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Don Valentine and Sequoia Capital

I had a special advantage going into the venture business. . . . I knew the future. And if you don't think knowing the future is a great advantage, it is a phenomenal advantage.

– Don Valentine, October 2010 speech¹

Don Valentine participated in the beginnings of two significant milestones: the birth of the silicon chip and the development of the venture capital industry. From humble beginnings, Valentine became a legendary salesman at Fairchild Semiconductor (Fairchild) and National Semiconductor (National), **before** founding Sequoia Capital (Sequoia) in 1972. Frugal to the point of being cheap, with a sharp tongue, and a “take no prisoners” attitude, Valentine was comfortable making high-risk bets on unknown entrepreneurs in markets where he saw great potential. Unlike other venture capitalists of the time that focused on finding outstanding entrepreneurs or groundbreaking technology, Valentine focused predominantly on the market. He noted, “My position has always been you find a great market and you build multiple companies in that market.”²

Dubbed “the man with the golden gut” by *Forbes* magazine³ and often cited as the “grandfather of Silicon Valley venture capital,” Valentine invested in a remarkable string of successful companies including Atari, Inc. (Atari), Apple Computer, Inc. (Apple), Electronic Arts, Inc. (Electronic Arts or EA), and Cisco Systems, Inc. (Cisco). As a firm, Sequoia continued Valentine’s focus on markets and made an equally noteworthy number of lucrative investments in companies such as Oracle Corporation (Oracle), Yahoo! Inc. (Yahoo!), Google Inc. (Google), and LinkedIn Corporation (LinkedIn). Over the years, Sequoia and its partners were consistently ranked among the top venture capitalists, with *The Wall Street Journal* describing Sequoia as “one of the highest-caliber venture capital firms.”⁴ Several of Sequoia’s early funds generated strong performance returns although like many venture capital firms it averaged significantly lower returns than in the past as a consequence of the dot-com bust of 2000 (**Exhibits 1, 2 and 3**).

Background on Don Valentine

Valentine was born in 1933 and raised in Yonkers, New York, a suburban community just north of New York City. His father drove delivery trucks and was a member and low-level official of the local Teamsters union. Virtually all of Valentine’s education was in Jesuit schools—he graduated from

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Mount St. Michael Academy in 1950 and Fordham University in 1954. Valentine reflected on the Catholic Church's role in his upbringing:

My middle initial is "T" for Thomas. Thomas was the apostle who was the doubting person. It probably did a great deal to encourage both my inquisitiveness and inclination not to believe what I was told or heard. In the business I'm in, it's all about figuring out which questions are the right questions to ask, and since we don't have a clue what the right answer is we're very interested in the *process* by which the entrepreneur gets to the conclusion that he offers. Our business is a business of highly intuitive decision making and the fact that it's done in a scientific area doesn't make it scientifically practical to make decisions that way.⁵

In 1952, Valentine was drafted into the military, where he studied and taught electronics. He noted, "I was a terrible soldier. Fortunately, it was an Olympic year and somebody decided to get all the athletes together to develop teams—basketball, water polo, whatever. I saw this as my way out of the military."⁶ Valentine offered to play water polo and as a result, was transferred from the Army to the Navy, where he was stationed in California to train with the other players. He reflected, "I discovered there were places where it didn't snow in your driveway and I decided I was not going to live in New York State any longer. I was eventually going to live in California."⁷

After Valentine completed his required military time he joined Sylvania Electric Products Inc. (Sylvania) in upstate New York. He commented, "My entire objective was to get employed in electronics in a company that had West Coast facilities, another scheming-oriented career move."⁸ Valentine started with various factory assignments in Sylvania's main business units: cathode-ray tubes, semiconductors, and vacuum tubes. He eventually moved into a sales position and after a short stint at Raytheon, a military and commercial electronics manufacturing company, went back to Sylvania and was transferred to California. He reflected, "I arrived in California and quickly identified that the future in electronics wasn't in vacuum products. Sylvania was not a significant leader in semiconductors. They treated them with some significant technical disdain. I was convinced that that was the future of components, and when the opportunity presented itself I joined Fairchild Semiconductor as one of their first salesmen on the West Coast."⁹

Fairchild Semiconductor

Fairchild had been founded in 1957 by a group of scientists and researchers known as the "traitorous eight," who left Shockley Semiconductor Laboratory's Palo Alto, CA offices en masse to continue their work on silicon transmitters. The group developed the first commercially viable integrated circuits using silicon and quickly began winning large contracts from government and defense agencies. The company, a division of Fairchild Camera, was led by Bob Noyce and became profitable after six months. Valentine was based in Los Angeles. He explained his decision to join the company:

Fairchild was an early company when I joined it. I was maybe employee number forty or fifty. It was in Mountain View, California, and it was in a leadership technology area. It [became] a spectacular company. It is the mother of all the spinouts in Silicon Valley.

