

# **What can reporters learn from venture capitalists when covering technology startups?**

**By Marie Alpman**

A technology startup contacts the newsroom. A small team of people has worked for three years on an invention, filed a bunch of patents, attracted some seed money and has an ambitious plan to expand to an international market. Now they want publicity.

The challenge for a reporter is to know:

Is the story worth writing?

How much is the story worth?

What are the important questions to ask about the company?

Early-stage venture capitalists are faced with similar questions. Just as reporters flooded with press releases and “PR-pitches,” venture capitalists must evaluate a big number of potential “deals.” And just like reporters, venture capitalists must choose which potential investments are worthy of a closer look.

This article examines what reporters can learn from venture capitalists when writing stories about technology startups, using information gathered through interviews with early stage investors in Stockholm and Silicon Valley.

First of all, there are some basic differences between venture capital investing and reporting. The ultimate goal for investors is to make money. Venture capitalists are looking for companies with a scalable product and a big potential market. A consultancy business or a niche-product is therefore less likely to attract venture capital.

Another very important point is that venture capitalists also want to be able to “exit” the company after five or six years. There are two typical exit strategies: either sell to another company, or sell shares of the company’s stock to the public through an initial public offering, or as it’s called in venture capital jargon, an IPO.

Reporting, on the other hand, serves other purposes, and the focus depends on the nature of the publication. A technology publication focuses on the technical issues while a business magazine focuses on the market.

A good innovation story deals with both the technology and the market and gives readers an understanding of the likelihood of the company’s success. It’s analytic and includes both pros and cons regarding the company.

To write a good innovation story, reporters can learn from venture capitalists.

### **First lesson: The team is more important than the technology.**

The fact that a technology is newer, faster, cheaper or more environmentally friendly than existing technologies doesn't necessarily mean that it has a place in the market. As one venture capitalist said: "There are lots of good technologies out there, the problem is to execute on them." Another said: "The belief in the team of people is critical when making an investment decision." From a venture capitalists' perspective, a good and innovative technology is simply the basis for the far more challenging task of commercializing that technology which takes a good team of people. A venture capitalist invests in people, not in technology. Therefore, in their early assessments, venture capitalists concentrate on the people behind the company.

So, how to evaluate the team? First of all, it's not done over the phone. Venture capitalists meet with the CEO and other key members of the team several times before making an investment decision. The assessment and financing decision is also not done alone. One venture capitalist explained that all 15 of the partners in his company would meet the team and then come together afterwards to discuss their impressions thereafter. An investment was not made unless a majority of the partners agreed to do the deal. A partner not in favor of the deal would be asked to take part in the on-going due diligence to raise critical questions.

Before meeting the team, venture capitalist do the same check-ups as reporters. They do a Google search on the company and the team, as well as relevant market and technology key words. Just like reporter, venture capitalists stick to their "beat" and only invest in markets that they know.

Finding out about the reputation and track record of entrepreneurs is perhaps most critical at this stage. One venture capitalist said he would ask for as many as ten references and then talk to them all. The investors also rely heavily on their network. Since they often work with companies in the surrounding area, an entrepreneur's reputation – good or bad - will quickly be revealed.

"It's a small world. To find somebody who knows about the guy is usually not more than two phone calls away," one venture capitalist said.

At the first meeting, the venture capitalists use an approach that is more psychological than technological. Some of the things that turn out to be just as important as the business plan are: Do the key team members give a first good impression? Are they passionate and truly interested in the technology field and about building a business? Can they explain what they do and what problem they solve in an easily understandable way? Will they be able to attract the right employees and customers?

The venture capitalist also ask himself questions like: Would I like to work with this person? Would I buy from this person? Can I trust this person? Will customers trust this person?

Another very important factor is whether the entrepreneur has had previous experience running a small business. A person with a proven track record who has started and run startups before – a serial entrepreneur – will attract venture capital more easily than a university student starting a business for the first time.

