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Demanding more: getting the most out of VC investments.

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Summary: A venture capitalist's primary concern is balancing opportunity and risk. Making information decisions through the use of actionable intelligence minimizes competitive risk and creates competitive advantage. Early stage companies (the typical VC portfolio company) stand to gain the most from using CI to provide early warning of technological and industry threats. Darrell Mockus reviews the reasons why venture capitalists need to demand a concerted CI effort from their portfolio companies.

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As investors continue to expect high returns, venture capitalists are looking to increase the success rates of their investments. Gone are the days of “spray and pray” venture capitalism.

Successful venture capitalists (VCs) are taking a more involved approach to their investments. There has long been a gray area in venture capitalism: how involved should a VC be in their investments? What is their responsibility to each company they fund? It is not their responsibility to manage the company -- they invest in an executive team to do that. There is an implied role of oversight, but many do not get intimately involved, leaving responsibility to the executive team in which they have invested. However, when a VC takes a completely hands-off approach, it leaves a company without many of the benefits a strong venture capitalist firm can offer.

A venture capitalist’s primary concern is balancing opportunity and risk. Their investment should be consistently moving towards stated goals while negotiating constantly changing industry risks. The company must effectively and efficiently use all of the resources at its disposal to make the best decisions that achieve these goals. However, where should the responsibility lie to make sure that these goals are met? Should a company’s executive team be solely accountable? Many venture capitalists typically rely on an executive team's ability to handle strategic decisions and to know their industry.

Is that where oversight ends? If so, board meetings would simply be updates on progress (or lack thereof). However, the more successful venture capitalists use board meetings to challenge the executives' decisions and draw out strengths and deficiencies. Part of that effort is determining that the executive team is doing all that it can to minimize risks.

Making informed decisions through the use of actionable intelligence minimizes risk and creates competitive advantage. Relying solely on experience, non-validated expert opinions and assumptions seriously falls short of successfully managing risks. Only with an organized intelligence system can a company be sure they are making the most effective and efficient decisions possible.

Managing risks

To successfully manage risk, one requires the ability to foresee impending competitor, technological, and industry threats before they occur. Competitive intelligence (CI) is the preeminent tool in a company's arsenal to provide this early warning. Early stage companies, (the typical VC portfolio company) stand to gain the most. CI can accomplish the things that VCs demand of their portfolio companies, such as streamlining resources and avoiding costly mistakes. Having the time to respond to impending competitor and industry threats allows a company to make strategic changes that move it towards its goals while avoiding company-ending mistakes.

Competitive Intelligence is a forward-looking decision support system that helps organizations identify, monitor and manage risks. It is the practice of creating a system to pick up signals, apply an appropriate analysis framework, and make sound judgments about the future.

CI creates the advantage of strategic decision-making, and greater control, instead of reactionary measures. Using various advanced gathering techniques, such as human source collection and proven analysis frameworks, a comprehensive picture of current and future events can be pieced together from seemingly unrelated pieces of information. Early-stage companies must have an edge in outwitting, outmaneuvering and outperforming the competition. An organized CI effort delivers that.

Managing costs

As with any program where it is hard to calculate Return on Investment (ROI), CI programs always raise a concern about cost. However, a systemized CI approach can maximize resources by focusing them on the areas that can provide the company the most benefit. It assists companies in avoiding costly mistakes through false assumptions. It also maximizes human resources by turning all of the employees into effective components of the CI system.

If you have a limited amount of resources, wouldn't you want to make sure that they are used in the most effective way and avoid costly mistakes? If you do not have the resources or flexibility to clean up decision mistakes, why not work smart and do it right the first time?

time?

CI programs sometimes raise the issue that if companies are over actively involved in monitoring the competition, they are not moving forward on executing their executive plans. The notion that CI systems have to be weighty programs that require intensive intelligence gathering efforts and lengthy analysis meetings is false. CI is simply the systematization of intelligence efforts in an effort to make better-informed decisions. Unless knowing less and gambling on assumptions is a good strategy, a CI system can only increase a company's efficiency in reaching its stated goals.

Venture capitalists need to demand a concerted CI effort from their portfolio companies. VCs are in the best position to influence early stage companies to gain the benefit of CI. As stakeholders in these companies, they need to be concerned with how the company manages the risks that affect that company's success. VCs need to use board meetings to ask pointed questions, challenge decisions, and ensure they are getting the benefits that an organized CI system can provide.

Implementing CI

The responsibility of implementing an effective CI system should rest squarely on the executive team. But as a key stakeholder, the venture capitalists should require it and allocate part of their investment towards it. For example, with an investment in the $5-10 million range, allocating at the minimum 5% of this investment towards building and maintaining a CI function helps to ensure that a proactive approach to decision-making is taken and that surprises are either being removed or reduced.

Following are a few questions key stakeholders can ask their executive teams:

- Quantify the current risk factors from highest to lowest. What methods will you employ to detect or monitor risk areas?
- Does your organization have adequate mechanisms to monitor and evaluate performance of the internal and external risk factors?
- Are you able to measure industry and competitive risk over the appropriate time frames?
- What critical checkpoints will mark the lowering of risk?
- How will you address blind spots?
- How is known intelligence fed to key decision makers?

If VCs are concerned about managing their investment risks, they should insist that their portfolio companies manage their risks as well. The number of failed companies and ones that fell short of their potential are an indication that more needs to be done to encourage active risk management.

Competitive intelligence is about managing risks using a forward-looking decision support system. As key stakeholders in early stage companies' successes, venture capitalists need to demand more of their investment portfolio. Only a direct push by the venture community will motivate executive teams to make smarter strategic decisions through the effective use of competitive intelligence.

Background:

Darrell Mockus is a technology strategy and intelligence analyst for Predictive Research Group. He is a veteran in evaluating and defining technical business strategies on behalf of Venture Capitalist and key company stakeholders. Darrell has performed technical, executive management, and product due diligence on behalf of over a dozen venture capitalist firms and corporations. He is a graduate of Rensselaer Polytechnic Institute where he majored in Computer Science with a Minor in Engineering Management and Marketing. Darrell has served as a Board Member and Advisor for early-stage start-up companies. He currently serves on the Strategic Steering Committee for the Southern California chapter of SCIP. Darrell recently presented at SCIP's Annual Conference & Exhibit in Cincinnati, Ohio.

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