Online Positioning Roundtables for Entrepreneurs

In addition to the Entrepreneur Journeys series of books, Sramana Mitra offers a series of free online positioning roundtables to mentor and help entrepreneurs further develop their business ideas. In these roundtables, she also addresses financing strategy for each business.

During each 60-minute online session, entrepreneurs are invited to pitch Sramana their ideas in a three-minute presentation. She reviews the material in real time and provides feedback on each pitch, as well as addresses specific questions from the entrepreneur. Afterward, she takes questions from other participants. Each session is open to 1,000 people but only the first five to sign up have the opportunity to pitch Sramana and discuss their business in an interactive mode.

You can find more information about these webinars, recordings of past roundtables and registration links to upcoming sessions at:

www.sramanamitra.com/entrepreneurship-strategy-roundtables/

We hope you will join us!

Entrepreneur Journeys, Volume Three
Positioning: How To Test, Validate, And Bring Your Ideas To Market
by Sramana Mitra

At the beginning of 2009, I found myself without a VP of Marketing in a young start-up company and a new product coming out of the door that would radically change the positioning of the company. I had been introduced to Sramana by a VC who said, you have to meet this great lady just to know her. I contacted her to help me redo the positioning of the company. She did an excellent job in a short period of time using her crisp methodology that has now positioned the company for success. There is no better person to write a book on positioning. In this new series, she lays out the requirements for positioning and uses real world people and companies to illustrate her points. She is a no nonsense leader in our industry that must be listened to.

-Mark B. Hoffman
Chairman and CEO, Enquisite; Founder CEO, Sybase; CEO, CommerceOne

Too many entrepreneurs allow their passion to drive them to take action rather than to distill their wisdom. This leads many to jump right into building out generic business functions and pursuing generic strategies. What I ve seen over the years is that the most successful entrepreneurs are the ones that pause to deeply understand what market potential they exactly want to unleash. They then set out and test and evolve. Sramana, in her book *Positioning: How To Test, Validate, And Bring Your Ideas To Market*, provides the critical case studies that highlight how entrepreneurs should continually self-evaluate and refine their ideas. It s a great reference.

-Gus Tai
General Partner, Trinity Ventures

Many start-up companies dissipate precious energy and capital without ever reaching a point of clear market traction. Too often, their failure stems from their inability to operationalize their vision into a compelling value proposition targeted at clearly defined customer segments. Sramana Mitra s book *Positioning: How To Test, Validate, And Bring Your Idea To Market* combines personalized vignettes of passionate entrepreneurs who, through trial, errors and sheer determination, have managed to integrate this important lesson across the defining dimensions of the emerging Web 3.0 environment. Aspiring entrepreneurs and experienced venture capitalists alike will benefit from this compilation of focused interviews and will want to test their own enterprises against the scrutiny of Sramana s probing questions.

-Eric Benhamou
Chairman 3Com; former CEO, 3Com & Palm; CEO, Benhamou Global Ventures

Entrepreneur Journeys

Copyright © 2009 Sramana Mitra
All rights reserved.

ISBN: 1-4392-4592-4
ISBN-13: 9781439245927

Visit www.booksurge.com to order additional copies.

Entrepreneur Journeys

Volume Three

Positioning: How to Test, Validate, and Bring Your Idea to Market

Sramana Mitra

To Dominique, to clarity.

Whoever knows he is deep, strives for clarity; whoever would like to appear deep to the crowd, strives for obscurity. For the crowd considers anything deep if only it cannot see to the bottom: the crowd is so timid and afraid of going into the water.

Friedrich Nietzsche

Contents

i. Prologue

ii. Going Vertical

a. Web 3.0 Under Construction
   Siva Kumar, TheFind
   Venky Harinarayan, Kosmix
   Mattias Miksche, Stardoll
b. Bootstrapped Web 3.0
   Samir Arora, Glam Media

iii. Cloud Computing

a. Deconstructing the Cloud
   Ken Rudin, LucidEra
   Mike Cordano, Fabrik
   Kent Plunkett, Salary.com
b. India, Inc., Beware
   Umberto Milletti, InsideView
   Steve Adams, Sabrix
c. SaaS-ing Back at the Economy
   Jim Heeger, PayCycle
   Brian Jacobs, Emergence Capital
d. SaaS on a Shoestring

iv. Collaboration

a. Kill the Business Trip
   Sharat Sharan, ON24
   D. D. Ganguly, DimDim

v. Content Publishing

a. Lost Talent Found Online
   Kevin Weiss, iUniverse
   Jeff Housenbold, Shutterfly
b. Gaming the Recession
   John Welch, PlayFirst

vi. Epilogue

vii. Appendix: Clarify Your Story

Prologue

Whatever you do, do not spray and pray.

While I devoted Volume Two to bootstrapping and capital efficient entrepreneurship, this volume is specifically focused on the topic of positioning, a discipline entrepreneurs need to master if they have any aspirations of raising money. Even in building a company with limited resources, a crisp positioning is essential to avoid the spray and pray that sucks up resources, while delivering little more than the kiss of death.

Professional investors   especially venture capitalists   demand three things to validate an investment: market, team, and technology. The priority of the three varies. Some prefer a strong team over a well-defined market opportunity. Others put market first. I belong to the latter camp. Too many times have I seen great entrepreneurs beating their heads against markets that simply do not exist; too many times have I seen solutions from great technologists searching for problems to solve.

The greatest tool I have found in defining a cost-efficient go-to-market (GTM) strategy is segmentation. Tightly segment your market, finding niches where your product or service has immediate applicability and minimum competition, and your chance of success goes up exponentially.