In my opinion, the whole world of electronics components prior to semiconductors was vacuum tubes. Places like General Electric and Philco and RCA and Sylvania made them, and they were all dead companies—East Coast, hidebound on the past, not forward looking or thinking. My bet was that the semiconductor business was the business of the future in electronics. All of that stuff initially was made with germanium, in its fundamental properties,

a very limited capability material. The first transistors were all germanium. Fairchild Semiconductor was the first company, as far as I could find, anywhere in the world that began making the semiconductors with silicon.¹⁰

While he was working, Valentine took late-afternoon classes in sales and marketing at the University of California, Los Angeles' Anderson School of Management. He had no interest in pursuing an MBA degree, but explained the rationale behind his coursework:

Early on at Sylvania I learned I was not going to be a great scientist. So what else is there to do in a great company? Where is the decision-making process in a great company? And the answer is it's in marketing. In a well-run company, the marketing department in conjunction to the science department decides, based on what their capabilities are, what problems they can solve, and what sequence should they solve them in, and how much money can they spend on developing that product, and how big is the market? Who's going to buy this stuff? I chose marketing because I thought that was the best place for me to be, on the West Coast, in new ideas and new companies.¹¹

Valentine's customers in Los Angeles were largely defense and aerospace firms that were building sophisticated weapons systems requiring advanced electronic capabilities. In his first year at Fairchild, Valentine personally sold more than had been sold in the history of the company. As Fairchild grew, Valentine was quickly promoted to head sales in Los Angeles and then to run sales for the West Coast region. Subsequently, he moved to Mountain View to manage all of Fairchild's sales efforts. During his seven-year tenure with the firm, the company grew from just over \$1 million in sales to over \$150 million. He noted, "Now you have to understand that in addition to there being very clever people at Fairchild, this product was spectacular. Once you could get the customer to understand it and how it worked, it was exceptionally easy to persuade them to buy."¹² He elaborated further on his experience:

It was my first taste of being in a start-up company instead of a giant corporation like Sylvania. The company was so small that when we had a need for a technical assistance at one of the large customers, sometimes Bob Noyce came himself. There was the survival instinct of getting established as a company against major competitors. Our major competitor was Texas Instruments, a hugely bigger company and a dominant supplier in a lot of ways. You had survival as motivation.¹³

[Fairchild's] major resource is our engineering, and customer after customer comes along and wants us to do something slightly different than we're doing. We didn't have the engineering resources to take care of all these people, so I evolved a system of selection. Which companies are we going to make these special units for? What are the ingredients of these companies? How big are their markets? How good is their management? And we would maybe make a special product for one out of fifteen. Having evolved that system, I used the same system to make small personal investments in companies located here and where I understood the science. I didn't have enough money to support too many companies at the same time, so it was an interesting, highly useful hobby.¹⁴

By the mid-1960s, many of the original "traitorous eight" and other key individuals began to move on, frustrated by Fairchild Camera's "East Coast" management style. While Fairchild Semiconductor generated the vast majority of the profits for Long Island, NY-based Fairchild Camera, the semiconductor division had little influence on management decisions, and its employees were not included in stock option allocations. According to Valentine, a key turning point occurred when the two individuals who created the linear circuit product line at Fairchild left to join National

Semiconductor. Just a few years later, when Noyce was passed over as CEO, he and Moore became the last of the founding eight to leave as well. They then went on to found Intel Corporation (Intel).

National Semiconductor

In 1967, Valentine was invited by his former colleague, Charlie Sporck, to join National Semiconductor. Valentine had reported to Sporck when Sporck served as Fairchild's general manager. Earlier that year, Sporck left Fairchild to become National Semiconductor's president and CEO. The company, a publicly traded Santa Clara, CA-based firm, was struggling, with approximately \$7 million in sales, but virtually no profits. When Sporck joined the firm, he brought a large group from Fairchild with him. Valentine felt that he had learned all he could from his experience at Fairchild, and was eager to test the waters in a turnaround situation. He noted, "...this was a very heady time in the late '60s, starting all over again and having to reinvest a different way to do sales, having to operate with a company that had no treasury and negative cash flow."¹⁵ Valentine described how the culture at National was different than at Fairchild:

Fairchild, interestingly, was formed almost exclusively by scientists. A lot of them were really research and development people, and not very much experience, understanding or possibly even interest in manufacturing. Sporck, by comparison, started National with a hard-core nucleus of manufacturing people, I think somewhat out of necessity, recognizing that just science would not carry the company to any great size. National is much more of a hard-core, figure out how to make them [kind of a place]. Make them in great quantity, make them in Asia, do whatever it takes to change the traditional model of the semiconductor business [with] products used only in military and exotic kinds of applications, to make it a much more ubiquitous product using lots of consumer as well as military kinds of applications. The character of the company, I learned even more during the Sequoia days, is almost totally determined by the nature of the individuals that start it.¹⁶

As at Fairchild, Valentine created a system at National to evaluate companies and business opportunities before dedicating engineering resources. He also continued to make small personal investments in companies in the area where he understood the science underlying the business. He reflected:

While at Fairchild, and more so at National, I began investing privately in small companies, some of which were customers of both Fairchild and National. They didn't require much money [and] I didn't have very much money. The interesting thing is not a lot has changed. At Fairchild and National my interest was investing in companies that were addressing very large markets and solving a specific kind of problem. At National we had limited resources [and] we couldn't do everything for everybody. Out of that period of four or five years, I hammered out this more intuitive investment selection process based on huge markets and solutions that made a significant short-term commercial sense.¹⁷

Under Sporck's leadership, National began to thrive. Sporck quickly implemented a number of cost cutting and overhead reduction efforts, and shifted the company's focus toward improving profitability. However, he did not like public speaking and often asked Valentine to speak on behalf of the company to Wall Street and other investors. Valentine explained:

We were really on a roll. When we joined National their revenues were insignificant, and by the early '70s, they had a revenue run-rate of fifty million. National became a prominent and desirable company to meet with and talk with. [However,] Charlie never had very great

interest in giving talks or meeting with financial people or the stock market people. I did more of that than I ever anticipated.¹⁸

I was approached by people in an organization, in the audience, who ran a very large mutual fund in Los Angeles called the American Funds or Capital Research and Management. And they knew about my private investing, and they asked me if I would be willing to manage a pool of money dedicated to starting new companies. They would help organize it.¹⁹

Valentine felt that he had learned all he could at National and was ready to move on.

