSET dealt with this issue:

> We always have conversations with the founders up front about their positions in the company. We don't invest if the founders don't understand that they may not have their current positions in the future. In fact, the more successful the company is, the less likely it is that they'll keep the role they began with.

Swett reflected on ONSET's role in the recruiting process:

> At the time we were looking for a CEO, there were 300 CEO searches going on in the valley and only 150 of those got the attention of an executive recruiter. ONSET's relationship with an executive recruiter, who they keep on a retainer basis, was a tremendous advantage to us since finding the right CEO was a make-or-break decision for us.

The team's investment in market research and in the development of a compelling business concept enabled them to successfully attract an experienced software executive to be the CEO of TallyUp. Mann considered this to be a major victory given the shortage of senior leadership talent in Silicon Valley. TallyUp's new CEO—Reed Taussig—came to the company after having served as the SVP of Worldwide Operations for Unify Corporation and SVP of Sales and Marketing for Gupta, both database tools companies, and most recently had founded an Internet company, named inquiry.com. Taussig reflected on his decision to join TallyUp:

> I was looking for an opportunity with a company with a very clear value proposition. Software companies were spending 10%-12% of revenue on the administration of compensation plans, and those dollars were mostly going towards developing and maintaining complex Excel spreadsheets. That was a very compelling value proposition for me.

Once Taussig was hired, ONSET invested the additional $250,000 they had planned to put in, raising TallyUp's (post-money) valuation to $2,625,000.

[1] *Compensation and Benefits Review*, September/October 1996.

Decisions Ahead

Conducting market research and hiring a CEO had taken almost nine months. This was longer than the team had planned. It had also cost TallyUp most of the $1,000,000 in capital it had raised from ONSET. Mann reflected on the decision to spend the money on developing a solid understanding of the market versus building the product:

> It's an interesting question: do you spend the initial money on building the product or developing the business model? A lot of venture firms and entrepreneurs will build the product first, then refine the business model. However, at ONSET, if we are fairly confident that a product can be built, which is generally the case for software these days, then we'll focus our efforts on reducing the market and execution risk. The way we like to work is to spend $1,000,000 or less to understand the business and determine *how* to build the product. The question really comes down to whether you prefer market risk or technical risk—is your bias toward how the business model is formulated or how the product is developed? In this case, we were more worried about the market and the business model.

Thus, in July 1997, ONSET and TallyUp needed to decide whether ONSET should invest an additional $1,000,000 into TallyUp to develop a beta version of the product, or whether TallyUp should go out to the venture capital community at the current stage—without a product—to raise $3 [million]-$4 million for product development and product launch.

Mann explained why $1 million was needed to complete the beta product, when this figure was equal to the amount of TallyUp's entire initial funding:

> Given the growth in the organization and the need to support both existing development partners and sales to new customers, the company would require an additional $1 million to get to the beta stage while supporting baseline marketing and sales capabilities.

Mann knew that either option would raise difficult choices:

> A beta product would certainly raise TallyUp's valuation by at least the $1,000,000 it would cost to develop the product. If we go this route, ONSET would likely be the sole investor and we'd get tangled in a discussion with management over the valuation in this interim round. On the other hand, securing first round VC financing would be a lengthy and all-consuming process for the management team, and I worried about the impact this would have on the momentum the team had generated coming out of their intensive market research process. I'd also be concerned that Taussig—with so little experience at the Company—might have a tough time selling the concept, without a product, to the venture capital community.

Mann was optimistic that if TallyUp went to market for $3 million to $4 million of VC now—without a beta product—the venture capital firms would be very interested. She based this view partly on the sense that the VC market was "hot"—who knew if the money would be available in six months? Finally, there was the issue of time. Given the looming presence of some of the larger software companies in this segment, Mann was eager to get to market as soon as possible. Was she better off recommending the company raise the money now and getting this phase behind them, so that the team could concentrate on getting a product to market without interruption?

Mann knew there were many criteria to consider in determining the valuation for TallyUp if they went forward with the outside financing now. First, TallyUp had decided to set aside a portion of shares to be used as stock options for new employees hired. The value of these options would likely be $750,000 (750,000 shares at $1 per share), which would increase TallyUp's valuation by the same amount. Second, she knew that ONSET's business model called for a 2 to 3 times step up in valuation from the seed stage (from a base which now included the value of the stock option pool). Third, she knew that in a first round financing of this nature, venture firms would want a 15% to 20% ownership stake (post their investment). Finally, she knew that ideally, ONSET wanted to invest 50% of the $3 to $4 million raised.