Furthermore, positioning needs to be looked at as a holistic effort, spanning not only value proposition, messaging, and competitive strategy, but also pricing and channel implications. If you have a $5,000 product, direct sales are off the table. Imagine having to visit every customer five times to close a $5,000 deal. Not cost-effective. Doesn t make business sense.

In this volume everything is about accuracy, about knowing your customers rather than guessing at who they might be. You will hear Mattias Miksche narrow Stardoll s focus to girls age 8 18. Siva Kumar focuses TheFind on Internet-savvy women in the 25 45 age group with a household income over $80,000. Later, Jim Heeger explains how PayCycle acquires its small business customers. With similarly crisp segmentation, targeting only those businesses with fewer than 20 employees, PayCycle needed a way to reach clients without high-touch direct selling, or even telesales. Jim offers the how.

As you follow the roadmap these case studies offer, notice the commonality of sharp positioning and undeniable success. By analyzing their markets and ecosystems with laser-like accuracy, clearly articulating the exact problem they solve and how their solution differs from the competition, they have gained unfettered access to hungry customers and even hungrier VCs. All by making clear that their market opportunity is no gray area; it is precise, and not so patiently waiting.

As for the format of this volume, as before, I have provided case studies and in-depth strategy discussions with experienced entrepreneurs in four broad segments. My choice of segments is based on three key criteria: (a) current and substantial entrepreneurial activity (b) remaining entrepreneurial opportunity, and (c) viability of bootstrapped entrepreneurship. My goal in choosing these segments is to give you somewhat concrete pointers to where, if you dig, you may find gold.

Going Vertical

Since I predicted the evolution towards Web 3.0 will be all about verticalization, we ve seen numerous companies crop up in the vertical domain: search engines, ad networks, social media, the list goes on. But the integrated user experience I envisioned Web 3.0 = 4C + P + VS (content, commerce, community, and context, plus personalization, plus vertical search) remains elusive.

Nonetheless, let s take a look at some companies that have made solid progress around the verticalization thesis, building real businesses to validate the vertical movement of the Web.

TheFind, a vertical product-search-engine company in Mountain View, California, focuses on the fashion and lifestyle segment. By the 2008 holiday shopping season, it saw its traffic leap from one million unique users a month to more than eight million.

Our search demographics track our design target nicely a third of the searches are in apparel, and if you take apparel, plus home, plus jewelry, plus beauty, it covers over two-thirds of our searches, says TheFind CEO Siva Kumar.

The site attracts largely female shoppers between ages 25 and 45. An average session lasts six and a half to seven minutes and involves three to four searches, accumulating at least five page views. My favorite element of TheFind s user experience is the ability to find other products like this. Based on a rather sophisticated image search and matching technology, you can scout for related products in your taste range, i.e., that navy blue Giorgio Armani jacket that was nice, but not perfect.

And there is little doubt that you ll find it. TheFind boasts comprehensiveness 250 million products from over 500,000 e-commerce Web sites and 300,000 brick-and-mortar locations as well as a pending iPhone application that will help users search and shop anytime, anywhere. Their validated business model via search advertising fees also generates revenues from display ads served by female-focused vertical ad network Glam Media.

TheFind is not the only startup tapping the verticalization thesis in Mountain View. Kosmix aims to create a home page for every topic. The company uses a technology called *taxonomies* for building customized navigation lenses into verticals. Featured Kosmix sites are RightHealth, RightAutos, and RightTrips. Total traffic across these health, auto, and travel verticals grew from 3.2 million visits in July 2007 to 11.3 million just a year later.

One of their vertical sites, RightHealth, is the second-most-visited health site on the Web, according to Hitwise. In 2008, the number of visitors to RightHealth increased 156%, from 2.4 million to 6.2 million, according to comScore.

Both TheFind and Kosmix have deep technology and a lot of computer science PhDs, just like that other Mountain View company, Google. So do numerous other emergent vertical search companies, including Kayak, Mobissimo, SimplyHired, and Indeed. But are they really giving Google a run for its money? I m afraid not (yet). If anything, Google s slice of the global search pie has only gone up from 64% in August 2007 to 71% in August 2008, according to Hitwise. The biggest contributor to this seven-point jump in market share: clueless Yahoo! has dropped from 23% to 18%, handing the lion s share directly to Google.

In the absence of a major brand getting behind the verticalization movement, a few hundred fledgling startups have had to hunker down and focus on building their own brands a Sisyphean battle to say the least in this noisy World Wide Web.

I do believe, however, that through theirs or the vision of yet unknown innovators, we re going to advance toward a more personalized and satisfying user experience within the next decade. After all, we went from Web 1.0 in 1995 to Web 2.0 in 2005. Just four years into Web 2.0, it is only natural to pause and fine-tune before the real breakthroughs usher in Web 3.0.

Siva Kumar, TheFind

While the vertical search segment has boomed to hundreds, if not thousands, of funded companies, TheFind.com is thriving like few others.

This interview with TheFind s CEO, Siva Kumar, was conducted at the front end of his Series B financing in April 2007. By mid 2007, Siva had successfully raised a total of $26.5 million in venture capital, including $15 million in Series B.

Let s see how Siva explains TheFind. It stands as testimony to his ability to squeeze money from increasingly conservative investors.

SM: Let s start with your personal background.You are a serial entrepreneur, yes? SK: Yes. I m first and foremost an entrepreneur. I ve co-founded several other venture-funded startups in addition to TheFind. Onebox, where I was the chairman, was acquired by Openwave. I also founded BridgeSpan, acquired by Hall Settlement Systems. Impresse, where I was CEO, was acquired by PrintCafe. Vialto was acquired by Cisco. I also founded and ran Scalent Systems. And I founded Telera, which was acquired by Alcatel.

I currently sit on the boards of both TheFind.com and SPOCK. I m also an advisor to several other startups Mobio, Buz, and SnapTell.