Silicon Valley Venture Capital

Venture capital was still a nascent industry in the early 1970s. While many wealthy East Coast families had been investing in early stage companies for decades, there were no firms dedicated to venture capital until the late 1950s. Many observers believed the Small Business Investment Act [SBIA], passed in 1958 to help the funding and management of small enterprises in the U.S., was a first step in spurring the creation of venture capital partnerships.

In 1959, Draper, Gaither & Anderson became the first official venture capital firm. In 1961, Arthur Rock, known for arranging the financing for the “traitorous eight” to start Fairchild Semiconductor, moved to San Francisco and opened the investment company, Davis & Rock. Other firms – Sutter Hill Ventures (founded in 1964), Asset Management Co. (1965), and the Mayfield Fund (1969) – were also early West Coast entrants to venture capital. The unique attributes of Silicon Valley – warm weather, proximity to Stanford University (Stanford) and the University of California, Berkeley, and an abundance of engineers and corporations such as Fairchild and Hewlett Packard – helped foster a geographic nucleus of technology and entrepreneurship.

During the 1960s and 1970s, the West Coast venture capital community was extremely collegial – principals from the various firms met regularly and often sought advice from each other. The most dramatic change to the industry occurred in 1978 with the relaxation of the “prudent man rule” provision of ERISA [Employment Retirement Income Security Act] allowing pension funds to include higher risk investments in their portfolios. As a result, institutional money from pension funds, universities, and foundations quickly flooded into venture capital.

The Capital Group (eventually Sequoia Capital)

Valentine left National Semiconductor in 1972 to help The Capital Group found its venture capital practice. It took approximately a year and a half to raise a \$5 million dedicated fund. Valentine explained, “Initially, it was difficult to raise money because the money was all controlled by the East, and they had no experience, really, in putting it in these kinds of illiquid investments.”²⁰ While many of his peers were relying on SBIA funding, Valentine was reluctant to do the same. He commented, “My lifelong preference [is] to never do business with the government. They’re unpredictable and irrational.”²¹ As part of the fund raising process, Valentine approached the investment banking firm, Salomon Brothers. He told the story about his experience there:

This was an interesting point in time because there was a friend of mine at Salomon Brothers. He was determined that I was on to something and wanted me to talk to the Salomon people. So, he persuaded me to go to New York City which is something I rarely do, and talk to the Salomon people. Their first question was, “What business school did you go to?” I said, “I went to Fairchild Semiconductor Business School.” Well, they were oriented toward backing

brilliantly educated, financially oriented Harvard Business School graduates. I told them venture capital was about building companies and industries. So we never did business. That was the orientation in the finance world then.²²

Nonetheless, Valentine was able to develop a rationale for attracting investors. He elaborated:

After twelve or thirteen years in the semiconductor business, I had a very high-profile reputation in this community. So people who were interested in starting companies often gravitated to me to help them start their company. From their point of view I knew how markets worked and how to help them position their company in the market. So I had a bit of an unfair advantage in those two respects. But the most unfair advantage I had is I knew what the future was. Having been at Fairchild, all of these products work because of a microprocessor. I knew that was coming and I would finance companies where that future played an important role. Nobody else was from the semiconductor businesses, nobody else knew marketing, and nobody else knew the microprocessor.²³

Valentine also knew he needed to establish an investment philosophy. He described the ground rules: “. . . must be a very big market; must be in Northern California; must be in advanced technology; must have high gross margin ability; must have the potential for Sequoia to make \$100 million; must be positively responsive to our active participation.”²⁴ Valentine also had help from Roger Kennedy, who was investing for the Ford Foundation and working aggressively to change the prudent man rule. Valentine called Kennedy his “patron saint,” who helped him understand the investor perspective and how to think about returns.

Early Noteworthy Investments

Atari

In 1975, Valentine took Sequoia independent from The Capital Group. Sequoia’s first investment, in Atari, was later that year. The company, founded by Nolan Bushnell and Ted Dabney in 1972, was known for developing the first arcade video games. Its early hit, *Pong*, was a simulated tennis game, initially made from television sets purchased at a Walgreens pharmacy store, with a milk carton inside to collect coins. First placed in a local tavern, the game quickly caught on and became a major success. As a result, the company began developing and producing additional games and consoles for broad distribution. In order to grow the business, Atari raised \$2 million in 1975 in a deal led by Sequoia. At the same time, Atari had been designing consoles for simultaneous play of multiple games. Bushnell was convinced that Atari’s new consoles would be enormously successful, but that they would require significant additional funding to bring to market. In 1976, he sold the company to Warner Communications for an estimated \$28 million.

The stories about Bushnell’s management style were legendary. Valentine reflected:

Atari—you go on the factory tour and the marijuana in the air would knock you to your knees—where they were manufacturing the product. We had board meetings in a hot tub, with bottles of Ripple floating around! There are no rules that say that certain behavior produces a result that’s directly related to the behavior. I think when you do that you get big companies that die, like our automotive companies. They have so many rules, so many things that they do and have long since forgotten why, that it takes a different attitude. Now, I don’t go around advocating marijuana-smoking in the manufacturing area, but that’s the way Nolan ran the company.²⁵

Apple

Steve Jobs had been an early employee at Atari. By 1976 when he was working with Steve Wozniak to form Apple, Bushnell suggested that they contact Valentine. Valentine felt that Jobs and Wozniak were not yet ready for venture capital financing (“Steve was twenty, un-degreed, some people said unwashed, and he looked like Ho Chi Minh”²⁶), but connected them with Mike Markkula, a successful marketing executive who had previously worked at Fairchild and at Intel. Markkula was impressed, and became convinced that Apple had tremendous potential. In early 1977, Markkula invested \$250,000 in the company, becoming a one-third owner with Jobs and Wozniak, and employee number three. That spring, Apple launched the Apple III and within a few months sold over 1,000 computers. The company closed on its first round of venture funding in January 1978, raising \$517,500 from Venrock, Sequoia, and Arthur Rock. Sequoia invested \$150,000, but in the summer of 1979, sold its stake for tax reasons and to make distributions to investors.

