

## Hallucinogenic Funding

In the pre-boom venture model, companies got enough funding in their early rounds to build preliminary products and test-market them to selected customers. Once they had found some market validation, VCs followed with larger funding tranches to fuel an expansion of sales and marketing. This encouraged early exploration and later (timely) spending. In the bubble, this was reversed: great concepts were fully funded up-front, with some interesting side effects. Here are some thoughts on how excessive early funding can warp a start-up's perception.



## Aren't We Past Overfunding?

Although huge VC injections are out of fashion, I still see overfunding in selected (hot) segments. For example... the next generation of wireless infrastructure is just coming to market, and there are some interesting innovations. One good thought is to marry wireless Access Points (APs) and the wired switches that support them, adding software that coordinates all of the pieces for better security and coverage. Oops. Nothing spreads faster than a good idea. There may be more than 50 companies about to deliver "AP/switch" solutions including [AirFlow](#), [AirGo](#), [Airespace](#), [Aruba](#), [Chantry](#), [Legra](#), [Trapeze](#) and [Vivato](#) – each a start-up with a unique approach to the problem.

Similarly, I'd love a truly effective anti-sp\*m product to wrestle the hundreds of junk items coming to me each day, and corporate email managers are even more anxious for solutions. I've tried [Sp\\*mAssassin](#), [Sp\\*mNet](#), and am now using [Qurb](#). A good market opportunity is easy to overpopulate, however. At last count, more than 80 firms were crowding into this niche.

In most new markets, a few start-ups receive massive early funding doses. They have the chance to inhale a lot of Sand Hill pixie dust. (Full disclosure: I'm just as guilty. There's none so righteous as a recovering VC addict. I try to attend meetings when I'm not pitching new business plans...) With such potent finances in the organizational bloodstream, it's easy to believe in your start-up's invulnerability.



## A Five Mis-Step Program

So you've joined the newest high-concept start-up. Investors are excited, with some shoving to get into a massive "A" round. (Everyone breathes in deeply.) How does this excessive funding affect your judgment?

1. "We're Right." It's easy to believe that raising \$50M or \$100M proves that customers will buy your proposition. A big war chest certainly gives you time to pursue your vision. The biggest advantage of a start-up, however, is the ability to get rapid product feedback and swerve with the market. Deep pockets let you ignore critical inputs, and continue spending on "market education."

Hank Chesbrough's research on spin-offs and start-ups shows that small companies succeed precisely because they are forced to serve real needs. Short on cash, they find actual customers with tangible problems -- and re-arrange their product visions to fit the real world. A daily dose of financial terror clears the mind.

2. "We make a product, not just a feature." Tiny companies have the luxury of considering different business models. For instance, some choose an OEM strategy, embedding their valued-added software into other products for a small royalty. ([Meetinghouse Communications](#) does this well for low-end Wi-Fi authentication.) Potential competitors can be turned into customers.

You're now part of an important, well-funded company, however. Important companies sell products to end customers. To do so, you'll need to deliver something that is highly differentiated. Most likely, you'll also have to match the feature set of whatever last-generation product you hope to replace -- and which has evolved through a dozen releases. Your engineers started with a handful of innovative algorithms, but they inherited a truckload of generic features that you need to displace incumbent vendors.

3. "This is a \$1B market." If you've taken \$75M from investors, they will want \$750M back later. This usually forces you to pursue a very large market with premium-priced products. Selling a few thousand copies of software at \$1000 each won't impress your Board of Directors. In fact, you probably predicted a billion-dollar market in order to raise this money... and are not eager to downsize your forecasts. (Hint: very few \$1B markets exist, and yours is not the first team to spot this one.) Now you're forced into overly aggressive goals and assumptions, which create organizational pressure to ignore what you hear from the market. Staffing plans are built against very optimistic targets. Leading to...
4. "We need to get big fast." To dominate a \$1B market, you need to sell \$20M in the first year. This calls for six or eight fully staffed regional sales teams. Even though your product isn't ready to sell, you'll equip each team with PowerPoints, data sheets, price lists, logo pens, ROI models, and other bits of science fiction. After all, you've identified a compelling need and expect to close dozens of customers within 60 days of product

availability. As if. Throw in an inevitable schedule slip or two, and Sales will insist that...

5. "PR and Marketing can accelerate customer adoption." Hardly. Most corporate marketplaces develop slowly. (Dust off your unread copy of "Crossing the Chasm." It's still valid.) IT buyers are risk-averse. Each will want reference accounts, extended evaluation periods, and budget approval time. Many customers have incumbent vendors with political support. Regardless, your sales force will demand qualified leads. Here's your chance to spend some of that idle cash on a massive PR blitz and multi-city road show - well in advance of final product. If the press loves your story, then perhaps Gartner and Forrester will be unwilling to point out the obvious.

We've all seen companies expand too fast, too soon, and overshoot the market. Revving the Sales & Marketing machine in advance of customer demand is tempting, and often asked for. *It's like burning down your house to keep warm, however.* After a wild night of marshmallows, cognac and cigars, you may need to find a new place to live.

The preemptive solution calls for humility and self-control: don't accept so much money. In practice, this is very hard to do - as demonstrated by generations of dieters and AA members.

After the fact, you should struggle to conserve your massive war chest for a well-timed expansion: keeping your powder dry instead of inhaling it. After some thoughtful wandering and market exploration, you'll be able to execute aggressively. (Still, it's hard to resist when funding makes you feel so smart and so successful.)

### *Sound Bytes*

Outside capital is a stimulant. Taking too much too early can blinker your judgment, make you feel omnipotent, and encourage risky behaviors. Most dangerous of all, it can help you ignore the market. Moderation in all things.

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