Before all of this there was an MBA from the University of Chicago, an MS from Penn State, and a BS from the Indian Institute of Technology in Madras.

SM: You ve kept yourself busy, Siva. With TheFind, can you describe your business value proposition? SK: TheFind is a discovery shopping search engine optimized for lifestyle products such as clothing and accessories, home and garden, sports and outdoor, kids and family, and health and beauty.

Consumers today primarily use Web search engines such as Google and Yahoo! for their shopping searches. While this has proven very lucrative for the search engines, the consumer experience is inefficient and sterile. The search results for shopping searches on these engines are intermixed text links from content sites and spam, or affiliate sites along with retail Web sites. The paid CPC text links on the side are more relevant but not comprehensive only the companies who pay show up. The text links themselves don t provide the needed answers, so the consumer is forced to click through these text link search results and CPC advertisements onto the actual retail sites to then find the desired product. Beyond that, multiple open browser windows are then needed to view the items from various sites before deciding on a purchase.

SM: Doesn t sound elegant at all.SK: No. TheFind obviates the tedium and inefficiency of using Web search for shopping by delivering an experience optimized solely for shopping. TheFind comprehensively indexes all products available for sale from all online retail sites and then, using derived knowledge of the shopping domain, serves up matching products ranked in order of best-selling brands, styles, and stores. The results display is very visual with large pictures like a customized shopping catalog constructed for each specific consumer search query. Additional search tools provide a way for consumers to search for items similar to the one that interests them, and find all the stores that carry a particular product in order to decide the best place to buy.

Think of TheFind.com as Google meets Bloomingdales we have both the comprehensiveness and robust search technology wrapped in a simple UI like Google, and the visual appeal, brands, and styles of Bloomingdales.

SM: Good analogy. Who is your target customer? SK: Our user demographics lean towards women shoppers 70% women to 30% men typically between the ages of 25 and 45. Household income tends to be $80,000-plus, and a majority of the audience is urban. Access to high-speed Internet at home and/or work is part of the demographic profile. Most of our users are comfortable shopping online while all of them are comfortable using the Internet for online research.

> ***We would define our ideal consumer as a savvy online shopper, who makes purchasing decisions not only for her, but the whole family. She s likely short on time, given family and work. She appreciates humor but doesn t want to be talked down to. She wants to feel empowered, efficient, and smart. She wants clear, concise, relevant information, but packaged in a hip, fun, modern fashion.***

SM: I like the psychographic targeting. I have come to the conclusion that demographic segmentation is not adequate. Psychographic segmentation makes all the difference in whether your target audience will adopt the solution or not. And how do you differentiate from your competition? SK: Our main competition is the current pattern of using mainstream Web search engines for shopping search. Hence our goal is to introduce consumers to the far better experience that comes from using TheFind.

While there are quite a few comparison-shopping sites like Shopping.com and Shopzilla, these sites are mainly oriented towards more commoditized products like computers, electronics, and media. The audience for these sites tends to be more male oriented and price conscious. These sites don t have any user loyalty and get much of their traffic by buying CPC links for shopping keywords on Yahoo! and Google.

The experience they deliver for lifestyle goods is very poor a small number of products, poorer result quality, and a very text-oriented display, as well as the biased nature of their paid placement results. The price comparison model is also poor because these engines lack true search technology to understand lifestyle-shopping searches.

SM: Sounds like a major differentiation factor is text versus image. Lifestyle shopping has a much bigger visual component to it. SK: True. In the emerging discovery shopping space, there are two other companies who ve introduced their sites to the market in the past few months. Like.com is a visual shopping search site that singularly addresses parts of the apparel, accessories, and home markets. Like.com s technology is visual search, which specifically compares product images to one another in order to gauge similarity. This feature is limited to the few categories where appearance similarity is a satisfactory criterion for making a purchase decision. Like.com evolved its business from an unsuccessful attempt to parlay visual search in an online photo site called Riya. As such, the company hasn t built any backend technology specific to shopping. Consequently, it lacks a deep product index and is limited, even in the categories of products it addresses, to a smaller set of stores and items.

ShopStyle.com is even more narrowly focused and calls itself a fashion search engine. It only covers the apparel and accessories market, with a UI based on a grid view. The number of stores

and products this site covers is even smaller than Like.com, and the site also lacks any backend to ensure comprehensiveness.

SM: So, synthesize for me the competitive positioning of TheFind with respect to Like.com and ShopStyle.com. SK: In our opinion, there are three main criteria a new discovery shopping search site must have to achieve broad consumer usage. TheFind.com addresses all three: comprehensiveness, ranked relevance, and visually engaging design.

> ***We differentiate by offering the best user experience for shopping search, combining comprehensiveness with the ranked relevancy of top-selling brands, styles, and stores in a visually stimulating browsing experience.***

SM: How big is the market for what you have to offer? SK: Lifestyle goods online sales have already surpassed that of electronics and computers combined. In fact, by 2010 Forrester forecasts online revenues for lifestyle goods to be $99 billion versus only $33 billion for electronics and computers.

SM: Wow. I worked on an e-commerce startup in the lifestyle space in 1999, but the market had not matured yet. Those numbers make clear it now has. So what portion of this market can TheFind address? SK: The TAM for a search engine like TheFind can be estimated as a percentage of the online market about 5% of revenues that retailers would spend on Internet lead generation and online marketing.

SM: Okay, so roughly $5 billion in 2010. That s certainly sizeable. How did the company get started? SK: The company was started in 2004 while exploring ideas to build a startup around the fast growing eBay ecosystem. In 2003 and 2004, eBay was doing extraordinarily well. In investigating what did and didn t work well with eBay, search came out to be far and away the biggest consumer problem preventing people from using eBay; in fact, it still is.

