

# Inside the Mind of a VC

## The Pendulum Swings

There has been a lot of talk about cycles in the venture capital industry. We've had the well-reported boom and more recent bust.



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We're also seeing a macroeconomic cycle play out in the U.S. economy. What has not been reported, however, perhaps because it will not be provable until after the fact, is a possible hardware–software cycle. If such a cycle occurs, it will change the face of startups in the Pacific Northwest.

### The First Boom—Hardware

Let's turn the clock back to the early 1980s, the first venture capital boom. This was the era of the microprocessor. Revolutionary new hardware fueled tremendous growth in technology startups, from PC manufacturers, to disk drive makers, to companies writing enabling software that was either embedded or quite targeted in its application. While that boom led to its inevitable bust, the fact remains that hardware created the driving force behind the good times.

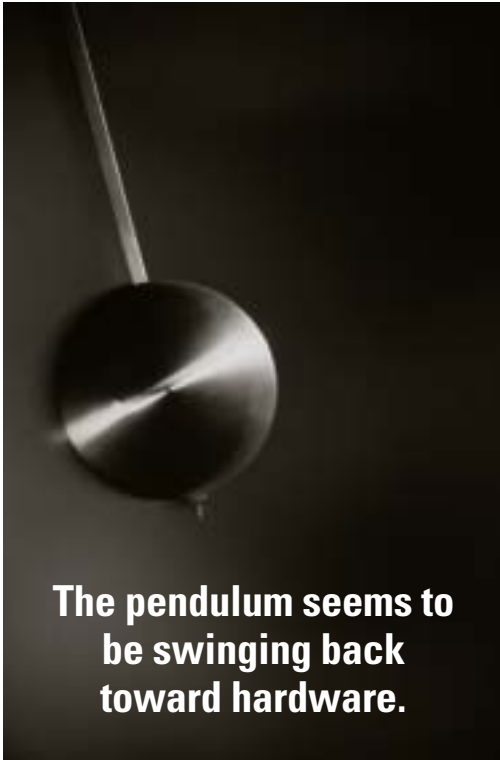
### The Second Boom—Software

Now let's step ahead to the early 1990s. By this time, microprocessor-based hardware

was becoming ubiquitous. Most of the infrastructure software that was needed to allow complex networks of computers to interact was in place. What followed was a rapid period of innovation in applications software. As time passed, we saw a phasing-in of more sophisticated software architectures, such as client-server and object-oriented. Venture capitalists were quick to jump on these bandwagons, realizing significant financial rewards. By the end of the decade, we lived through what we can now label as a “blow-off.” With the arrival of the Internet and the availability of HTML, people were able to create software (or something that looked like software) with exceptional ease and speed. Not surprisingly, this fueled a rapid rise in startups backed by venture capital. But we learned that not only did many of the business models for these firms not make sense, but the ease in writing the software was such that copycats proliferated, destroying even sensible markets.

### The Coming Boom—Hardware Again?

We recently held a partnership retreat to look ahead and map our investing strategy. One piece of data we picked up on was a change in our deal flow. Over the last 10 to 15 years, we've seen about three interesting deals in the greater Seattle area for every one



in greater Portland. In turn, Portland has outrun Vancouver, British Columbia, by about three to one. We are now seeing something quite different. There are as many interesting projects in Portland as Seattle, with Vancouver showing up more prominently on the radar than ever before. What gives?

It turns out that Portland is largely a hardware town, with the historical presence of Intel, Tektronix, Hewlett Packard, Mentor Graphics, Radisys, FLIR, and others driving an infrastructure that thinks in terms of shipping products lifted by forklifts, rather than in jewel cases or via downloads. Seattle, with its preeminent players such as Microsoft, Real Networks, Nintendo, and others, clearly has a software orientation. Vancouver seems to be somewhere in the middle, with a mix of hardware and software companies. The pendulum seems to be swinging back toward hardware.

OVP's history actually speaks to this issue. At our founding in 1983, it was not clear whether Portland or Seattle would be the technology nexus of the Pacific Northwest – hence our choice of offices in both

locales. Remember, 1983 was smack in the middle of the first hardware boom. Since then, software and Seattle have dominated. This may still be the case going forward, but the difference may be less dramatic.

### So Who Cares?

We care because we try to anticipate where the next profitable technology trends are to be found. Today the market is telling us that enterprise software is a very tough space and that the possible emergence of businesses based on Web services will be slower than Microsoft would like. On the flip side, opportunities in standard network processing hardware and its attendant software abound, as do openings for companies with combinations of dedicated hardware and software serving well-targeted markets. Of course, none of these issues are absolute. We will still see and happily fund enterprise software companies in Seattle. But as the folks on Wall Street are fond of saying, "The trend is your friend." At this time, we think the trend is back toward hardware and tightly coupled software. Riding that pendulum will be easier than fighting it.



VENTURE PARTNERS

*OVP Venture Partners is a leading technology-focused venture capital firm in the Pacific Northwest. The firm makes equity investments in early-stage companies primarily in the western third of North America, with a leading market-share position in the Pacific Northwest. OVP's emphasis is on firms in software technology infrastructure, communications infrastructure, and process solutions.*

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