The Apple investment served as an example of Valentine’s focus on big markets as well as his “center-periphery” method of investing, where a big portfolio company would be supported by multiple smaller ones. Valentine explained:

The two founders of Apple had in mind the idea of you having your own computer. The opportunity to have your own computer then was a DEC 100 computer that cost \$250,000. . . . We don’t choose people, we choose markets. . . . And, we rarely ever invest in an area where there’s only one product. If you think of the Apple computer as a system, we knew we had to finance one or more memory companies, disk drive companies. In the final analysis we made over 15 [related] investments.²⁷

LSI Logic (LSI)

Wilfred Corrigan founded LSI in 1981 after serving as president and CEO of Fairchild Semiconductor. LSI specialized in ASICs (Application-Specific Integrated Circuits) for embedded systems. Valentine elaborated:

LSI was another semiconductor company. It’s a business that we know. It’s a business in which there are very few recognized experts at starting companies. It was a different approach to the type of product that had been made previously. Most of the earlier days prior to 1980 the semiconductor industry was either made up of pretty standard products which you bought off the shelf, or on occasion a custom product which took a long time to make, was very, very expensive, and represented a very, very small percentage of the so-called customized circuit. LSI Logic’s product was a programmable product that allowed the customization of what the customer really wanted and didn’t find in the off-the-shelf products, something that he could realize his dream by only having to vary how the product was made at the end and not from inception. So we believed this form would allow many customers to seek what they allegedly wanted, which was a highly specific custom product proprietary to them, different from what was available commercially. And we felt that that kind of a product would find applications in both military and commercial kinds of environments which would allow building a major company.

The second thing which was important to us, and we’ve always believed this at Sequoia, we would much rather finance someone who has failed in their prior company than somebody who has succeeded outrageously in their prior company. Most people are not very objective or realistic about why. They think it’s all about their personal brilliance. And in significant part it is, but they forget the luck factor and the contribution of other people and timing and the

economy and all the rest of it. People who fail often times are desperately in need of a success. They're smarter, they're more clever about how they do things, their sometimes tremendous egos are suspended in check. And in my opinion, when we encountered Wilf Corrigan in the late '70s and 1980, he was at a point where he really needed a success. He was a very ascendant star at Motorola, joined a group of people who came to Fairchild to take over and run this mighty company in the West, and I think he found it more difficult than he ever anticipated, and it was never a very successful company after Bob Noyce left it. And I think when I encountered Wilf, who I had known, he was at a point in his life where he had really distilled his thinking far better, had his ego in some realistic check, and we loved the fact that he had failed before, and could talk about it and could explain what he had learned from his prior company and why it hadn't worked.²⁸

LSI was initially funded with \$6 million from a number of venture capitalists including Sequoia. In 1982, LSI raised \$16 million in a second round of financing. One year later, the company completed its initial public offering, raising \$153 million. Valentine continued to sit on LSI's board.

Electronic Arts

Trip Hawkins founded Electronic Arts (formerly Amazin' Software), the video game concern, in 1982 after working at Apple. Before starting the company, Hawkins spent many years formulating his ideas, and learning about home computers and how to run a company. After resigning from Apple, he read an article in an in-flight magazine about Valentine. He recalled, "One anecdote mentioned that Don was so tough that one time a visitor in his office got so nervous that Don made him pass out on the floor. I decided that I just had to meet Valentine, and figured that he might be the kind of disciplined, tough thinker that would be a good board member for my new company."²⁹ Valentine was impressed enough that he offered Hawkins free office space at Sequoia. Hawkins elaborated further, "Valentine took me to lunch... and told me that he was not going to regularly tell me what to do. However, he said, if I was only going to do what he told me to do, he was not interested in investing. He wanted to make it clear that I had better have better ideas about how to run my company than him, or, to quote him exactly, 'what the hell would he need me for?'"³⁰

Hawkins worked from Sequoia's offices for four months while he further refined his company's strategy and began hiring its first employees. In November 1982, Hawkins began considering raising a round of financing for EA. He explained:

I got offers from many VC firms to invest and spent time playing them off against one another; it was far from conclusive that Valentine would even get into the deal. I had to use Brook Byers and John Doerr of KPCB [Kleiner Perkins Caufield & Byers] to set a more competitive price by making it clear that KPCB would not get in the deal at all unless they did so. Valentine did not like the price but he went along with it and I let Valentine take 50% of this first round; KPCB had 25% and Sevin Rosen had the other 25%. [Valentine] then went on over the years to give me the fight of a lifetime. It was very frustrating at times but in the end I consider him one of my most important mentors. He and I would agree that he was my "hair shirt."³¹

Electronic Arts raised \$2 million in its first round of venture funding. The company's early games generated revenue of \$5 million in its first year, and \$11 million in its second. In 1983, Electronic Arts raised \$3 million in a second round of financing. The company continued to grow dramatically, and distinguished itself by selling directly to buyers and by recognizing its programmers and developers as artists. In 1989, Electronic Arts went public with a market capitalization of approximately \$84

million. Within the next three year period, EA's stock rose significantly, and its market capitalization climbed to \$2 billion.