We then looked for a technology approach for a compelling search solution to work with eBay, where myriads of sellers describe products in myriads of ways, while consumers search using their own search terms. With the help of some graduating Stanford researchers, we arrived at the answer. Our answer, however, was more broadly applicable than with just eBay. So we focused our efforts on addressing the growing segments of online commerce, lifestyle goods, and the TheFind was born.

> ***We followed a typical startup process where looking carefully at consumer problems, in the context of a large and fast-growing market, can lead to interesting business opportunities.***

SM: Who financed the company in the beginning? SK: Because our idea involved a new algorithmic approach, we had to show that it would work to get venture money. This made a prototype critical. For building a prototype that effectively demonstrated our technology, we raised some seed capital from Cambrian Ventures a seed fund started by the two guys who co-founded Junglee, the very first shopping search site.

SM: Yes. Venky Harinarayan. I know him. Smart guy. Good early-stage investor. Really, more an entrepreneur than an investor. Can you take me through the rest of the financing you ve raised? SK: Sure. Our Series A1 took place in February 2005, and we raised $7 million from Redpoint, Lightspeed, and Cambrian, including the $1 million seed capital.

Our Series A2 was in November 2006, and we raised $4.5 million from the same set of investors.

Now we re out raising our Series B.

SM: What stage are you at now business-wise? SK: Our site has been open to consumers for the last five months and is seeing very good user adoption. We ve begun to generate revenues from CPC and will generate revenue from banner advertisements in a few weeks. We ve also made significant progress on attracting key blog and content Web sites as distribution partners.

With these market-proof points under our belt, we re in the midst of raising a new outside round of financing that will take us to cash positive operations within the next 12 months, following which all options are open. Our company s assets include the unique and patent-pending technology we ve developed and the broad market appeal we re already seeing.

SM: What kind of traction do you have? SK: We ve experienced very rapid growth since our launch in October 2006. In five months, we ve grown to a run rate of more than one million visits, generating over five million page views a month. Since December 2006, month-over-month growth rates have been accelerating as repeat users and others seek out TheFind. Consumer activity on our site is very intense, with average sessions lasting six and a half to seven minutes, involving three to four searches and five-plus page views. This shows us that many of our design assumptions are proving correct as we tap into the unmet need of consumers for the shopping search of lifestyle products.

SM: So you ve got enough validation for your usage model and customer acquisition assumptions, and you re ready to scale. What is the business model of your company? Ad revenue only? Or are you also going to private label on behalf of other Internet companies? SK: We believe in offering the best unbiased shopping search results based on true market relevance, and building advertising opportunities around those results. At present the most appealing model is a combination of banner advertisements (CPM) and CPC-based product listings clearly marked as sponsored results.

> ***We re partnering with lifestyle goods sites, including blogs and publishers. These partnerships help us brand ourselves to consumers by associating ourselves with known and trusted entities.***

They definitely help drive search volume and page views on our site. The partnerships are co-branded with a Powered by TheFind icon and our own user experience framed by the partner s identity. The business model is typically a revenue share with the partner.

SM: So that s how you re acquiring customers.What is the revenue and profitability status of the company? SK: We re generating revenue at present and expect to hit profitability early in 2008.

SM: A crisp, clear pitch! Good luck with your financing, Siva.

Venky Harinarayan, Kosmix

Venky Harinarayan is a computer scientist, a successful serial entrepreneur, and a venture capitalist on the side. In this discussion, Venky positions his audacious challenge to Google in the domain of search.

The most interesting piece of the Kosmix story is its competitive differentiation from the rest of the search ecosystem and the choice of market penetration strategy. Instead of going after Google directly, Kosmix ensures that Google s organic search results naturally drive traffic to Kosmix s vertical portal pages.

On total available market (TAM), Venky uses another interesting tactic: citing a highly visible comparable. Thereby ensuring VCs that not only can a large company be built based on his business idea, but that such a company has in fact already been built on lesser ideas.

SM: Let s begin with your personal background lay the foundation for me, please.

VH: My journey starts in Bombay, where I was born. Then I spent most of my childhood and youth in Madras. I was born into a family of doctors and businesspeople. One of my grandfathers was a medic in World War II, during which he was captured by the Japanese and escaped after spending two weeks in the jungles of Burma. My other grandfather was the managing director of Automobile Products of India, a leading auto manufacturer in the country.

My father was an entrepreneur, which is no trivial task in India. Unlike the United States, entrepreneurs in India at the time had to put up all the money for their company with no outside financing at all. Also, government regulations and bureaucracy made running an enterprise very tough. My mother was the central point of our lives and a very strong influence on me and my sister. (As an aside, she was a childhood playmate of Salman Rushdie and is relieved she s not mentioned in *Midnight s Children*)

My family valued education most. Then, it was the Indian national pastime of cricket. I captained my high school cricket team and played tennis in college. The rigorous education system of India combined with sports taught me a phenomenal amount about individuals. As Plato said, You can discover more about a person in an hour of play than in a year of conversation. My sister ended up in medicine and I in business, so you can say we took from either side of our family.

I attended IIT Madras and then moved to the United States in 1988, where I did my master s degree in computer science at UCLA before receiving a doctoral degree from Stanford University in computer science as well. I was fortunate to have advisors who were doing pioneering work in the Internet field Len Kleinrock at UCLA and Jeffrey Ullman at Stanford.

At Stanford, I met my co-founder in Junglee, Cambrian Ventures, and Kosmix, Anand Rajaraman. We started Junglee in 1996 with two of our IIT colleagues and then sold it to Amazon in 1998. After staying at Amazon in Seattle until 2000, Anand and I decided to head back to the Bay Area and start a venture firm. Cambrian Ventures is an early-stage venture capital firm, which has invested in companies including Efficient Frontier, Transformic [acquired by Google], Kaltix [acquired by Google], Mobissimo [profiled in Volume Two], Aster Data, YouSendIt.com, TheFind, and Neoteris [acquired by Juniper Networks].

