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"Blink" – the Startup

by: Larry Kubal, Labrador Ventures – August, 2005

Can early stage VC's 'thin slice' a company, knowing within the first few minutes of a pitch whether they'll invest? Absolutely.

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VCJ

Venture Capital Journal

In the introduction to Malcolm Gladwell's book, *Blink:The Power of Thinking Without Thinking*, the author tells the story of a marble statue purportedly dating from the sixth century BC whose style and type – a 'Kouros' - matched that of only 200 other statues known to still be in existence. The statue was nearly seven feet tall and almost perfectly preserved. As Gladwell tells it, it was indeed a 'rare find'.

An art dealer, Gianfranco Becchinam was offering to sell the statue to the J. Paul Getty Museum for a cool $10 million – not a bad investment for the Getty if this particular 'Kouros' was the real thing. The Getty took the statue on loan and moved with caution, though its due diligence yielded as many questions as answers. "Where and when had the statue been found? No one knew precisely," stated Gladwell.

The art dealer had provided reams of information on its recent history, and the Getty even hired a geologist to take core samples of the statue's stone and surface layers. The conclusion? The stone, dolomite, came from an ancient quarry on the island of Thasos – and because it took hundreds if not thousands of years for Dolomite to turn into Calcite (found on the layer of the statue), this particular 'Kouros' had to be very, very old indeed.

The Getty was satisfied and, after 14 months of background due diligence, bought the piece for its collection. As with any other startup, however, the bad news only started to emerge after the first 'Board meeting'. In fact, as the Getty's Curator of Antiquities, Marion True, began to proudly show the 'Kouros' to some of his own Board members and several other art historians, the doubting began in earnest. "Something simply didn't feel right about it," noted one antiquities expert. "It looked too *fresh*," said another. Upon shipping the statue back to Greece for further verification, another expert said simply, "It looked like something that had never been in the ground."

Digging deeper, the documents accompanying the statue turned out to be fakes. The scientific evidence dating the stone? Flawed – nothing a little 'potato mold' on dolomite couldn't replicate. The experts had proven in their first few seconds of what Gladwell calls "thin-slicing," what the Getty and its scientists and researchers hadn't nailed down in 14 months of hard analysis – that the piece was likely a fake, their investment all but worthless.

With that in mind, we began to wonder – what returns might we all have as early stage VCs if only we could be as prescient and intuitive as those art historians and antiquities experts? If we learned, or at least understood, how to better trust our instincts as much as we rely on months spent doing due diligence? Could we 'blink,' particularly when evaluating an early stage company where there is not much hard data portending its chances for success or failure, and gain a strong intuitive hit as to it being a winner or alternatively, a loser?

If Gladwell calls such rapid cognition 'thin slicing, and others simply call it trusting a 'gut instinct', VCs call it 'having a nose for the right deal.' Whatever it is, could "Blink" according to Gladwell apply to early stage investing? Can we listen to an entrepreneur's pitch and know ten minutes into the PowerPoint – perhaps even two minutes following the first handshake – whether this 'feels' like something we should take a deeper look at?

At Labrador , the more we consider this, the more we feel that yes, we can 'blink' and know whether a deal feels right or wrong. Often, the rest of our due diligence merely confirms what we thin-slice upon first impression. Though it's often hard to know in advance which information is, in Gladwell's words, "central to the outcome of a decision" and which is irrelevant or, more importantly, corrupting – the ability to recognize what information matters and what doesn't – often separates good VC's from great ones, good investments from homeruns.

For example, the venture capital firms that first looked at Cisco years ago all said the same thing – the technology looked great but the husband and wife founding team were considered a nightmare. The firms that backed Cisco took that same data, made those same observations, but decided not to care. Was that husband-wife relationship relevant to the company's future success? Obviously not. It was the technology and its capacity for market creation that mattered. Likewise, how many firms passed on *eBay* on its first run up and down Sand Hill Road. Benchmark 'blinked' but looked far beyond pez dispensers. This was about community and do it yourself retail, and that spark, that one 'blink' made history.

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With Altierre, a San Jose, Calif.-based RFID (radio frequency identification) company we recently invested in – alongside ATA Ventures and Kinetic Ventures — we didn't have to filter out such hurdles. The company captured our interest on several different levels and we, the three partners, 'blinked' in unison. It didn't take longer than 30-minutes into the first pitch to know that a) there was something there in terms of solving a real business problem, b) it was the kind of large market opportunity that we all like and c) that all three of us were 'blinking' at the same time – something very important within our partnership as we only make funding decisions unanimously.