* * * * *

"Have a good weekend Terry," Mann called out to Opdendyk as he headed out the door. She turned her attention to the stack of files on her own desk. Mann wondered whether she should advocate outside VC financing for TallyUp, and if so, on what terms? How much of this financing should she recommend ONSET itself provide?

Exhibit 1 Excerpts from ONSET III Investment Memorandum

Table of Contents

*Included.

OVERVIEW

Investment Focus

Like its predecessor funds, ONSET III will distinguish itself from other venture capital funds by its investment focus. First, ONSET III will focus on initial and follow-on investments in seed stage projects, because excellent returns are possible from such investments. Second, ONSET III will increase seed stage company success rates by investing the partners' time, skills and resources using the Partnership's proven value-added incubation and development methodology. Third, ONSET III will primarily invest in technology-based companies that match the partners' experience and ability to add value. Fourth, ONSET III will locate most of its companies in Northern California and Austin, Texas, to facilitate the ability of the partners to work closely with the companies as they develop.

Seed-stage Investments

ONSET III will target seed stage projects because the returns from successful seed stage investments can be several times higher than later-stage investments. Even though the potential for higher returns is generally recognized, relatively few venture capital funds focus primarily on such investments, mostly because successfully managing the risks of seed stage investments demands more from the investment management team than the traditional monitoring approach used for later-stage investments. Selecting the targets requires greater care and investment discipline, and implementing the supportive incubation process requires more experience and hands-on, day-to-day involvement. This under-served investment segment creates an opportunity for ONSET II, a venture fund focused on and capable of developing seed stage companies.

Selecting seed stage projects requires great skill. All ventures will be evaluated on not only the merits of technology, product, personnel, and marketplace, but also on how well the incubation process can offset the risks. For example, ONSET III will seek projects that it can develop into companies that

- have excellent personnel,
- can be the leaders in their markets,
- are in emerging growth markets,
- have proprietary product technology with compelling competitive advantages,
- have clear return on investment leverage,
- can be financed easily after a successful seed financing,
- require moderate amounts of capital, and
- have the types of risks that can be mitigated during the incubation stage.

However, at the point ONSET III will make its initial investment decision, a project may be little more than an intriguing idea, an exciting technology, or a capable entrepreneur. Such projects generally lack one or more key elements that traditional venture investors look for and that are necessary for eventual success. For example, a seed project will often have one or more of the following characteristics:

- an unproven technology,
- incomplete marketing and distribution plans,
- inadequate business and operational plans, and
- an incomplete or inadequate management team.

ONSET II is structured through its proven incubation process to provide the expertise and attention necessary to assist its seed projects in overcoming these inadequacies.

The Incubation Process

The incubation process to be employed by ONSET III was developed by its predecessor funds and the general partner organization. The ONSET Ventures' incubation process and its importance to ONSET III's investment strategy have already been described briefly. But how does it really operate?

The incubation process will often begin prior to ONSET III making an investment commitment. When an idea, technology, or entrepreneur shows promise, the first step is to explore fully the opportunity. To do so, ONSET III often will locate the entrepreneur in its Menlo Park or Austin facility. The exploration process may last months and will involve the equivalent of one full-time partner. In some cases, small amounts of capital may be used to finance particular exploration goals prior to a formal seed financing, further ensuring the viability of the business and reducing investment risk. ONSET III will make its seed stage financing commitment only after both the entrepreneurial team and ONSET III are convinced of the project's potential and appropriateness for the ONSET ventures' incubation process.

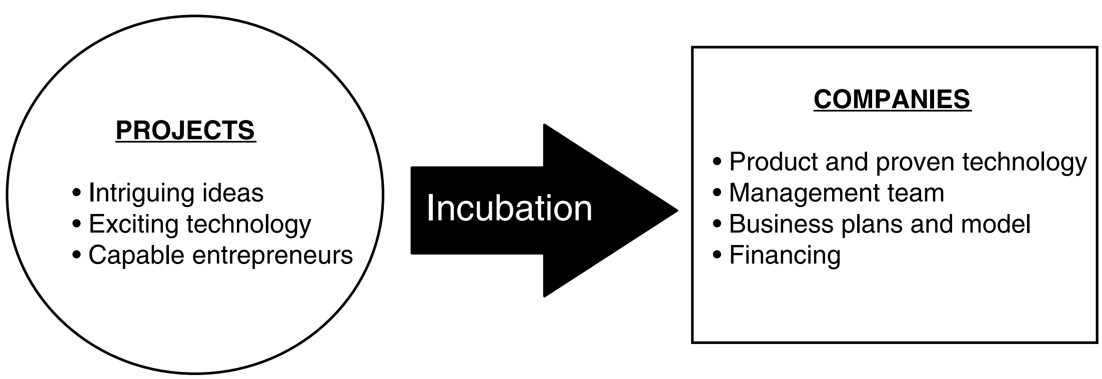
The second step is to articulate clearly and agree on what should be accomplished during the incubation. Once the goals are articulated, ONSET III's partners (generally acting as interim officers of the company), the company's management and other professionals work together as a team to accomplish the goals.