In 2004, Anand and I decided to found Kosmix, a company that is leading the way in creating home pages for any topic on the Web.

SM: Where did you get the idea for Kosmix? VH:

> ***We started with the thesis that the Web is like the library of Alexandria   the repository of all human knowledge. Today the only window people have into this repository is search. Our vision was to have programs that access this Web intelligence and mine it to create new applications.***

Since search returns an unstructured set of 10 results, programs cannot be built on top of it. Fundamental to building such a Web intelligence platform is the need to categorize the Web structure the Web into categories. These categories become the handles on which programs operate, which humans can use in their day-to-day interactions.

SM: What was the market landscape like in terms of competitive positioning when you founded the company? VH: We build home pages for topics as varied as rooster comb injections and Acura NSX. We do so algorithmically, by using Web intelligence to lay out and program the page.

> ***While no one is doing exactly what we re doing today, our business model is most similar to that of a content site. From an operational point of view, we find ourselves focusing most on organizations like Wikipedia, Mahalo, WebMD (a healthcare portal), Edmunds (a car site), etc.***

SM: Describe the value proposition, including differentiation from the rest of the market. VH: There is an explosion of content, especially user-created content, today. Yet much of it sits in silos on the Web. For instance, a topic like diabetes has information in mainstream media sites, blogs, social networks, videos, UGC content sites, message boards, news feeds, and the list goes on. But there is no single place on the Web where you can go to see what s happening for this topic alone. We want to be that place   the unofficial home page for every topic on the Web. Think of us as a starting point from which users can explore the Web.

Other players do this manually, so scalability in terms of topics covered is miniscule. Mahalo, for example, returns tens of thousands of topics. We do tens of millions.

SM: Sounds like what About.com had set out to do manually! How big is the market? VH: We believe the overall TAM is very large   Wikipedia is a good proxy. They are sixth on the Web in traffic. Our business model is ad supported and very robust as we have highly targeted, high-value ad inventory.

SM: What are your top target segments? VH: Our flagship vertical is health. Today, we have 2.5 million unique visitors to our flagship property, RightHealth.com, with close to 10 million search queries a month. We re one of the top-tier health sites, according to Hitwise. We ve also just launched betas for autos and travel with RightAutos and RightTrips and are getting good traction.

SM: So you re developing taxonomies by verticals and then building out each node of the taxonomy. Interesting approach. VH: Yes, but we re also planning to launch a horizontal version by the end of this year.

SM: Why bother? My thesis on the Web, as you know, is that it will get verticalized anyway. And with the taxonomy approach, horizontal is a much harder problem to solve. VH: Yes, I ve seen your thesis on the verticalization of the Web. We are experimenting with an automated technology to generate the taxonomy and *then* build the content for each node of the automatically generated taxonomy.

SM: Way too hard, Venky! How did you penetrate the market and get early traction? VH: Our starting strategy, which has proven successful, was to partner and become a part of the huge search ecosystem.

> ***People search based on keywords, and our sites organically receive traffic flow because of our natural concentration of relevant content.***

SM: Cost-effective customer acquisition! What stage are you at now? Revenue? Profitability? Traffic? Customers? Advertisers? Any other metrics you track? VH: We have 2.5 million unique visitors to RightHealth and close to 10 million searches per month. We don t give out any other metrics right now.

SM: How did you finance the different phases of the company? VH: Our company is funded by VCs, Accel and Lightspeed, and private individuals such as Jeff Bezos of Amazon.com and Bill Miller of Legg Mason. For now we have enough financing.

SM: Great! Good luck with building Kosmix. It s good to see an approach that is different from Google s pure horizontal keyword search. It is also interesting to see that you have so far succeeded by creating separate vertical brands both to showcase your technology, and also monetize effectively. And your organic customer acquisition strategy is simply brilliant. All entrepreneurs should have a compelling organic customer acquisition strategy!

Mattias Miksche, Stardoll

Stardoll is a bustling online community where girls age 8 to 18 dress and design virtual dolls. Seem small market? Think again.

The greatest lesson from the Stardoll story is that niche markets, with their highly specific behavioral patterns, are the cornerstones of sticky, viral, highly monetizable online communities.

Whether it is Argentine Tango dancers or collectors of Pre-Columbian art, the World Wide Web is full of opportunities like the one Mattias explains.

SM: Please describe your personal background family, upbringing, and early career leading up to this venture. MM: I have a multicultural background: Austrian dad, German mom. They came to Sweden during World War II. I was born and raised in Sweden grew up speaking German at home, Swedish on the playground. I also spent a year as a high school exchange student in Halstead, Kansas (population 1,017), which was a huge culture shock but a great life experience. I am still very close with my American family.

I did my master s at the Stockholm School of Economics, which included a semester at the Anderson School of Management at UCLA in 1994. That s when I took a new media class that really changed my life. Instead of going into investment banking, I followed my heart and joined maverick Scandinavian media company Modern Times Group in 95.

I started in broadcasting but quickly fell in love with the Internet. We launched one of Sweden s first Web sites,ZTV.se, and did some really fun stuff like launching a fake reality show online.

Three years later, I became one of the founders of E*TRADE Financial in Europe. First as a stand-alone startup where we licensed the E*TRADE brand and technology, and then in 1999 we were acquired and became a wholly owned subsidiary. I started out as head of product and bizdev, later becoming managing director for Sweden and then Germany.