This latter point should not be underestimated, even if 'blinking' feels completely random and individualistic – as much emanating from our subconscious as it is a result of years and years of experience. One of our partners likes startups that have a larger company "look and feel." Altierre had that. Another likes to see technology geeks who possess domain expertise in a specific technology functionality. Altierre had that as well. And I appreciate the scrappy startup guys, the types of entrepreneurs who will make it happen regardless of what's thrown at them. Again, that was all part of Altierre's story.

Moreover, Altierre was the type of startup that had worked for us before – it was already a model of success, of positive 'blinks' from the past. If this sounds like venture capital 101 it is – and it isn't. Though many firms could have looked at Altierre in just the same way, many didn't. Beauty is in the eye of the beholder. What gets in the way of their own 'blink,' their initial 'gut instinct,' is their own rapid cognition (i.e. does Altierre trigger a negative or positive blink based on past experience?) and what will the subsequent due diligence checklist tell them that their own subconscious can't, or won't. Yet, in this regard, there's an axiom we've found all too true: *If you need to know the unknowable, you'll never make the investment.*

If we can assume for the moment that 80 percent of all investment decisions are made within the first hour of looking at a deal, then due diligence ultimately becomes the exercise that either confirms or rejects your initial 'blink.' Yet, without even an initial 'spark' of interest in a startup opportunity, no amount of due diligence will ever overcome a doubting intuition – VC's know this, as do entrepreneurs.

"You know going in, even from the body language, whether someone is going to invest, the rest of it is just a validation exercise," says Sunit Saxena, CEO of Altierre. "You're either looking for the fear or the spark… And I can't recall even one situation where we didn't see a spark at first, but then saw it later. Yet, if there's fear, the fear of making even the slightest wrong move, then the due diligence is all about looking for just the right answer to validate those fears."

As Saxena tells it now, when pitching Altierre to other VC's, it often didn't take more than 15 seconds to know someone wouldn't invest. Whereas during the first meeting with ATA Ventures, the company spent several hours with the partners explaining the business even though it was allotted less than one hour to make its first pitch. "It's a pretty easy blink actually. You walk into a firm and a guy's sitting there eating a meatball sandwich and you ask yourself, 'How can I work with a guy who's eating a meatball sandwich while I introduce myself?"

Ultimately, however, entrepreneurs know it's about getting all partners to 'blink' – even if they 'blink' in different ways. At a recent Board meeting for another Labrador portfolio company, the conversation focused on both the timing of the next investment (pre- versus post- new product launch) and the investors the company should target. While the timing question clearly influenced the projected valuation and the potential amount of the raise, the more interesting discussion focused on a categorization of potential investors.

VC's were broken down into 'fall in love' types – ie. 'feeling' types that would rely more on 'blinking' – or 'Missouri' types (Missouri being the 'show me state') who are pursuaded by more rigorous analysis and company metrics. If we were choosing to pitch for funding pre-launch (i.e. prior to any hard data proving the full business model), we should pitch to the 'fall in love' types; post-launch to the Missourians, the more 'thinking types' who like to make their decisions based on data and logic.

In evaluating another deal, a recent pitch from an Emeryville, California-based startup, Pictopia, that specializes in e-commerce for digital images, we 'blinked' – and yet we didn't. That is to say, two of us 'blinked' and had a good feel for the deal from the start while our third partner had doubts, a negative 'blink,' if you will. Where was the defensible technology? Why couldn't anyone else do exactly the same thing? It wasn't a strong enough 'blink' to pass, but it was clearly strong enough to check ourselves and make us dig deeper into the due diligence. Finally, after reviewing a large due diligence package, making our calls and constructing our own financial model of the business, the Missourian partner's brain said invest.

Why was his brain willing to 'blink' now as opposed to the initial meaning? That's the beauty, and complexity, of rapid cognition. His subconscious, his thin-slicing, said wait; ours said go. VC firm partnerships need both. Complementary 'blink' chemistry among partners is essential for partners to save each other from making bad investments. We each bring years of different company building experiences that fuel our subconscious pattern recognition.

In fact, after taking a look at nearly all of our investment decisions over the years, we discovered a fascinating fact: When we all 'blinked' as one, that is when no single partner simply gave in to the logic or passion or spark that the other one or two saw in a deal, positive results usually appeared down the road. Yet, when even one partner fought intuition, ignoring his own 'blink' for the myriad of other reasons that play into partnership decision-making, more often than not, disaster lay ahead.

Can VC's thin slice companies? Absolutely. Should they do so in lieu of due diligence and their own years of better judgment? Absolutely not. It's the willingness to combine the two that seems to better our odds.

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This is one in a series of monthly columns on seed and early stage investing that Labrador Ventures was selected to contribute to the *Venture Capital Journal.*