Typically, the incubation process takes 6 to 12 months. The process ends when the company is sound enough to succeed without the support structure provided by ONSET Ventures and is able to attract traditional venture capital financing. By the end of the process, most companies will have

- proven the technology,
- demonstrated the product concept and design,
- positioned the product (and the company) in the marketplace,
- developed strategic and operational plans to reflect a viable business model, and
- completed its management team.

The final step in the incubation process is to provide for future funding of the successful seed company. The Partnership will organize a syndicate of other venture capital funds to participate with ONSET III in funding the next stage, usually known as first-round financing. This downstream financing syndication is a critical element in the success of seed stage investing. ONSET III will typically introduce projects in their earliest stages to other major venture firms (including the more than 40 firms that have co-invested with earlier ONSET Ventures' funds) to facilitate first-round investment. Upon completion of the financing, the company will have successfully emerged from the incubation phase and established a more conventional venture capital relationship with ONSET III.

ONSET Ventures' Incubation Process



Value-added Approach

As a company transitions from the incubation phase to independent operation, the ONSET Ventures' partners will remain active on the company's board and will continue to be involved throughout the company's development. The principals of ONSET Ventures couple their past experiences as operating executives in both small and large businesses with a personal commitment to achieving success in each portfolio company.

Technology-based Industries

ONSET III will target seed investments in high-technology industries (particularly computer software and hardware, communications products and services, pharmaceuticals delivery, and medical devices and instrumentation) for several reasons. First, companies based on an advanced technology usually have significant early risks that ONSET Ventures and the project team can reduce during the incubation process, substantially increasing the companies' chances of success and value. Second, companies in technology-based industries often have many of the desired investment characteristics described above in "Seed-stage Investments." Finally, the partners have extensive investment and managerial experience in technology businesses in these areas.

Northern California and Texas Focus

Most of ONSET IIIs projects will be in Northern California or Texas, often initially located in ONSET Ventures' facilities in Menlo Park or Austin. The incubation process requires that the project team and the general partners work together closely on a frequent basis. Locating the project in or near ONSET Ventures' offices facilitates this interaction.

Key Success Factors

To be successful, a seed stage venture capital fund must

- be exposed to a flow of high-quality investment opportunities,
- be selective in its investments,
- provide focus, guidance, and managerial assistance to its seed projects,
- have access to capital for follow-on company financings, and
- provide ongoing company monitoring and guidance.

ONSET III has the expertise, commitment, and structure to address these requirements.

Exposure to Investment Opportunities

ONSET III will have several advantages in exposure to high-quality investment opportunities:

- The partners of the General Partner have developed relationships with entrepreneurs and executives throughout Silicon Valley through their association with existing and prior portfolio companies, other venture capital funds, and prior employment at leading high-technology companies. In addition, the partners have established strong deal flow over the past three years in Austin. Texas, and are well positioned to take advantage of this burgeoning new center of entrepreneurial activity.

- Investment opportunities are frequently referred by Paul Gomory, a premier executive recruiter that maintains extensive contacts with entrepreneurial companies and the best executive talent.
- David Kelley, as president of IDEO, a prominent product design firm, and as a professor at Stanford University, has a broad network of entrepreneurial contacts that offer investment opportunities.
- ONSET Ventures' location in Silicon Valley, where more venture-backed companies are formed each year than in any other region, results in high exposure to entrepreneurial activity.
- ONSET Ventures' unique position as the first Silicon Valley venture firm to establish an office in Austin, Texas, positions the firm to be a leader in an environment with strong high-technology job formation and entrepreneurship, and limited early-stage capital availability.
- Fewer venture firms compete for the seed stage investments on which ONSET III will focus.

Careful Selection of Investments

Selecting which companies to invest in may seem an obvious critical factor in the success of seed stage venture capital funds. However, it requires looking beyond the conspicuous flaws and defects of seed stage projects to understand their potential, given adequate development, for becoming successful companies. This potential is resident in relatively few opportunities. ONSET I and ONSET II both invested in less than one percent of the potential opportunities presented to them—a model of selectivity that ONSET III intends to continue.

