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Colorado Business: The Art of Building Businesses

Colorado Business

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A Decade of Business

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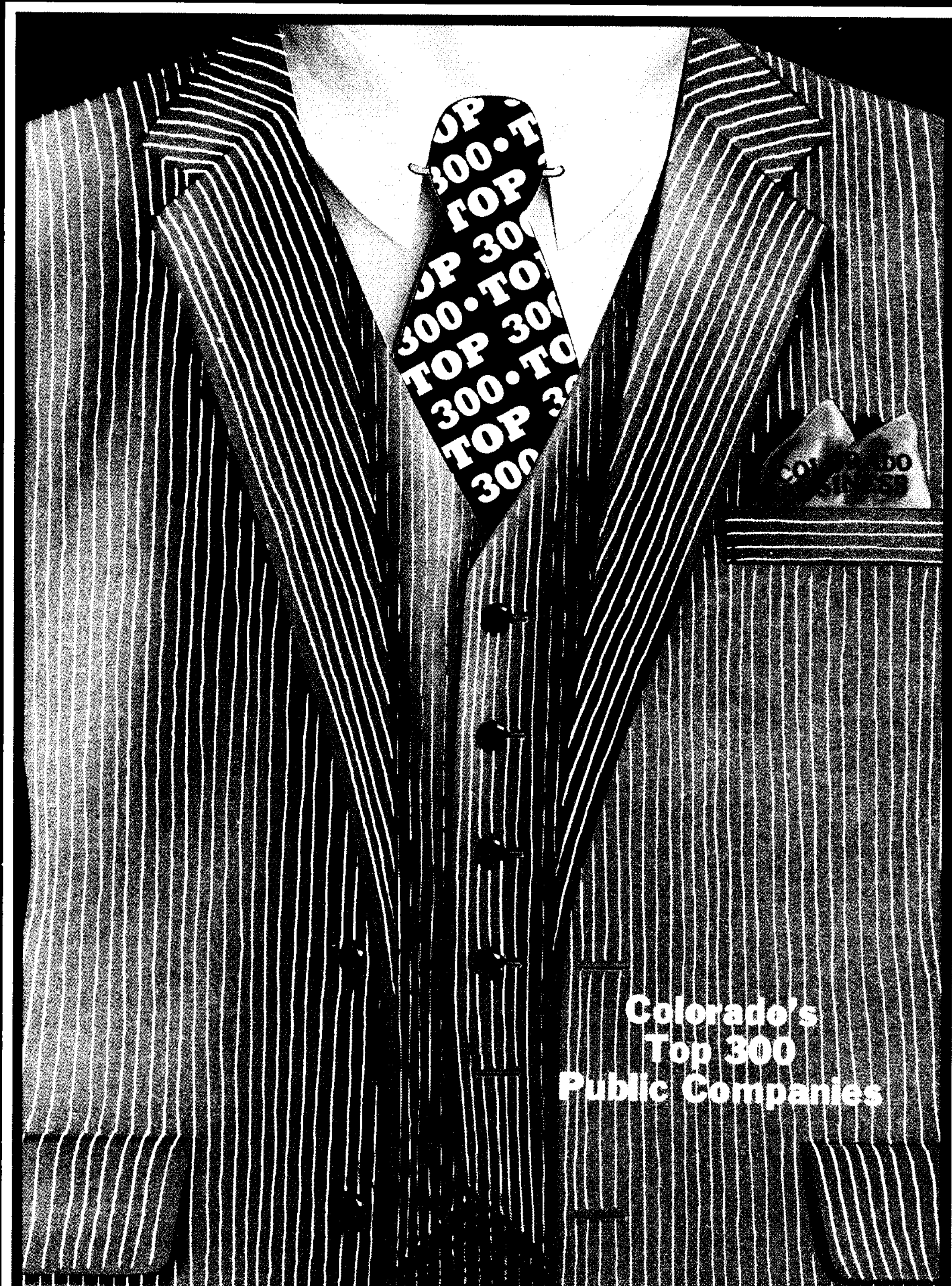


This business of building businesses

This is the story of success. It is about two entrepreneurs who each built strong companies and are now using that expertise to create Colorado's future fortunes.