I left E*TRADE in 2002 to start Boxman.com, a DVDsubscription rental service à la Netflix, which I merged with UK-based Lovefilm in 2005 to form Europe s leading DVD rental and download company. I joined existing Web site PaperdollHeaven.com in late 2005 and revamped it into Stardoll in 2006.

SM: How did PaperdollHeaven come about? MM:

The initial magic of PaperdollHeaven was all because of Liisa, our original founder, and her vision of a fun, creative place for a forgotten Web demographic: young girls.

The new team then added the idea of personalized avatars, or MeDolls, and the idea of building a virtual world around them, focusing on selling virtual items as the core source of revenue. Since I had no experience in the segment, nor was I anywhere close to the core audience myself, I hired fantastic women to build and run the product.

SM: How *did* you get attracted to the venture? I presume you ve never played with dolls! MM: When I first saw the initial site, I didn t really get it like most men. But I showed it

to my wife, who was 35, and to my daughter, who was five and they both absolutely loved it. So I figured there could be quite an untapped market there.

SM: What was the market landscape like? MM: There was really no one making anything unique for teen and tween girls online. Nothing that bridged the gap between Barbie and Disney and social networks like MySpace. We really only saw Neopets and Habbo Hotel doing anything unique online. And they didn t offer the same experience we were after. I saw it this way: Neopets was all about playing with pets; we re all about role-playing and fashion.

SM: How do you describe the experience? MM: We offer a fun, safe, and creative environment for girls interested in our three Fs: Fame, Fashion, and Friends. It s a totally international site, drawing traffic from over 200 countries per week. We run the site and support it in 15 languages witnessing how our girls interact and communicate across language, age, country, and religion is completely amazing. I m very proud of the positive international vibe we have.

SM: Charming! How big is the market the TAM? And what is your business model? MM: The market for girls online between 8 and 18 is huge: tens and tens of millions. Our business model is a combination of selling virtual goods (clothes, furniture, accessories, etc.) and integrated advertising. Most of the fun on Stardoll is free, but you can have even more fun if you purchase Stardollar packages, our virtual currency. Our US office has already done some great campaigns with partners like DKNY, Sephora, and Disney.

SM: What are your top target segments? MM: Our audience is extremely targeted 93% girls, and 90% between 10 and 17. The average age is 13.5 years.

SM: How did you penetrate the market and get early traction? MM: Well, we ve been fortunate in not having to advertise for growth. Our users have told their friends, who ve told their friends, and we ve been able to grow from schoolyard to schoolyard.

SM: I wish we had this when I was in school! What stage are you at now in terms of revenue, profitability, traffic, and advertisers? Any other metrics you track? MM: We don t comment on our financials. Today we re over seven million unique visitors a month and hope to be in the double digits soon. We re over two million in the US and over a million in the UK.

SM: How did you finance the different phases of the company? MM: We have VC financing Index Ventures and Sequoia Capital.

SM: What financing stage are you at now? Will you be raising more money? And can you talk about your ideal investor? MM: We re not raising another round, and we re fortunate to already have the ideal investors on board. Their insights and networks are invaluable, especially for a Scandinavian company like ours, far from the epicenter of Silicon Valley.

SM: Describe some of your team-building experiences. MM: We ve been very product-oriented from the start, hiring female illustrators, female designers, and female product and project managers alongside the male-dominated development team. We re never complete and

are now looking to expand further on the sales and bizdev side.

SM: What is your growth strategy? MM: Keep building a product the users love!

SM: Any thoughts about exit? MM: As long as we re meeting the demands of our audience, I think we re building value in the company. Fortunately, I have investors who are way better than myself at determining if, when, where, and how an exit might happen. I focus on building the product and the company.

SM: What are some of your key learnings from this journey? MM:

Stay true to your vision users appreciate something unique. I d rather build something small and unique than build a me-too product. And as usual, do not underestimate the user even if they love pink and are 11 years old.

SM: Cool story, Mattias!

Bootstrapped Web 3.0

Now that you have seen several case studies of entrepreneurs operating in the general vicinity of Web 3.0 and within the framework of a verticalized Web, I want to bring to focus the opportunities for bootstrapped entrepreneurship within the domain.

Simply put, all the strategic underpinnings we have discussed in the context of the verticalized Web apply to bootstrapped ventures as well. All except one: the TAM doesn t need to be as large. But a well-defined competitive positioning and precise segmentation these are universal.

Take for example the competitive positioning of TheFind. At the end of the day, it is a search engine. But Siva Kumar does not position it to compete with Google. He goes granular and defines product search for lifestyle products as his domain. The competitors, consequently, become Like.com and ShopStyle.com. Much smaller, much less formidable than the mighty Google. And he defines his target segment as women between 25 and 45 years of age, which further crystallizes the needs, behaviors, and desires of the users, making it easier to define the product and customer acquisition strategy.

Now, let s say, you want to bootstrap a venture within the same space. One possibility is to go even narrower. Let s take personalized shopping for busy, professional women in the 25 to 45 age group who are also style conscious and belong to a household income group of $100,000 and above. Focus group research shows that this segment spends at least $2,000 a year on clothes, so where TheFind levels off at lifestyle products, you might tighten the focus another notch to clothes only.

The competitive dynamics would then change, as would the product roadmap. And if you apply my Web 3.0 formula, you would then look to combine content, community, commerce, vertical search, and personalization needs within the context of clothes shopping. You might look to include a style guide written by a fashion consultant focusing on professional outfits, even how to efficiently go from work to a cocktail party without having to change: just add Pashmina!

By defining the target audience as professional women, you will also zero in on a psychographic that is different from, say, housewives. The former is busy and decisive. The latter has time to spend on the site. The former may spend less time on the site, but buy more quickly. The latter may hang around, but buy less. Thus, if you design a cost-per-action (CPA) based revenue model, the former may yield better than the latter.

