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Venture capital money starting to find start-ups

Venture capitalists are again looking at early-stage start-ups like HotGigs, and they're willing to take measured risks for a big payday down the road.

Thomas Lee, Star Tribune

Call him Doug Berg 2.0. The founder of Techies.com, a once high-flying job portal that crashed and burned during the stock market shakeout of 2001, is back, armed with a promising Internet start-up, millions of dollars in venture capital and truckloads of perspective that eluded him during the crazy days of dot-com mania. "I learned a lot of life lessons: not to go too far, too fast," said Berg, referring to his failure at Techies. "I highly doubt that will happen again. Back then, Wall Street was funding ideas. Now Wall Street is funding companies with solid revenues."

In many ways, Berg's new company, Minnetonka-based HotGigs Inc., which he founded three years ago, demonstrates how investors are again directing venture capital money toward early-stage start-ups with solid business plans and stable revenue.

HotGigs, whose website matches companies seeking contract labor with staffing firms and independent consultants, received $5.2 million in first-time financing from Updata Partners, a venture capital firm in New Jersey. HotGigs is one of three Minnesota firms in the third quarter to get first-time funding, as opposed to companies getting multiple follow-on investments, according to the PricewaterhouseCoopers/Thomson Venture Economics/National Venture Capital Association Money Tree Survey.

"There is an appetite for companies like HotGigs that exhibit a certain amount of customer and revenue traction prior to venture capital funding," said Conor Mullett, co-founder and general partner of Updata.

After the dot-com bubble burst in 2000-01, venture firms put money into the later-stage companies they'd already sponsored to keep them going until the market improved enough for a public offering, buyout or other "exit strategy." That dried up much of the funding for early-stage companies, which have been scrambling until recently.

With the large-cap stock indexes at record highs and well-financed private equity firms looking for deals, investors are again looking at promising start-ups, said Dan Carr, president of the Collaborative, a Minneapolis group that assists entrepreneurs.

"The proven entrepreneur is getting funding again," Carr said. "People see a higher return possibility that's worth the added risk. You are starting to see innovation rewarded."

Venture capital investment in seed and early-stage companies totaled $1.2 billion in the third quarter, up 10 percent from the previous quarter, according to the MoneyTree report. Such firms accounted for half of the $1.5 billion that went to first-round deals.

Internet companies made out especially well, capturing $1.1 billion in venture capital money, a four-year high, and accounting for 17 percent of total investment.

But experts say the latest interest in Internet companies, dubbed Web 2.0 and fueled by the popularity of websites like Google, YouTube and MySpace, is a far cry from the late 1990s boom, when money was fast and loose. Venture capitalists now demand companies possess proven concepts, experienced management teams and real revenue before getting even first-round financing, said Joy Lindsay, president of StarTec Investments of Bloomington.

The salad days

Perhaps no one knows the ups and downs of an Internet start-up better than Berg, who helped raise $100 million in venture capital money for Edina-based Techies, which he founded in the mid-1990s.

"I used to go to San Francisco where someone would write me a check for $100,000, and this would happen six times a day," Berg said. "It was crazy."

At its peak, Techies boasted $30 million in revenue and 650 employees. The company planned to go public in 2000 but postponed and ultimately scrapped its initial public offering as the market bubble began to sag. Then came the recession and the 9/11 attacks, and Techies soon collapsed.

Berg took some time off before founding HotGigs in 2003 after consulting with some former clients who said they need a quick and seamless way to find contractors in professional services like marketing and sales.

"They needed to find the right guy for the right job on the right day," Berg said. "We want to help companies manage their growth a lot better. Companies don't want to go through cycles of hiring tons of [full-time] employees and then laying them off. That's bad public relations."

Staffing firms and independent contractors pay HotGigs annual subscriptions of $2,500 or $5,000 to be paired with companies that need their services. While Berg declined to give specific figures, he said HotGigs, which employs 30 people, generates "high six-figure" revenue. Next year, Berg expects HotGigs to generate $3 million to $5 million in sales and hire up to 70 more employees.

If Techies taught Berg anything, it's to "measure everything."Someone told me that it's better to have a measured failure than an unmeasured success," he said. "If something good happened but you can't explain why it happened, then [investors today] are going to tear you apart."

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