Because uncertainties surround early-stage investments, ONSET III will often follow an incremental investment policy. That is, when a project shows promise, the Partnership will often move the project team into ONSET Ventures' incubation facility without a seed-financing commitment. The partners will then work closely with the entrepreneurs exploring the dimensions of the opportunity. When both the entrepreneurs and ONSET III are satisfied with the definition of the opportunity and have a clear understanding of what needs to be accomplished during the incubation process, the Partnership will commit to seed-round financing. Often this commitment will involve incremental funding contingent upon accomplishing agreed-upon milestones.

Focus, Guidance, and Managerial Assistance

Successful entrepreneurs generally have an overriding sense of optimism, self-confidence, drive, and creativity. They are rarely individuals of broad general-managerial background. They are frequently technically oriented, possessing a particular insight. They infrequently appreciate marketing and other functional specialties necessary for company success. This is particularly true in seed stage situations.

To increase a seed stage company's chance of success, it is necessary to provide constructive counsel and value-added support during the early months of a new company's development. Typically, the Partnership will devote the equivalent of one full-time partner to working with each company. This intensive commitment limits the number of investments ONSET III will make each year but increases the likelihood that each investment will succeed.

Access to Capital for Follow-on Company Financings

Seed-stage companies often fail because they lack the ability to attract first-round financing after the seed investment. ONSET III's incubation approach in itself lessens this risk, but beyond this, ONSET Ventures also offers transitional support. ONSET III will introduce its projects to other venture capital firms at an early stage, often before making its own investment commitment. This facilitates first-round financing by creating an understanding of the needs and desires of the later-stage investors and recognition of the need to adjust the incubation plan accordingly The partners' knowledge of the characteristics of attractive first-round investments and the partners' contacts in the venture community lay the groundwork for a smooth transition to later financings. In fact, more than 40 different venture capital organizations have invested in the later-stage financings of ONSET Ventures-led seed stage companies.

Ongoing Company Monitoring and Guidance

Beyond the seed stage, companies still face developmental hurdles: sales ramp-up, quality manufacturing, subsequent product research and development, team building, reaching profitability, and evaluating additional financing options. ONSET III is committed to building strong boards of directors for its companies, thereby increasing the developing companies' chances of success.

ONSET III intends to maintain a significant ownership position in its companies and to contribute to their later-stage development through active participation on the boards of directors The partners have participated in the financing and later-stage guidance and monitoring of nearly 50 companies over the last 10 years.

Prior Funds

ONSET I

ONSET I is a $30 million fund formed in late 1989 for the purpose of investing in high technology companies with a special focus on incubating seed stage investments. The general partner, ONSET Management, L.P., is managed by Rob Kuhling, Terry Opdendyk and NEA as general partners. David Kelley is a special limited partner of the general partner. The investors of ONSET I include institutions and successful entrepreneurs and other individuals. (A list of the institutional investors can be found in **Exhibit 1, Appendix D**.)

As of March 31, 1997, ONSET I had invested $22,467,635 in 20 companies. Of these companies, 8 are medical technology-related, primarily drug delivery and medical devices, and 12 are in information technology with a software focus.

ONSET I is over seven years old and the portfolio is mature, with distributions of $60,200,000 and a fund IRR of 26% at year end 1996. To date, eight companies are public, six have been acquired and several others are prospects for 1997-1998 acquisitions or IPOs.

The following table summarizes ONSET I's IRR performance since inception in 1989:

ONSET I Annualized Cumulative Internal Rate of Return

	1989	1990	1991	1992	1993	1994	1995	1996
Fund	-38.12%	-23.67%	-12.77%	1.05%	5.10%	19.11%	26.62%	26.30%
Limited Partner	-38.12%	-23.67%	-12.77%	0.70%	3.87%	15.10%	22.26%	21.72%

ONSET II

ONSET II is a $67 million fund formed in late 1994 for the purpose of investing in high technology companies with a special focus on incubating seed stage investments. The general partner, ONSET II Management, L.P., is managed by Rob Kuhling, Terry Opdendyk and Tom Winter as general partners. David Kelley, Alexis Lakes, Darlene Mann and NEA are special limited partners of the general partner. The investors of ONSET II include institutions and successful entrepreneurs and other individuals. (A list of the institutional investors can be found in **Exhibit 1, Appendix D**.)