### **Second lesson: No market, no business**

No matter how innovative a product or technology, without a market, there is no business. Someone's got to be willing to pay for the product. A good understanding of the market is crucial for investors. (Never mind that in most cases, the company didn't pick the right market at first, but had to change the business model a couple of times. But as one venture capitalist said: "With a good team you can always change the business model.") Bad signs for venture capitalists are when the company doesn't know their market and the CEO makes comments like:

"We don't have any competitors."

That probably means that the company's idea is not a good one and that a market doesn't exist. Or, the company simply hasn't done it's homework in assessing the market that they are aiming at. There is always competition in any market. The company should know in detail how the problem they want to solve is being solved today.

"The market will be worth \$1 billion dollars in five years due to a market study by analysis company X."

If a major analyst firm covers the market, it's usually a somewhat mature market. These figures are often misleading for a startup. Market analysis can give an indication of the total space, but will the startup be able to serve the whole market?

"We only need to grab one per cent of that market to reach \$10 million in sales."

For a venture capitalist this indicates that the startup is not aggressive and only want's to become a niche player.

The venture capitalist will also ask for a list of customer references. A company that has customer relationships at an early stage is usually a good sign. If they can't name a single customer, then they simply have not started to sell their product, or, even worse, they don't trust their customers to give them a good reference.

Many venture capitalists spend a lot of time doing research on the market potential of a new technology product. The later stages of their due diligence might even include paying external experts and analysts to write a report.

Some of the investors interviewed for this article explained that they used a backward model to understand the likelihood that a startup would reach its sales goals. They simply asked this question: In order to reach annual sales of for instance \$200 million, how much of the product to which customers does the company need to sell?

For Internet companies the challenge is to make a true estimate of the market size. It includes estimating the size of the potential audience, what traffic will look like and how much revenue the company can make per user. A venture capitalist specializing in online media businesses explained that a site with a broad reach need to be among the top ten with 50 billion page views per year to reach \$50 million in revenue.

### **Third lesson: Be aware of the risk involved**

Venture capital investment is a risky business. It's often compared with Hollywood film-making. Most companies that receive venture capital will never become a Google. For every blockbuster there are many more companies that fail.

It's also a business that follows economic cycles and that has become known for creating bubbles. Today, many venture capitalists warn of a web 2.0 bubble as well as a clean tech bubble. Despite this, more money is being poured into social networking and solar power startups.

Dealing with the risk is a key element of investing in startups. As one venture capitalist put it: "What I really do is look for faults."

The time it will take for a product to reach market is also generally underestimated. It's very rare that the sales curve goes straight up and it's not unusual for companies with long product development cycles, like those in semiconductors, to wait as many as six years for their first sales.

Reporters, investors and entrepreneurs generally underestimate the time it takes for a new market to emerge.

### **Summary of lessons learned**

Despite the differences in the aims of venture capital investing and reporting, there are some practices that reporters can learn from investors when covering startups. This is a summary of venture capital inspired advice for reporters.

Learn the technology field. Without at least a basic understanding of the technology in question you won't be able to assess the new technology and put it into the right context.

If you don't know the technology, take time to do your research. Look up key-words, use patent databases and check competitors' websites.

If you are writing a major story about a startup, always try to meet with the team; don't just interview them on the phone. And when you meet them, imagine that you are an important customer. Would you buy from these guys?

If you fall in love with your story (and actually would buy all that the company can sell), tell it to a colleague with a critical eye. Listen carefully to the colleague's questions and find the good answers.

Don't just ask the executive team what market their company is aiming for. Ask them to describe exactly what problem their product is solving and how it is solved today. If they can't answer, check with a potential buyer.

Spend some time doing your own research on the potential market. If some of the competitors are listed companies, check their numbers and see what they say about future market estimations.

Be skeptical and critical. Use more than one source for the article. Include both pros and cons. Be aware of the fact that most startups never become a Google or a Cisco. Even if the product is genius, the customers might not like the idea of buying from an unknown startup or the market may simply not be ready. Timing is an important element in the success of every startup that becomes a big company.

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