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Start-Up Clarabridge Takes the Capital and Scores

By Thomas Heath
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Ted Leonsis a few years back provided the best description of venture capital that I ever heard.

The former AOL mogul compared the exercise of investing in start-ups to drafting hockey players for his Washington Capitals.

Out of 10 picks, several don't work out or are just average. One or two are maybe above average. One is really good. And every once in a great while -- just maybe -- you get an All-Star like Alex Ovechkin.

Ovechkin is the NHL version of a Google, the hugely profitable online search site.

Sid Banerjee, a well-known local entrepreneur who is on his third start-up, isn't calling his venture-backed Clarabridge Inc. the next Ovechkin.

But the growth of the Reston firm provides a peek into how businesses get funding from venture capitalists, hoping to hit the "set for life" home run that makes everybody rich.

Banerjee has done quite well for himself. A 43-year-old graduate of the Massachusetts Institute of Technology, he lives near the wealthy Foxhall area in the District, has a second home and a boat, and -- by my estimation -- is worth tens of millions.

Banerjee was one of the founders of MicroStrategy, the McLean-based software company that specializes in business intelligence. He left MicroStrategy in 2001. Then he started and sold a computer software company called Claraview (from the Latin root meaning "clear") in 2008 to a Dayton, Ohio, firm for millions.

Banerjee is now building Clarabridge.

The company started around 2004 when Banerjee and a couple of partners put up $1 million from their Claraview earnings. Clarabridge specializes in sifting through truckloads of customer feedback that originate online, on paper or in telephone calls. His clients include big pharmaceutical firms, financial services companies, and hotel and retail chains.

Clarabridge drills down for nuggets like these: "Your best airline passengers don't like paying for wireless in the frequent flier lounges." Or, "A few people are gumming up your call centers because they recently had a death in the family and can't figure out the tax effect." Or my personal favorite: "Your hotel customers think the air conditioners in the rooms are too loud."

The company is able to uncover that information through a technology known as "natural language processing," or NLP.

Using NLP, the phrase "Sid Banerjee really loves latte," for example, would be broken into three parts, "Sid," "latte" and "loves" -- each part yielding boatloads of related data.

It might be of interest to a lawyer suing a coffee company.

"We realized if we could take the core concepts and package them into business information, we could make a lot of money," said Banerjee. "So we basically went to the VC community."

VC stands for venture capitalists. They are capitalism's version of the horse track bettor. Some use their own money, or they combine it with money their clients give them.

VCs provide money for expansion in return for an ownership stake and a say in management.

"This is shared risk and shared reward," Banerjee said. "You have to be willing to give up equity, give up a percentage of your business. You sell a software company in a good climate, your valuation might be four or five times revenue. A $50 million revenue company will get you a quarter-billion dollars. You take dilution, but you get it back if you build a successful company."

Getting the VC money isn't easy.

Before Clarabridge made a single pitch to a venture capital firm, it researched the character of each company. Who made the decisions? Was it an individual or committee? What was their specialty? What were their backgrounds?

Are they an East Coast VC firm or West Coast? East Coast VC firms tend to be more conservative, asking detailed questions about numbers and incremental progress. West Coast firms are more dreamy, open to the long shot. East Coast VC firms even look the part, preferring suits to the open-necked shirts and sports coats of the West Coast brethren.

"I have found more skepticism on the East Coast," Banerjee said. "They want you to prove to them why they should invest. I had one East Coast VC who kept interrupting me and said no matter how good you are, you won't make money."

The first round of fundraising, known as the A Round, is critical, because the start-up usually has zero income and only an idea. When start-ups go back for the second round, companies usually have revenue and are moving forward. By the third round, they should have a real, growing business with a strong management team.

Banerjee and his team rehearsed their 90-minute PowerPoint presentation as if they were appearing on prime time. There was a tight introduction, followed by a definition of their market, an estimation of revenue growth and then a close that urged the audience to invest.

Clarabridge's A Round pitch went to six companies. Banerjee got $3 million from Boulder Ventures in Colorado in 2006; Boulder in return got an ownership stake in Clarabridge of at least 25 percent. Banerjee immediately hired 10 software engineers.

"We had the rocket fuel to take it to the next level," Banerjee said.

The company got its first customer in 2006, and it grew revenue five-fold the next year. Clarabridge now employs more than 80 people, has more than 50 clients and has -- by my estimation -- revenue in the tens of millions.

The company has had some profitable months, and it is confident it will soon be consistently profitable.

Venture capitalists have put up a total of $20 million in three rounds, with the most recent C Round of $12 million last July. I am guessing Banerjee and his two partners still own about a third of the firm, so they have sold more than half.

And if Clarabridge sells for $100 million, Banerjee and his two partners' one-third ownership will earn them . . . well, you do the math.