As of May 9, 1997, ONSET II had invested or reserved for investment $43,214,765 in 19 companies. Of these companies, 7 are medical technology-related, primarily medical devices and drug delivery, and 12 are in information technology with a focus on software, services and communications. ONSET II was the initial venture investor in 8 of the companies; 14 of these were at the seed/start-up stage when ONSET Ventures made its first investment. Fourteen of the companies are located in California, mostly in the San Francisco Bay Area.

The following table summarizes ONSET II IRR performance since inception in 1994. (Given the early stage of development reflected by the majority of companies represented in the ONSET II portfolio, these numbers should be viewed as highly variable and not necessarily indicative of the long-term performance of the fund.)

ONSET II Annualized Cumulative Internal Rate of Return

	1994	1995	1996
Fund	-14.26%	-36.32%	15.49%
Limited Partner	-14.26%	-36.32%	11.69%

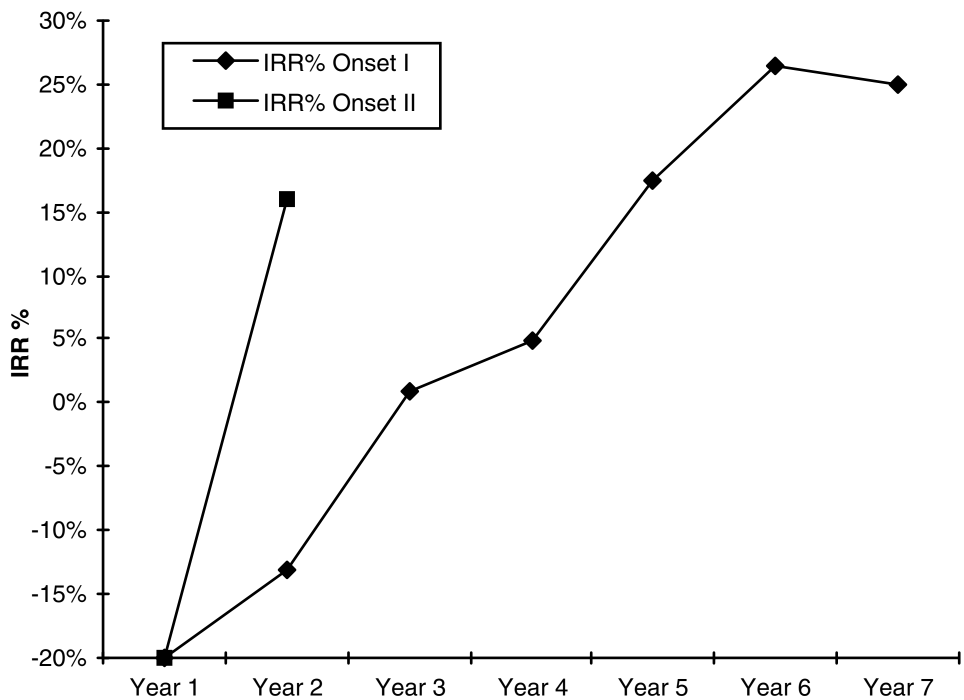
ONSET I vs. ONSET II Comparison

The following graph compares the annualized cumulative Internal Rate of Return (IRR) of ONSET I vs. ONSET II for the same period within each fund. Note that the ONSET II IRR was substantially greater than was the ONSET I IRR at the same point (Year 2) of the fund's life.

ONSET, a California Limited Partnership ("OLP")

OLP, a company incubator, was founded in 1984 with $3 million from three venture-fund limited partners and $2 million from 31 individual investors. OLP was structured to serve as a "feeder" fund to provide later-stage financing opportunities to the venture-fund limited partners and tax advantages to the individual investors.

While OLP was not a traditional venture fund, its focus was to establish the ONSET Ventures investment approach of creating and investing in seed stage, high-technology companies lacking the completeness necessary to attract capital from traditional venture investors. It was in OLP that the ONSET Ventures' incubation process was developed and refined (see “The Incubation Process”). At this time, the fund is inactive, with one final security awaiting liquidity.



OFFERING DESCRIPTION

The Offering

ONSET III expects to raise $80 million through investment in limited partnership interests by selected investors who are capable of assuming the substantial financial risks and illiquidity of venture capital investing. The initial closing may be held when at least $60 million of committed capital has been raised. ONSET III may elect to continue this offering on the same terms and conditions for up to 12 months after the initial closing. The General Partner may increase the amount of this offering to a maximum of $95 million of Limited Partner interest.

The General Partner will contribute an amount equal to 1% of the total capital of the Partnership on the same draw-down schedule as the Limited Partners. The General Partner's capital contributions may be made either in cash or by an interest-bearing full recourse promissory note.

