Redpoint Engineering in the News

An Open Letter to Venture Capitalists

Let me start by admitting that I don't know much about the decision-making processes of venture capitalists. From my recent losses on Wall Street, though, I think I know something about the process of investing money, and based on that little knowledge, I would like to suggest a tool for making VCs more successful than they already are.

As I understand it, it's a statistics game. VC's don't expect to bat 1.000. What they try to do is to have a good batting average, and for the rewards from their 'hits' to more than offset the losses from their 'misses'. Obviously then, any measure that offers to improve their batting average is worth considering. First, however, we need to understand the reasons for the 'misses', i.e. the reasons why many start-up companies fail. Conventional wisdom is that most start-ups fail due to insufficient capitalization. Well, I'm not going to challenge that notion, nor am I going to tell VC's anything that they don't already know about that. So let's look at another major cause of start-up failures, failure to deliver the product.

My contention is that many start-ups fail because they are ineffective at translating their product concept from the idea stage to the manufactured product. This is not surprising, since most start-ups lack some of the skills necessary for successful product development. People who are good at coming up with product ideas and starting businesses based on them, i.e. entrepreneurs, are not necessary the same as people who are good at product realization. Nor can start-ups typically afford to have comprehensive internal development staffs that can address all the key aspects of product realization.

The failure can take one or more of several forms. One form of product realization failure is schedule failure. It often takes longer to get the product into production than was originally anticipated. Delays result from inexperienced development teams following flawed or nonexistent development processes, or from errors caused by a lack of expertise in disciplines not staffed properly. The upshot is that extra design iterations are needed, and they consume time and money. The worst case is when the delay causes the product to miss its window of opportunity.

Another form of product realization failure is cost failure. The product fails to meet its production cost target because it is not really producible. Products are designed that require prototype processes in a production environment. That is a recipe for disaster. Why would such a thing happen? Often the entrepreneur builds a working prototype to demonstrate the product concept, and then simply tries to build a million of 'em. Don't laugh; it happens. The patent office is full of better mousetraps that no one can afford to build.

One more form of product realization failure is feature failure. Here the entrepreneur, who is often techno-centric (MS Word tells me that techno-centric isn't a real word, but you know what I mean), attempts to put every feature into the product that he is capable of doing. What often results is a product that is a) too expensive, b) takes too long to develop, c) is unfriendly to the user, or d) is unmarketable. Choose one of the above.

OK, here is where the VC comes in. Instead of simply accepting or rejecting a venture based on the product idea (and other considerations that I know little about), wouldn't it be better to anticipate some of the flaws mentioned above, and to suggest remedial steps to avoid them. Perhaps 'suggest' is too mild a word here. Let me be specific. There are companies whose full-time business is developing products for clients. These companies contain the skills and resources needed to turn ideas into successful products. And some start-up companies utilize

them. The problem is that many start-up companies don't use them. For a variety of reasons. Pride, insufficient resources, ignorance, you-name-it. Getting back to the batting average analogy, I contend that the batting averages of start-ups would be higher if more of them opted to utilize such services. It is in the best interests of both the start-ups and the VCs that fund them that this occur. So, I'm advocating that VC firms, in general, establish strategic alliances with product development companies, and that they facilitate the working relationship between the start-ups and the product development firms. Ultimately the cost of product development is borne by the client, the start-up, but with VC money. The cost of product development has to paid no matter what, so why not do it effectively with a higher chance of success?

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