Oracle

Oracle was founded in 1977, by Larry Ellison, Bob Miner and Ed Oates, under the name Software Development Laboratories. In 1976, Ellison was working for Ampex, when he came across a research paper in the *IBM Journal of Research and Development*, which described a working prototype for a relational database management system.³² As he describes it, he was "stunned" to discover that "for the first time, someone had ascribed a mathematically consistent and complete way of managing and retrieving information." Though the commercial potential of this technology seemed enormous to Ellison, it had not been exploited up to that time. IBM had developed SQL, a complete language for accessing a relational database, and had been developing prototypes for the technology for years, but at the time it seemed that only universities were interested in relational databases. These were believed to be too slow and inadequate for managing large data or accommodating a large number of users.³³ Ellison immediately decided to build a commercial system on the basis of IBM's technology and "beat IBM to the marketplace" with it.

It took Ellison, Miner and Oates two years to develop Oracle, during which time they supported their company by doing consulting work for computer firms in Silicon Valley. The first version of Oracle was sold and installed in November 1979, to the Advanced Technology Division of the Wright Patterson Air Force Base.³⁴ Oracle's technology allowed companies to store their information among different types of computers, such as minicomputers and workstations, while users could access it from their desktop PC. This meant that managers could now access corporate intelligence in a manner useful to them, without relying on programmers to interpret punch-cards for them.³⁵

Oracle was not backed by venture capital in its early days. At the time, there was no venture capital pool for software in Silicon Valley; investors preferred semi-conductors or otherwise tangible hardware-related products.³⁶ Ellison describes himself and the rest of Oracle's co-founders as "persona non-grata" in the venture capital community.³⁷ "In fact, the only time that we would go into venture capitalists' offices to seek funding, they would search my briefcase to make sure I hadn't stolen a current copy of *BusinessWeek* on my way out."³⁸ The non-capital intensive nature of software allowed Oracle to start with an initial investment of \$2,000 provided by the founders.³⁹

One of the things that distanced Ellison from venture capitalists was the "Mephistophelian" terms under which they provided funding for new startups and their common practice of replacing founders with professional management.⁴⁰ Cisco had been seeded under such terms, with Sequoia Capital obtaining one-third stake in the company, with accompanying rights to choose the top executive and the option to buy the ownership interests of the founders.⁴¹ In fact, Ellison gave a speech in 1994 themed "Venture Capital, just say no," where he criticized exactly this aspect of venture backed deals. He later recognized, however, that venture capital played an instrumental role in sustaining Silicon Valley, and that venture capitalists accelerated corporate development by bringing in not just money, but "a variety of insights in areas ranging from product areas to helping the entrepreneur bring in professional management and developing the entrepreneur."⁴²

Sequoia financed Oracle in April 1983. According to Valentine "Oracle is interesting and one of my favorite companies . . . because we financed it and made a lot of money. But also, I'm a great admirer of the kind of raw-boned entrepreneur that Larry Ellison is. He is willing to speak out even if he's wrong occasionally."⁴³ Ellison viewed Valentine with equal respect: "Don Valentine . . ., who can be rather gruff, and say a lot of things that are offensive, has a wonderful track record. [He] asks a lot

of hard questions, and is someone I've always been impressed with. . . . [H]e says what he really thinks, [even though] that really tends to piss a lot of people off..."⁴⁴

Oracle went public on the NASDAQ exchange in 1986, in a technology boom that included IPOs from some of the industry's major players: Microsoft, Sun Microsystems and Adobe Systems. By the end of the 1980s Oracle was transformed from a company of 35 employees to a publicly traded powerhouse of more than \$500 million in revenue and a signature corporate campus in Redwood Shores, California.⁴⁵

Cisco

Cisco was founded in 1984, by a husband and wife team, Len Bosack and Sandy Lerner. The couple started the company while working as computer support staff in two different departments at Stanford. Bosack had devised a way to communicate via computer with Lerner while at work by connecting the local area networks in their offices. Based on that technology, they decided to start Cisco (named as shorthand for San Francisco) to develop internetworking routers with software that automatically determined the most efficient data transfer paths between networks. Lerner and Bosack resigned from Stanford, mortgaged their house, deferred salaries, and ran up credit card debt in order to fund their new company. In 1986, Cisco sold its first products, becoming the first company to commercially produce multi-protocol routers. Within a year, sales grew to over \$250,000 a month with only eight employees.⁴⁶ However, cash flow continued to be a constraint and in 1986, Lerner and Bosack approached Valentine for funding. He recalled:

We want people who are interested in solving technology problems and creating new products. Why did Cisco come out of the box screaming? Their [Stanford] IT department was where the product was developed interestingly. The problem was PCs had now populated the remote offices in big companies. And the information packets coming from the east to the west at light speed had a hard time finding the right mainframe. So, you had a condition called broadcast storms. There were collisions of these packets all over the place. Cisco's solution was to design a product called a router which merely identified something coming at light speed and directing it to the right end location. Initially, they did this from a private home in Atherton until the Atherton Police found out. And they sold them to all of the other IT departments in all of the other universities when they first approached customers.

In 1987, Valentine invested \$2.5 million for a controlling stake in the company, and became chairman of the board. He then hired John Morgridge, a Stanford MBA from Grid Systems Corp., and replaced several executives who had been friends of Lerner and Bosack, with more experienced and professional managers. Lerner served as vice president of customer service, and Bosack was chief technology officer. The company continued to grow rapidly, targeting mainstream corporations and developing products that supported an even broader array of protocols. In February 1990, Cisco went public with a market capitalization of approximately \$224 million.