Allocation of Income, Gains and Losses

Generally, all income, gains and losses will be allocated 75% to all Partners based on the respective amounts of their capital commitments and 25% to the General Partner. However, if the Partnership has cumulative net realized losses, all income, gains and losses will be allocated to the Partners based on the respective amounts of their capital commitments. Distributions of securities to the Partners will be treated as sales for the purpose of calculating realized gains and losses.

Investor Committee

The Partnership will have an Investor Committee consisting of at least three members chosen by the General Partner from among the Limited Partners, which will serve at the discretion of the General Partner.

The functions of the Investor Committee will be to confer with the General Partner as to the conduct of the business generally, without advising as to the merits of Partnership investments, and to: (I) review the annual operating budget of the General Partner; (2) review certain changes in the fee paid to the General Partner and approve changes in the percentages of such fee allocated among the ONSET Ventures' partnerships; (3) review certain distributions authorized by the General Partner; (4) approve certain guarantees for the Partnership on behalf of its portfolio companies; (5) approve the values established by the General Partner for portfolio assets and liabilities; and (6) resolve questions relating to certain potential conflicts of interest between the Partnership and the General Partner or between the Partnership and ONSET I or ONSET II, including an investment by the Partnership in a portfolio company of ONSET I or ONSET II. All actions taken by the Investor Committee must be authorized by a majority of the Committee members.

Appendix C: Resumes

Robert F. Kuhling, Jr.

Work Experience

1987-Present	ONSET Ventures, Menlo Park, CA General Partner, ONSET III (in formation) General Partner, ONSET II General Partner, ONSET I General Partner, ONSET, a California Limited Partnership Special Partner, New Enterprise Associates V, VI & VII Special Partner, Chemicals and Materials Enterprise Associates. L.P.
1985-1987	SUN MICROSYSTEMS, Mountain View, CA Director, Design Automation Marketing Group. Started up and managed Sun's entry into the design engineering markets. Responsible for marketing, technical support and sales development.
1983-1985	CALMA COMPANY (a General Electric Subsidiary), Milpitas, CA Vice-President, Electronic Design Automation Products & Marketing. Responsible for Calma's $100 million electronic CAE and CAD/CAM business including Product Development (R&D), Marketing and Sales Development. Director, Microelectronics Marketing. Director, Business Development.
1980-1983	THE BOSTON CONSULTING GROUP, Boston, MA and Menlo Park, CA Case Team Leader. Managed teams of consultants developing business strategies for U.S. and international corporations. Specialized in high-technology assignments.
1972-1978	THE CHARTER COMPANY, Jacksonville, FL and Houston, TX Assistant Vice President. Worked in several Charter divisions, including real estate finance, commercial banking and petroleum exploration but primarily in commercial real estate development.

Education

1980	HARVARD BUSINESS SCHOOL Master of Business Administration, with Distinction
1971	HAMILTON COLLEGE A.B. with Honors, Economics

Appendix C (continued)

Darlene K. Mann

Work Experience

1996-Present	ONSET Ventures, Menlo Park, CA Venture Partner, ONSET III (in formation) Venture Partner, ONSET II
1995-1996	AVANTOS PERFORMANCE SYSTEMS, Emeryville, CA Vice President, Marketing and Sales. Managed all sales, marketing, and technical support functions for start-up software company in the Human Resources and Electronic Performance Support Systems market.
1993-1995	BROADVISION, INC., Los Altos, CA Vice President, Marketing and co-founder. Responsible for all marketing activities for next-generation electronic commerce systems provider.
1993	PARAMOUNT COMMUNICATIONS, Sunnyvale, CA Director, Product Marketing. Managed marketing staff and business planning functions for multimedia educational products representing $80M in revenue.
1989-1993	VERITY, INC., Sunnyvale, CA Director, Product Marketing. Managed product management, marketing and sales development activities during growth of business from start-up through $20mm in revenue for recognized market leader in text retrieval applications.
1986-1989	LOTUS DEVELOPMENT CORPORATION, Cambridge, MA Product Planning Manager, Lotus Notes. Responsible for product management and market research teams for first product in the "Groupware" category. Manager, Inside Sales and Customer Support, Information Services Division. Developed and managed inside sales and customer support organizations to support lead generation and leverage performance of direct sales force.
1984-1986	DATA TRANSLATION, INC., Marlborough, MA Senior Technical Sales Representative. Managed major accounts and OEM sales at leading vendor of analog to digital conversion and image processing products.

