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Top 10 Tips for New VCs from an Old Hand

By Fred Dotzler, De Novo Ventures

I've invested in many early stage life sciences companies during my 19-year career as a venture capitalist. Following are 10 lessons that I have gleaned from my experiences that might be useful to someone embarking on a career in venture capital.

1. Generate deal flow. You can't invest in companies you don't see. Having a reliable source of investment opportunities is crucial to the success of any venture capitalist. There are many different ways to create deal flow, and it's wise to use all of them. Among the more prolific are an individual's network of entrepreneurs, former work associates, law firms, patent attorneys, consultants and other venture capitalists.

2. Keep an open mind. Many venture capitalists have declined an investment opportunity that earned a great return for those who invested in the company. One reason for rejecting companies is the belief that the technology will not work or cannot be developed. After doing this early in my career, I devised a question that I ask myself each time I see a company with a challenging product development problem: "What if it works?" Big money can be made investing in products that many believe cannot be developed. When evaluating a company I use the Ben Franklin technique of listing the plusses and minuses, with a third category for "unknowns" to guide my due diligence.

3. Follow the money. It's easier to build a company investing in products that will be sold to customers who are making a profit and have discretionary spending. In the health care industry, hospitals have money to spend for medical devices, pharmaceuticals and equipment used by their medical staffs, and for medical information systems. Physician practices can sometimes be difficult customers — many don't reserve a lot of capital for reinvesting. Selling capital equipment to university researchers is often problematic because of budget limitations.

4. Learn how to identify great people. Everyone knows that great people make great companies. The trick is to learn how to identify them. Early in my career I attended a three-day seminar on how to interview candidates for jobs. Ask questions that focus on past behavior and results. Following up with thorough reference checking is essential to hiring great people. I have evaluated some candidates positively during an interview, only to readjust my assessment after checking references. It's also helpful to review a candidate's work product — patents, marketing plans, sales reports, etc.

5. Be rational on terms of investment. Venture capitalists who offer standard terms develop reputations for being fair and reasonable. Those who add 2x or higher liquidation preferences, full ratchets, conversion price adjustments on public offerings and the like often aren't invited by current investors to evaluate other companies.

6. Be patient with startups. The first attempt at product development often fails or the specifications change for the product preferred by customers. Occasionally a product launch fails because the company targets the wrong customer segment. The product/market strategies of many companies evolve over time.

7. Keep track of cash balances. It's the lifeblood of portfolio companies. Know how many months of cash burn remains. Have a plan to raise money through a venture capital financing, corporate partnering, borrowing, grants, etc. Know what milestones the company must achieve to enhance its chances of raising money with favorable terms.

8. Spend time every week working on all your portfolio companies. A

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corollary of this is to avoid getting on too many boards. I have found it valuable to ask CEOs the following question: "How can I help you?"

9. Don't get too high on good news. Likewise, don't get too low on bad news. Many companies find themselves on a long-term, secular upward trend with cyclical variations. If things appear too bad or too good, just wait because they'll change.

10. Treat everyone with fairness and dignity. That goes for founders, management, co-investors and service providers. Failure to treat people with respect will damage your reputation and turn off your deal flow. Express gratitude to your management teams for their successes.

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