My point is, by going narrower, you can also go deeper. And while on a shoestring budget, without external financing, the precision could be extremely advantageous.

Take for example how Venky carefully positions Kosmix not against Google, but against the content portals: WebMD, in the case of RightHealth; Edmunds, in the case of RightAuto.

If you follow the logic further, you can create the singular destination for schizophrenia. Or Alzheimer s in India. Pancreatic cancer in the UK. Accordingly, then you would layer in content, community, search, and commerce elements. You would, perhaps, offer personalization that pertains to an even narrower category of users: patients, caregivers, physicians, or family members. What are their specific needs? How can you offer value? What are the monetization options?

I would submit that there are millions of such opportunities in every domain awaiting a Web 3.0 expression. Some larger, warranting venture financing towards building billion-dollar

enterprises. But many small, built on a shoestring, organically, gradually, and in the end fruitfully.

As the 2008 financial crisis has taught us, an economy suspended on the shoulders of a few mammoth enterprises too large to fail may not be the most desirable structure going forward. Thus, the importance of stimulating hundreds or thousands of million-dollar or five-million-dollar businesses is paramount in my mind.

A bootstrapped and tightly segmented Web 3.0 would offer fertile new ground to plow.

Samir Arora, Glam Media

While bootstrapped entrepreneurship continues to be my recommended route, some with the adequate track record still prefer the venture capital avenue. Samir Arora has raised over $100 million for Glam Media. Here he discusses the broad trends in the evolution of online advertising and publishing and then illustrates how he has positioned Glam to take advantage of the discontinuities within.

In general, big opportunities arise when an industry goes through major discontinuities. In this case, the trend that cracked the market for a player like Glam was the emergence of highly fragmented user-generated content, and advertisers desire to further hone in on their audience.

Samir Arora does an excellent job painting the big picture without losing sight of Glam s precise market strategy.

SM: Samir, where does your journey begin? SA: I was born in New Delhi. I had traditional schooling but was also very serious about acting. I was onstage as early as six and have been in 30 productions. I also wrote some plays and musicals. But in school I had a very strong focus on math and physics. My family is filled with business entrepreneurs, which is where I get my passion for business.

In my teens I was bit by the hardware bug. When the first hardware kits came available, I became a hardware hacker. At the same time, I was trying to figure out what my career should be. There was no computer science major back then, so I literally flipped a coin between architecture and chip design. The coin landed on EE, so I went into electronics.

SM: Why did you come to the US? SA: I originally came here to explore school options. I had already spent time working for Apple in India, which was managed through Apple Hong Kong and Cupertino. I had done two years of an accelerated master s program in EE at BITS Pilani in India, but I left right in the middle of the program. Everything I had studied was so different from what I learned at Apple, so perhaps that s why I never committed to school my heart was still committed to working for Apple. I did continue my education later. I received my diploma in sales and marketing at the London Business School, and I did my executive management program at INSEAD.

I moved to the US at a time when Mac had launched, but not established. In late 1986, I wrote a white paper at Apple called *Information Navigation: The Future of Computing*. It was a thought piece about how information needed to be linked together to be simple and browsable. Because of that paper, John Sculley asked me to work for him directly and supported my work on navigation and browsing applications.

SM: When were you at Apple, how long did you stay? SA: I was there from the mid 80s to the early 90s, just shy of 10 years. It was an incredible education. There were very few places where, at such a young age, you could command teams developing software on that scale. That job brought together all the elements of design, technology, and business.

SM: Why did you leave Apple? SA: I left to start Rae Technology and create software for mobile devices. We built the beginnings of information navigation applications. One of the first products we built was Rae Assist, a personal information manager that was the first of its kind. It brought together the concept of having a calendar, contacts, and notes all in one place. It was unique because it had a Back and Forward browser button. It was all based on a browser application. We built the first navigation applications without Internet connectivity.

Rae was founded with Apple s support, and we had two people from Apple on the board with me. A dear friend and mentor, Bill Campbell, taught me an invaluable lesson: There are only two types of companies either you re a department within a large company, or you re a startup. There is nothing in between.

SM: Was Rae a successful venture for you? SA: Rae did well. We created navigational applications for Apple, then PCs, and later worked with Wells Fargo and American Express. Interestingly enough, they introduced us to a small company called Mosaic. Once I saw what Mosaic was doing, I knew we had the legs to deliver our technology. I went back to the team, and we made a decision to create a new company called NetObjects, as opposed to continuing to evolve Rae.

NetObjects created the first Web site building product, and we helped build and popularize the term Web site with that team. We were one of the first 10 companies on the Internet. We launched NetObjects Fusion as a graphical design product, and publishers loved it. They felt great building things for the Internet without coding. We created the concept of a site versus just one page at a time. We also developed the concept of a Web site building editor. The US Patent and Trademark Office recognized this, and the first Web site building editor and the first page layout editor for HTML patents were issued in 1998; these are now owned by Adobe. In total, 12 patents were issued between 1996 and 1999 for inventions at Rae Technology and NetObjects.

SM: And this was all funded by Apple? SA: No. In addition to Series A, which was done through Rae and me, NetObjects received venture funding. IBM then acquired the company for $100 million. We took the company public, and it did well. As the market started to slow down, IBM moved to privatize it. We sold the consumer portion, and the enterprise side was licensed out.

SM: What did you do after NetObjects? SA: I took some of the money I d made and started investing as a limited partner in venture funds. I also helped create Information Capital in 1997. In 2000, I took some time to think about the cycles I had been through in technology and identified powerful 7 12 year economic cycles. I ve gone through these cycles three times. The best times to invest are during the downturns.