At age 62, Duane Pearsall is known as a statesman in the area's small business community. He founded Statitrol, the company that developed the first practical smoke detector in the United States and he was named Small Businessperson of the Year in 1976 by the U.S. Small Business Administration. He has served on a number of national panels and committees that have tried to fashion a better business climate for small and medium sized companies. Now, he is one of five partners in Columbine Venture Associates, a venture capital company that may be the largest fund of its kind in the Rocky Mountains.

One of his partners is David Miller, founder and chairman of the board at Denelcor, a publicly held electronics company that is also one of the successful high-tech firms along the Front Range.

Pearsall says he and Miller are "recycled entrepreneurs" whose hands-on experience complements the venture capital backgrounds of the three other other partners—Mark Kimmel, Terry Winters and Sherman Muller. Together, Pearsall says, they are "in the business of building businesses."

The story of how Statitrol developed the smoke detector dates back to the 1960s, but it is important in understanding why Pearsall is philosophically committed to his new enterprise. It also explains how he and Miller joined the same venture capital firm.

Statitrol built devices to control static in places such as darkrooms, and in the process developed a gadget that measured static in the air. In doing so, "we noticed that every time the technician would smoke very much while he was near it, the meter would go crazy," Pearsall recalls. At a trade show some time later, Pearsall met representatives of Honeywell Corp. and remarked that he didn't see a smoke detector among Honeywell's array of fire safety equipment. There was such a device, the Honeywell people said, but it was impractical and triggered many false alarms. Pearsall said he might have something better.

David Miller, founder of Denelcor and partner in Columbine Venture Associates.

Honeywell's people visited Statitrol and offered the little company a three-year contract to develop a smoke detector for commercial properties. The problem, however, was that 52 percent of Statitrol was owned by Powers Regulator Co., a direct competitor to Honeywell in other fields. Statitrol had to buy back that interest to get the contract—and Pearsall accomplished that with venture capital.

Central Investment Co., at the time a Dillon Cos. subsidiary headed by the late Blaine D'Arcey, invested $150,000 in Statitrol to buy out Powers Regulator, another $75,000 to pay off debts and a final $25,000 to develop the new product. D'Arcey, who died about two-and-a-half years ago, served on Statitrol's board for 13 years. He helped Pearsall make the numerous critical decisions that all small-business people face. "He agonized with me," Pearsall says.

The Honeywell contract was completed in 1969 when Boulder inventor Lyman Blackwell came into Pearsall's office with a small box and announced that he thought everyone in the country ought to have access to the same practical means of smoke detection—life preservation, as it were—in their homes at a reasonable price. This device, Blackwell said, included a mechanism that triggers automatically when the batteries are weak.

Pearsall says he doesn't make many quick decisions in business, but that was one of them. It wasn't a quick process to get the device accepted, however. "People didn't know what it was," he remembers. But after about three years, most of the important associations in the fire prevention business had approved the smoke detector. Sears Corp. started selling the device in 1972, and by 1976, there were 54 competitors in the marketplace.

In 1977, Emerson Electric bought Statitrol and the Dillon Cos. sold Central Investment to Northwestern Venture Capital Management Inc. Pearsall ran the smoke detector division for Emerson for a year-and-a-half, during which time he became increasingly involved with several national committees and organizations. Eventually, those activities would lead his tale to intertwine with the story of David Miller.

About the same time Statitrol was developing the home smoke detector, Central Investment, under D'Arcey, had invested in another company called Denelcor, which Miller founded in 1968. Denelcor went public about 10 years later through E.J. Pittock and had a secondary rights offering in 1980. The amount of capital placed in the small company has mushroomed far beyond the $200,000 D'Arcey originally invested. Since the fall of 1981, Denelcor has had $35 million in private placements from institutions, including a number of European investors. Denelcor's annual revenues rose from $1.8 million in 1982 to more than $3.5 million for 1983, placing it among the 110 largest public companies in the state in terms of revenues. It is also one of the 100 largest employers among publicly held corporations in Colorado.