Nonetheless, tensions had been increasing between Lerner and other members of the management team. Valentine provided his perspective:

[Lerner] happened to be smart, but tough beyond all comparison, and forgiveness was not in her vocabulary. And when somebody in management didn't do it the way she wanted it, she shredded them publicly. And the president, whom I had hired wanted to terminate her. I said, "You know, it's your call, but I would encourage you to find a way to use this talent, because it's an unusual talent and I think it's core to what will differentiate this company." So he agreed, they had a conversation, [and] she took an oath of behavior. The next thing I knew,

about a month later there were seven vice presidents of Cisco in my office. Their position was very simple. Either [we] stay, or Sandy stays. What's your preference? So I called the president, and I said, "John, I have a war ready to be declared in my office here. What do you want to do?" And he said, "I can't make it work; Sandy has got to go." So Sandy was separated from the company, and both of them left a then public company with \$170 million each. She hasn't spoken to me in 15 years. I might be lucky; there's no telling what she would say.

So decisions are sometimes made that you don't like to see made, when a creative force in a company that's doing a lot more good than evil, has to go. Otherwise, you have to build a whole new management team, including the president. The footnote on the president, John Morgridge, is that he ran the company from basically nothing, to revenues of \$1.5 billion. John was the most like me, president, I ever hired. Now what does that mean? He was the only president I ever hired that was cheaper than me. He would go to huge lengths to stage talks for the management of the company about spending. This was a company growing extremely rapidly, had gross margins of 68%, and was monumentally cash flow positive. They currently generate \$6 billion a year of excess cash on a \$40 billion sales base. So John's lesson, a DNA he created, has done the company a lot of good.

Valentine continued to chair Cisco's board of directors until 1996. Spencer Ante, author of *Creative Capital* noted, "Cisco is Valentine's blockbuster investment. He nurtured one of the most successful high-technology startups of all time."⁴⁷

Investment Philosophy and Growth

The investment philosophy at Sequoia remained consistent over the years, with a continued emphasis on finding and exploiting big markets. Valentine described the process as "100% subjective and zero analytical."⁴⁸ He continued:

We have always focused on the market: the size of the market, the dynamics of the market, [and] the nature of the competition because our objective was always to build big companies. If you don't attack a very big market, it's highly unlikely you're ever going to build a big company. So, we don't spend a lot of time wondering about where people went to school, how smart they are and all the rest of that. We're interested in their idea about the market they're after, the magnitude of the problem they're solving and what can happen if, in fact, the combination of Sequoia and the individuals are correct.⁴⁹

Finding the right market opportunities took careful probing. Valentine often told the story of forcing a rambling entrepreneur to condense his pitch onto the back side of business card. He noted:

In my world, the art of storytelling is incredibly important, and many – maybe even most – of the entrepreneurs who come to talk to us can't tell a story. [Often,] we don't understand the product or the market well, [but] we're listening. We have learned to string questions in a way that provides the entrepreneur with a way to explain what he wants to do, how long it's going to take, who the competition is, [and] how much money he needs without feeling threatened. For many of the investments we've made we didn't understand the answers, but we constantly work on developing the questions. And when we have had a company that's failed we always have post mortems at Sequoia because we're trying to understand what we missed. What question didn't we ask? What answer did we not understand? Because we're dealing with amateur storytellers and it's important that they comfortably can tell you what's relevant. And

despite our audience, which is made up of almost exclusively technology people and people who have been founders of companies, [we have a lot of] questions.⁵⁰

Business plans and financial statements rarely influenced an investment decision. Valentine remarked, “We don’t spend time looking at the financials because we know they are wrong!”⁵¹ However, the partners did look at forecasts to assess potential gross margins and the burn rate on cash. They used back of the envelop calculations to determine initial costs, and then encouraged founders to do as much outsourcing of non-essential operations as possible. Valentine elaborated:

We have gone into business with some people who had absolutely no business credentials. And we organized the companies in ways so that the people could run them based on the limited experience they had. We taught them outsourcing. We tried to teach them that you only had to do a couple of things well in our companies. You had to be very good at technology and engineering. And that normally took us about six people to start the company. The second functional skill we were interested in establishing was marketing so that we could tell what the dynamics of the market were. With our checkbook and [at] Sequoia, we were not interested in creating markets. It’s too expensive. We have always had a search function looking for the people we want to populate our companies with. Unlike other people in the venture business, we don’t wait for you to knock on our door; we knock on your door. The last person we hire in the management team is the financial officer. [In the interim,] we have people who act as CFOs for our companies and they may do two or three of these companies at a time. There’s only one metric that matters in finance and its cash flow. So we hire people that are wizards at cash flow.⁵²

While Sequoia believed it provided a high level of support for its companies, it was careful to leave the bulk of the decision making with the founder and management team. Valentine commented, “It is their company. On the tactical level we are at best a partner, but mostly a cheerleader.”⁵³ Sequoia typically provided funding in stages based on reaching certain milestones. When objectives were not met, the firm was quick to cut its losses. Valentine noted, “We reserve for future rounds of financing because we never finance anybody, totally, on day one. Depending on how well they do meeting the milestones, then we refinance them. It’s all done very critically, and if in fact the return expectation that we started with is no longer reality, we oftentimes shut the company down.”⁵⁴ He estimated that Sequoia shut down roughly 20% of the companies it had invested in.