Education

1982	UNIVERSITY OF CALIFORNIA AT SAN DIEGO, REVELLE COLLEGE Bachelor of Arts with Honors, Psychology

Appendix C (continued)

Terry L. Opdendyk

Work Experience

1984-Present	ONSET Ventures, Menlo Park, CA General Partner, ONSET III (in formation) General Partner, ONSET II General Partner, ONSET I General Partner, ONSET, a California Limited Partnership Special Partner, New Enterprise Associates V, VI & VII Special Partner, Chemicals and Materials Enterprise Associates. L.P.
1980-1984	VISICORP, San Jose, CA President, Chief Operating Officer. Responsible for all company activities, organization and P&L during the growth of the business from a start-up to a $40 million leader in the personal computer software industry.
1973-1980	INTEL CORPORATION, Santa Clara, CA Several responsibilities including: Co-Manager of the Development Systems Business Segment. Responsible for the P&L, marketing, manufacturing and R&D of microcomputer system products. Manager, Computer Systems Engineering. Responsible for microprocessor architecture and hardware and software systems R & D in California, Oregon, Arizona and Israel. Manager of the Corporate Human Resources Business Segment.
1970-1973	HEWLETT-PACKARD, INC., Cupertino, CA Project Manager/Member of Technical Staff. Responsible for design and development of systems software products. Also responsible for corporate software strategy and methodology for software management.

Education

1972	STANFORD UNIVERSITY Master of Science. Computer Science
1970	MICHIGAN STATE UNIVERSITY, The Honors College Bachelor of Science with High Honors, Computer Science

Appendix C (continued)

Thomas E. Winter

Work Experience

1993-Present	ONSET Ventures, Menlo Park, CA
	General Partner, ONSET III (in formation) General Partner, ONSET II Consultant, ONSET I Special Partner, New Enterprise Associates V11
1991-1993	BIRD MEDICAL TECHNOLOGIES INC., Palm Springs, CA
	President, Chief Executive Officer and Director. Returned company to profitability, positive cash flow, re-structured bank debt and re-staffed senior management team during turnaround of this $50 million manufacturer of respiratory care equipment and disposables.
1983-1991	BURR EGAN DELEAGE & COMPANY, San Francisco & Costa Mesa, CA
	General Partner of the general partner, of partnerships managed by Burr Egan Deleage & Co investing in early stage high technology enterprises within the information science and biomedical products fields, including Alta III, L.P., Alta IV, L.P., Alta Subordinated Debt, L.P., and Alta Subordinated Debt II.
1981-1983	BURROUGHS CORPORATION, Detroit, Ml
	Executive Vice President Finance and Director. Responsible for all financial and administrative activities.
1966 -1981	XEROX CORPORATION, Rochester, NY and Stamford, CT
	Numerous assignments combining staff and operating responsibility including: • Vice President Operations/Information Products Group • Corporate Controller • Vice President Finance/Information Systems Group • Director Distribution/Information Systems Group • Controller & Director Planning/Research & Engineering Division • Director Pricing & Strategy Analysis
1963 -1966	AEROJET GENERAL CORPORATION, Sacramento, CA
	Various engineering positions in test and project management.

Education

	GEORGIA INSTITUTE OF TECHNOLOGY
1963	Master of Science, Industrial Management
1959	Bachelor of Science, Aeronautical Engineering

Appendix D

INSTITUTIONAL LIMITED PARTNERS OF ONSET I

Ameritech Pension Trust
Computrol Limited, BVI
Crossroads Providence Limited Partnership
Delaware State Employees Retirement Fund
The Ford Family
Henry J. Kaiser Family Foundation
Hughes Aircraft Retirement Plans
The James Irvine Foundation
Kansas Public Employees Retirement System
Metropolitan Life Insurance Company
Meyer Memorial Trust
NED Delaware Co, Ltd.
Oberlin College
St. Paul Fire and Marine Insurance Company
Technology Funding Venture Partners IV
T. Rowe Price Associates

INSTITUTIONAL LIMITED PARTNERS OF ONSET II

The Casey Family Program
Computrol Limited, BVI
Delaware State Employees Retirement Fund
The Ford Foundation
Hitachi Chemical Research
Hughes Aircraft Retirement Plans
The James Irvine Foundation
Henry J. Kaiser Family Foundation
Ewing Marion Kauffmann Foundation
Meyer Memorial Trust
Nippon Enterprise Development Corp.
Oberlin College
Pratt Street Ventures IX, LLC
Prime New Ventures Management, L.P.
Scinet Development & Holdings, Inc.
St. Paul Fire and Marine Insurance Company
United States-Japan Foundation
Ziff Investors Partnership, L.P. II