With his company expanding rapidly, Miller decided that Denelcor needed additional management expertise. He brought in Jim Hill as president, and knowing that a company can't have two bosses, stepped into a new role as chairman of the board.

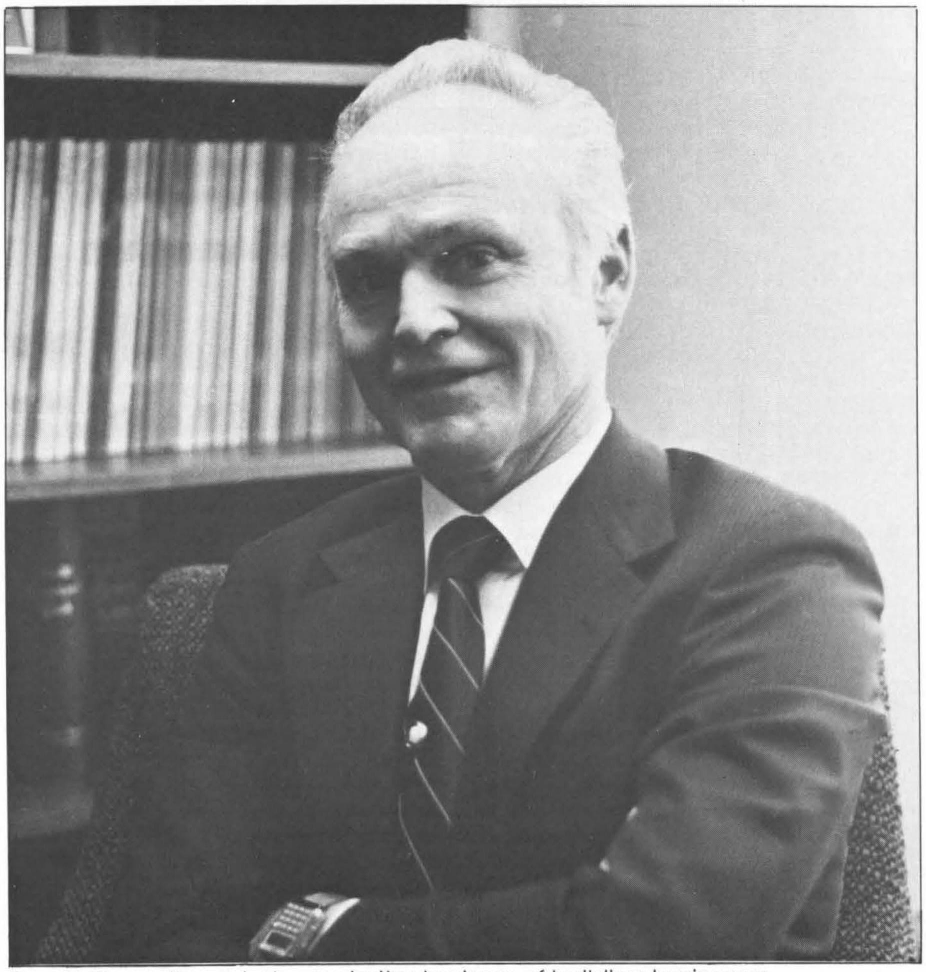
A few years before this management change, Mark Kimmel had asked Miller to join a small business investment company called Enervest. But Miller, busy at Denelcor, declined the offer. Kimmel had also been a consultant to Denelcor when the company was seeking new funding and was one of eight persons who purchased interest in Denelcor when the Dillon Cos. divested itself of the Central Investment subsidiary.

With Hill as president of Denelcor, though, Miller had some additional time. And Kimmel would again approach him about joining a new investment firm.

Pearsall, meanwhile, had been involved with equity financing in other ways. He had served on the Venture Capital and Equity Capital Committee of the Small Business Administration, which made 19 recommendations for change. Among them was a revision to the Employment Retirement and Income Security Act of 1974. At that time, the law effectively precluded pension fund managers from investing in small, growing companies—and those pension funds represented $500 billion in investable income to which small business did not have access.