As Sequoia grew the firm began to add staff and take on new partners. Valentine elaborated:

Adding new talent was and remains a continuous process: conventional education was never a high priority. We look for people with functional experience in a startup, i.e., design and application engineering, product marketing, sales, [and] aspects of out-sourcing manufacturing. Our investment decision-making process requires very self-confident people—[people who are] able to be challenged publicly. We pride ourselves on our differences and the methodology by which we develop our individual opinions. I look for people that are different than I am, because we do things here on the basis of consent among the partners. I don’t like having a homogenized set of opinions. I want as much confrontation and different thinking as possible. We are slow and cumbersome [in] making our decisions because we’re trying to find out everything that’s relevant. This is a business [that relies on] the Socratic technique—first you have to figure out the questions that are relevant, and then you have to ask them. [Then] you have to understand the answer in the context of what it is you’re trying to do. You can’t do that forever alone. It just requires more people.⁵⁵

Sequoia's key partners in its earlier years included many of Valentine's former colleagues. Gordon Russell had worked with Valentine while employed at a unit of The Capital Group. Russell joined Sequoia as a general partner in 1979 and developed the firm's healthcare practice. Two years later, in 1981, Pierre Lamond also became a general partner at the firm. Prior to joining Sequoia, Lamond oversaw product development at Fairchild Semiconductor, and then joined Sporck's group to help co-found National Semiconductor. Lamond eventually became National Semiconductor's CTO. At Sequoia, he focused on semiconductors and became a trusted advisor to Valentine. Lamond was known within Silicon Valley as "one of the hardest working venture capitalists."⁵⁶

Perhaps the most unconventional hire for Sequoia was Mike Moritz. Moritz studied history at Oxford and the University of Pennsylvania, before going on to get his MBA from the Wharton School. He joined *Time* magazine and "quickly became known as a guy who could cut through business speak."⁵⁷ A friend commented, "He had the journalist instinct to go for the jugular and not hold back."⁵⁸ In 1984, after writing a cover story profiling Arthur Rock, Moritz became intrigued by venture capital and resigned to help start a venture capital industry newsletter. In 1986, he convinced Valentine to hire him at Sequoia. According to observers, Moritz reminded Valentine of Steve Jobs. Valentine articulated, "Steve always has been an incredible questioner. Draining, exhausting. Same characteristic that I recognized in Moritz."⁵⁹

Doug Leone, who along with Moritz quickly became a full and influential partner at the firm, joined Sequoia in 1988 following a cold call to Valentine. He had worked in sales and sales management at Sun Microsystems and Hewlett-Packard. Leone received a BS in Mechanical Engineering from Cornell University, an MS in Industrial Engineering from Columbia University, and an MS in Management from the Massachusetts Institute of Technology.

Conclusion

Valentine stepped down from his management responsibilities at Sequoia in 1996, and control transitioned to Doug Leone and Mike Moritz. Sequoia went on to make a number of successful investments. Valentine pointed out, "Our return to our investors from Yahoo! was as great as our return to our investors from Cisco. Cisco is a much bigger, seemingly more successful company, but Yahoo! went public early [in 1996] and got to a \$100 billion valuation quickly." In 1999, Sequoia invested \$12.5 million in Google, and in 2004 when Google underwent an IPO, the company was valued at over \$26 billion. LinkedIn was another major success for Sequoia. In 2003, Sequoia led a \$4.7 million investment in the company, and based on LinkedIn's 2011 initial public offering price, the stock was worth approximately \$750 million. Within months, the stock traded significantly higher, and Sequoia's stake was worth roughly \$1.2 billion. Sequoia also had hits with PayPal, YouTube, NVIDIA, and Zappos.

In a 2009 interview, Valentine reflected back on decades of success. He noted, "It is a rare partnership that makes the transition to a second generation of management. I have not managed Sequoia for at least the last eight or nine years, and we have been better than ever. This stability is part of why we have had the same limited partners for almost 40 years. Stability and returns is how Sequoia is positioned."⁶⁰

Exhibit 1 Sequoia Capital Funds 1972 to 2000

Fund Name	Size (USD Mil)	Fund Stage	Vintage	Net IRR %
Sequoia Capital - Unspecified Fund	-	Balanced Stage	1972	
Sequoia Capital I	2.9	Early Stage	1974	
Capital Management Services	10.6	Balanced Stage	1976	
Sequoia Capital II (Capital Management)	20.0	Balanced Stage	1979	
Sequoia Capital III (Capital Management)	64.0	Balanced Stage	1981	106.0
Sequoia X (Capital Management)	0.1	Later Stage	1981	
Sequoia XI (Capital Management)	0.023	Later Stage	1981	
Sequoia Technology Partners	2.2	Early Stage	1983	
Sequoia XII (Capital Management)	-	Early Stage	1983	
Sequoia XIII (Capital Management)	0.6	Later Stage	1983	
Sequoia Capital IV	90.0	Balanced Stage	1984	
Sequoia XV	0.027	Later Stage	1985	
Sequoia XVI (Capital Management)	0.2	Balanced Stage	1985	
Sequoia Capital Growth Fund	160.7	Later Stage	1987	
Sequoia XVII	0.007	Early Stage	1988	
Sequoia Capital V	63.6	Early Stage	1989	
Sequoia Capital VI	100.0	Early Stage	1992	
Sequoia Capital VII	150.0	Early Stage	1996	174.5
Sequoia Capital VIII, L.P.	250.0	Early Stage	1998	90.4
Sequoia Capital Franchise Fund, L.P.	350.0	Later Stage	1999	-17.0
Sequoia Capital IX, L.P.	351.3	Early Stage	1999	-6.1
Sequoia Capital X, L.P.	695.1	Early Stage	2000	-31.0

Source: Compiled by casewriters using data from three sources: 1) Thomson Reuters; 2) Andrew Metrick and Ayako Yasuda: *Venture Capital and the Finance of Innovation* (Wiley; 2 edition, 2010), p. 61; 3) Investment Reports, University of California, "The Regents of the University of California Alternative Investments as of March 31, 2013."