Exhibit 2 Summary Statistics on Venture Capital Industry—Mid-1977

Most Active Venture Firms (ranked by number of 1996 investments)

	Venture Firm	1995	1996	1st Half1997
1.	New Enterprise Associates	108	105	41
2.	Robertson, Stephens & Company L.P.	35	63	32
3.	Norwest Venture Capital	62	58	NA
4.	Oak Investment Partners	NA	52	39
5.	Hambrecht & Quist Venture Partners	52	51	40
6.	Sprout Group	29	51	NA
7.	Accel Partners	32	49	NA
8.	Sequoia Capital	NA	46	NA
9.	U.S. Venture Partners	46	46	32
10.	Mayfield Fund	44	45	NA
11.	St. Paul Venture Capital Inc.	33	45	31
12.	Institutional Venture Partners	NA	44	NA
13.	Burr, Egan, Deleage & Company	58	43	NA
14.	Enterprise Partners	NA	42	NA
15.	Greylock Management Corporation	NA	42	NA
16.	Kleiner Perkins Caufield & Byers	66	39	NA
17.	Bessemer Venture Partners	30	37	29
18.	Crosspoint Venture Partners	25	37	NA
19.	OneLiberty Ventures	39	37	NA
20.[a]	Advent International Corporation	NA	36	39
20.[a]	Dominion Ventures	NA	36	NA

Source: *The Private Equity Analyst*, February 1997

[a]In a tie for 20th place, both Advent and Dominion had 36 investments in 1996.

Venture Capital Activity 1995 thru 6/30/97

		Investment[a] ($ billions)	Number of Deals	Average per Deal ($ millions)	Median Pre-Money Valuation ($ millions)
1995	Q1	1.1	276	4.0	NA
	Q2	1.8	436	4.1	NA
	Q3	1.6	407	3.9	NA
	Q4	2.1	424	5.0	NA
Total		6.6	1,543	4.3	
1996	Q1	2.3	489	4.7	12.2
	Q2	3.0	584	5.1	14.1
	Q3	2.3	519	4.4	10.9
	Q4	2.5	571	4.4	12.9
Total		10.1	2,163	4.7	
1997	Q1	2.4	586	4.1	12.0
	Q2	3.2	684	4.7	14.9
Total	1st Half	5.6	1,270	4.4	

Source: Private Equity Analyst, August 1997 and Venture Edge 3Q, 1997

[a]VC investment into portfolio companies.

Exhibit 3 TallyUp Operating Plan—Excerpts

Seed Round Operating Plans

Responsibility/Task	*Deadline*
A) Office of the President	
Achieve Objectives for First-round Financing	**Q4 97**

Objectives for first-round financing, planned in October of 1997, include:

- Hire key employees to achieve seed plan
- Bring product to "trial" stage
- Sign 3-5 "development partners" with expectation of installing two paying partners in target markets
- Significant progress toward signing one key marketing partner
- Develop and validate business model, including market size, pricing, and sales and distribution
- Develop business plan and presentation for first-round financing

Develop and Validate Business Model	**Jun. 97**
Develop Critical HR Policies & Guidelines	**Feb. 97**
Recruit Core Team	**Ongoing**
Establish Product Advisory Board	**Q3 97**
B) Engineering	
Deliver Sales Prototype	**Apr. 97**
Complete Product Design and Roadmap	**Apr. 97**
Deliver Development Partner Release	**Oct. 97**
C) Marketing	
Prove a Viable Attainable Market	**Jun. 97**
Complete Corporate Identity	**Jan. 97**
Complete Sales Collateral	**Jan., Apr., Nov. 97**
Assist Development with Product Direction	**Mar. 97**
Deliver Marketing Requirements Document	**May 97**
D) Sales and Business Development	
Sign 2 Development Partners in Key Markets	**Jun. 97**
Prove Sales and Distribution Model	**Jun. 97**
Progress Towards Signing Strategic Marketing Partner	**Sep. 97**
Sign 2 Strategic Marketing Partners	**Q4 97**
Develop Lead Tracking System	**Feb. 97**
Hire VP of Sales	**Q4 97**
E) Finances and Operations	
Establish Financial and Board Reporting Systems	**Jan. 97**
Retain Payroll, Benefit, and Audit Services	**Feb. 97**
Secure Office Space and Office Equipment	**Mar. 97**
F) Staffing	
Hire According to Plan	**Ongoing**