These "prudent man rules" were modified, as the committee had suggested, and the results were dramatic. According to Pearsall, in 1974, only $10 million was invested in venture capital by institutions. In 1983, there was more than $3 billion invested.

A second change fueled the expansion of venture capital sources for small businesses. In 1978, the capital gains tax was altered to make long-term investments like venture capital more attractive. With new money and new incentives for investors, venture capital has become "quite a growth industry in itself," Miller says.



Duane Pearsall says he's now in the business of building businesses

Another of the numerous organizations to which Pearsall belonged was the Small Business Council of the Denver Chamber of Commerce. There, he met Kimmel. A partner in the Enervest SBIC, Keith Shwayder, invited Pearsall to join the Enervest board of directors. "I was intrigued by what they were doing," he says.

The SBIC program however, depends on government loans, and as with many federal projects, has been scaled back because of budget cuts. Three of the Enervest partners created an institutional investment fund with a 10-year life cycle. That's a common practice in the venture capital business, where companies in which funds have been invested mature in five to seven years, Pearsall says.

Columbine Venture Associates was formed in 1983 and the four founders—Kimmel, Pearsall, Miller and Sherman Muller—were joined by a fifth partner, Terry Winters. Enervest's portfolio of 22 companies will be liquidated and should "demonstrate an excellent financial performance," Pearsall says.

By the end of April, Columbine was to have concluded its funds-solicitation period and expected about $30 million in capital, making it the largest single fund in the Rocky Mountains. Most of the capital comes from pension funds, insurance companies' investments, corporate development funds and private individuals. About 15 percent of the money has come from offshore sources, including the investment company of Flanders and the Japanese Long-Term Credit Bank, a $50 billion institution. The Japanese, Pearsall explains, are interested in learning how Americans make venture capital investments.

"It's an exciting business to be in," Pearsall says of venture capital. "Everyone I talk to wants to be in it. But it takes more than one expects. It takes experience. I don't consider myself a venture capitalist yet... maybe in another four years or so."

Kimmel, Winters and Muller, he says, are professional venture capitalists because of the length of time they have spent in this infant industry. Such pros need to understand risks and evaluate management, product potential and a company's overall viability, he explains.

They also play a numbers game. Of 100 business proposals the firm receives, a venture capitalist will invest in maybe two of them. The firm may build 20 companies. Five or six of those will be losers, with three or four having reasonable returns of five to one or 10 to one. A couple will be big winners—the Statitrols, the Denelcors, the NBIs, the Apple Computers. The balance will be part of the "living dead," Pearsall says. "They make nice companies for the people running them, but not much money for us."

Given those numbers, venture capitalists know their losses early, but need to wait longer for their successes. Quoting venture capital guru Stan Pratt, Pearsall says "lemons ripen early. Pearls take longer to develop."

Venture capital, he continues, is critical for the development of small business. "Look at the Front Range—all of the high-tech companies that are successful originally had venture capital support." He points to studies that show that between 1969 and 1975, small business was responsible for 86 percent of the net new jobs in the United States. More recently, the president's report to Congress on the state of small business said that in 1981 and 1982, 100 percent of the net new jobs were created by small businesses. The Fortune 1,000 showed a net loss of jobs during the same period.

Furthermore, Department of Labor reports have shown that, per dollar spent on research and development, small businesses are 24 times more efficient in producing new technology than is big business.

"In my view, it demonstrates that the future of our country's creativity in high technology is vested in small business. We couldn't depend on big business to do it," Pearsall says.

Miller says he hasn't been in the business long enough to compare the outlook of a venture capitalist to that of a small-business person searching for equity financing. "In a sense," he says, "it may make me more empathetic" to the small-business person, since he has had similar experiences. "Who knows," Miller quips, "I may turn into a hard-nosed banker."

In any case, there is a characteristic that makes for a successful entrepreneur.

"Tenacity. That's the top of the list," Miller says. "Anyone who thinks that they can do this part time or do it easily won't make it. It takes total commitment to success to do what you have to do... Entrepreneurs don't admit to failure. They plow ahead to get the job done."

—Penelope Purdy