

When A CIO Should Think Like A Venture Capitalist

Guidelines for viewing the post-bubble world of technology

by Pete Sinclair

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Back in the early 1990s, CIOs were responsible for keeping IT systems running. Innovation was considered only when the pain level of individual departments got so high that the CIOs faced possible armed rebellion. Then came the late 1990s, which we now affectionately call the "bubble." CIOs were expected to buy and implement the latest and greatest of everything, lest their company fall behind their competitors who were all doing the same. As we all know, the bubble burst and CIOs collectively found that few of the new products they bought really worked. So they spent the next few years figuring out how to remove everything without further damaging the IT systems.

Now it is 2006, and the IT systems are running fairly smoothly again. So how should a CIO view the technology world going forward? Consider evaluating new products like a VC would. I'm not referring to the VCs you remember as the guys who funded all the companies that made those nonfunctional products you were "forced" to buy during the bubble. They were drinking the same Kool-Aid you were. I'm talking about the traditional VCs, the ones who tend to be as risk-averse as you are. Did I say *risk-averse* and VC in the same sentence? Yes, because good VCs, like CIOs, are under renewed pressure to do more with less. The surviving VCs live by a set of fundamental rules that help them avoid bad investments. Modern CIOs can use these same rules as they evaluate new technologies.

So let's look at these golden VC rules and see how they might apply to the decisions a CIO needs to make.

Get first-mover advantage. Your first reaction to an innovation is probably to let your competitors work out the wrinkles first. But what if it works? You are going to be left in the dust. Assuming that the vendor meets all of the rules listed below, you should be willing to try new products if the potential value is significant enough.

For instance, eTrade was the first buyer of a system performance monitoring tool from Timestock, one of our startup portfolio companies. The product helped give eTrade better uptime than its competitors', a distinct advantage that could have been achieved only by taking a risk on a new technology.

Great deals for first customers. VCs encourage companies to literally give their product away to their first few customers and do whatever it takes to make them successful. You should try to be one of these first customers. You can often get the product for less than ten cents on the dollar and do not have to pay until the company delivers.

Avoid mission-critical solutions. I know this sounds backward, but VCs have learned that enterprises won't buy mission-critical products from small companies. It is just not worth the risk. Enterprises do, however, buy products from startups that increase performance or productivity without being irreplaceable. VCs have learned to search out companies with compelling products that are not mission-critical. You should do the same.

One of our other portfolio companies, Netli, sells Internet application acceleration via a proprietary yet

transparent protocol. It has put together a prestigious list of customers, by delivering these benefits while designing a failure mode that simply bypasses its acceleration nodes. So if it works, it delivers great value. If it fails, the customer is not left in a worse position than if it hadn't bought the product.

The 10% rule. Do not commit more than 10% of your annual capital and operating resources to any single new technology. Venture funds would not commit more than that to a single investment.

Check the business model. How big is the market? Do you know of other companies that would significantly benefit from the product? If the vendor is offering to make a product that is completely customized to solve only your business problem, it is going to have a hard time selling it to anyone else. A company with only one customer is not going to be around very long.

Survivability. What if the company fails after you have committed to its technology? Can the product still deliver value without the company's being around to support it? Many products continue to deliver value long after the company that made them goes away. Just make sure you understand the dependencies of the product, so that you can determine if it can keep working without upgrades. And don't forget to ask for the escrowed source code.

Look for a rabid team. Buy new technologies from companies that have great people. Just as a venture capitalist does, do your homework to ensure that they have the knowledge, commitment, and track record to be successful. Great people know they have to make you successful if they are to be successful. The right team can be even better than your own staff, because they know they have to please you or they might end up out of business.

Don't boil the ocean. If the technology promises to solve literally every problem you have, run for the hills. Pick products that try to fix one or two problems. If a product is trying to move the needle on multiple technologies at the same time, it is most likely going to fail, due to numerous risk factors. No matter how smart the team seems, companies just seem to fail if they try to push the envelope too far.

Look for other deep pockets around the table. Most VCs don't want to be the sole investor in a company, because the company always seems to need twice as much money as they forecast in their most conservative plan. Make sure the company has multiple credible investors. This will help ensure that it will be around long enough to deliver real value to you.

View new technologies like a portfolio. Don't expect every technology to work out. A few will fail. However, if you have cut great deals, the few that succeed should put you far ahead of your competitors.

I'm sure it is obvious that these rules operate as a group rather than individually. A company needs to satisfy every rule to be a candidate for VC investment. Likewise, a CIO shouldn't buy unless all of the same rules are met. So go ahead and take some risk. Do it right, and you can end up with an outstanding return.

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Feedback question: [Tell us](#) about a bet you made on a new technology that paid off handsomely—or failed miserably.