Notes: Net IRR for the 1981 fund is based on information available up to 2007; for the 1996, 1998, 1999 and 2000 funds on information available up to 2003.

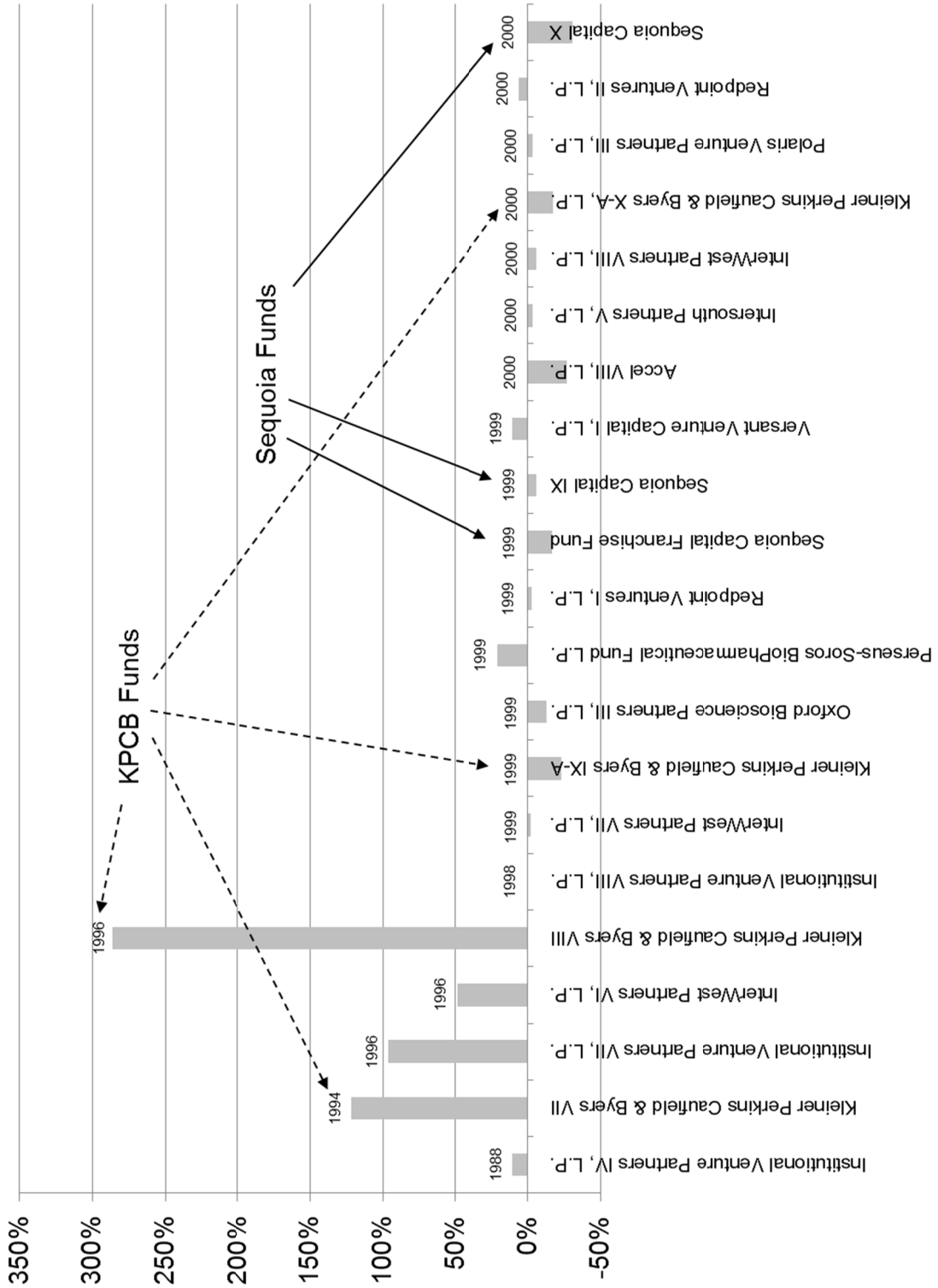
Exhibit 2 Kleiner Perkins Caufield & Byers Funds 1974 to 1985

Fund Name	Size (USD Mil)	Vintage	Net IRR %
KPCB II	65	1974	50.6
KPCB III	150	1976	10.2
KPCB IV	150	1979	11.0
KPCB V	150	1981	35.7
KPCB VI	173	1981	39.2
KPCB VII	225	1981	121.7
KPCB VIII	299	1983	286.6
KPCB IX	550	1983	-23.3
KPCB X	625	1983	-17.5
KPCB XI	400	1984	
KPCB XII	600	1985	
KPCB XIII	700	1985	

Source: Compiled by casewriters using data from Andrew Metrick and Ayako Yasuda: *Venture Capital and the Finance of Innovation* (Wiley; 2 edition, 2010), p. 62.

Notes: Net IRR for funds is based on information available up to 2004.

Exhibit 3 Sequoia Comparative Net IRR Fund Performance



Source: Compiled by casewriters using data from Investment Reports, University of California, "The Regents of the University of California Alternative Investments as of March 31, 2013," p. 3.
 Notes: These data pertain only to funds in which the University of California maintained an investment. As per the report, IRR calculations for Kleiner Perkins Caufield & Byers and Sequoia Capital are based on information as of March 31, 2003 as determined by Cambridge Associates LLC. The years given in the exhibit reflect fund vintage years.

Endnotes

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