SM: This is typically when strong companies emerge. SA: Google is a perfect example. It focused on building technology and a publisher base when nobody else was investing in those areas. AdSense is new, but Google has done a good job carving out that space because of its foundation.

> ***If you look at the Web as a series of layers, you need the lower layers before you can build value on the top. During stage one, market developers need tools. The problem for tools companies is that as soon as the market shifts to stage two, the better***

opportunities are in applications. When the market shifts to stage three, it s very much at consumer-level services.

My view on the Internet as it is today is very simple. At one point, we did not have connectivity. Once we had connectivity and tools, Web sites became important. Once Web sites had proliferated, the platform for content-based advertising businesses and e-commerce emerged. The cycle changed again in 2001 because of blogs.

Once a technology platform is simple enough for large numbers of people to use, it moves very quickly from stage one to stage two. Now the long tail can do blogs; individuals can do blogs; AOL and Facebook have blogs embedded. Video is on the same curve today, though it s still expensive and hard for users to produce quality videos. Quality is the key. YouTube has removed a lot of the technology barriers to uploading and streaming video, but the question is how will quality catch up.

SM: It s the same with text content. A small percentage is high quality while the rest is crap. SA: What has been the result of enabling so many publishers? That s the real question.

SM: What is the story behind Glam? Where did the idea come from? SA: Glam was interesting from the first concept. It started as a jewel of an idea in 2001, and it developed in 2002 at the bottom of the downturn. A lot of people on the Web were building Web sites, blogs, or e-commerce stores under the concept Build it and they will come, but it wasn t working. Our founding team identified an opportunity to connect Web sites to more users and better advertisers.

SM: It began as a horizontal play? SA: Exactly. Glam started as Project X a concept and then became more formally Project Y as a company with a big idea: to bring brand advertisers online. We then focused on understanding and analyzing the problem. One of the first people I called was Jim Breyer at Accel, and I remember a 10-minute phone conversation with him I was driving on 280 and pulled off at Woodside Road. He got it in two minutes, said it sounded like a great idea, and encouraged me to go ahead with my investment.

We found what I would consider the single biggest change happening in the behavior of users today, which is something most people do not talk about. People think of the long tail as either individuals or professionals being able to self-publish quicker and faster, thus enabling more content on the Web. What most do not recognize is that as a result of self-publishing, users are actually going to more sites. Everyone talks about the cause, but they miss the entire effect driving this change.

Most people now have clusters of 10 to 20 sites for their passions. If you like to travel, you go to travel sites; if you love sailing, you go to sailing sites; if you re a foodie, you look for food sites.

It s fascinating to me that nobody is talking about this being the first time in media history where distribution is no longer controlled by a few companies.

That is a big deal. In print, magazines, books, radio, TV, and movies a few companies control distribution, but on the Internet, talented and creative authors, publishers, designers, and video producers can create professional content and distribute it directly.

SM: You identified this trend when you started Glam? SA: At Glam there are three critical aspects we identified very early on. First, Glam identified massive fragmentation in the content space. We also found that for almost every content area, there was no singularly large destination. In the early stages of the Web, there were large destinations contrasting with small ones. We could not find one good destination in women s sites that was reaching two million people. Fragmentation was wide and deep.

The second aspect we identified was that due to the change in distribution and the breakup of distributor power, publishers were becoming more important. Glam decided early on to launch a destination site that had a consumer brand, Glam.com. We also launched a publisher network. This has made our company unique as we are vertically focused, audience focused, and have had both a consumer brand and a publisher network from the start.

The third aspect we recognized was the need to be uniquely focused on brand advertisers. I was very fortunate to have hired Carl Portale, formerly the publisher of *Elle* and *Harper s Bazaar*. Together, we visited the top brands directly. We asked them why they weren t on the Internet. What I heard were concerns about the quality of editorial content which could be associated with the brand. Proximity to other brands was also important. Prada would ask if Gucci was there, Gucci if Prada was there. They also considered the distance from advertisers or brands that they did not want their brand to be near. Another concern was prime time or placement magazine covers versus anywhere, anytime. Finally, they were concerned about what audience was engaging with their brands.

We realized something was fundamentally broken in the way display is done on the Internet.

> ***If you go to most Web sites today and refresh the page, what you ll find is a great ad by Neiman Marcus, followed by Hit the Monkey, followed by Get a Mortgage, followed by a Netflix ad or ads on sites that are never viewed or that are not communicating in social networking mode.***

The last major medium created was television and cable. When that medium emerged, the focus was on prime time and brand advertisers. Middle-of-the-night remnant and advertorials came second. On the Internet, this is reversed. There is a significant amount of ad inventory that I call sub one dollar. This inventory is remnant and non prime time. The problem: most media companies are not technology companies. They are not able to differentiate between audience, context, behavioral targeting, prime-time targeting, or placement targeting. Glam is unique because we monitor the placement of every ad on Glam and on our publisher network. Over time, we understand what types of ads engage audiences differently.

We started the company with the understanding that the packaging of content and ads, when done right, is extremely desirable to the point where customers want to TiVo the ads. Print and TV created a language to capture this idea of packaging, and the Internet is at the stage where it is about to be defined.

SM: How did you assemble your management team? SA: Our seven key founders are all serial entrepreneurs and pioneers in Silicon Valley and Internet technology. Fernando Ruarte, our CTO and VP of engineering, built one of the first content management systems on the Web. Raj Narayan is the chief architect and holds the patent on the first page layout editor to generate HTML. Susan Kare created the first graphical user interface for the original Apple Macintosh in 1984 and Microsoft Windows 3.0. Vic Zauderer worked with Clement Mok in one of the early

agencies before forming his own. Ernie Cicogna spent his career at IBM in finance and business management technology before moving to Silicon Valley and working at several startups within the media and entertainment space. Rebecca Bogle brought product and technology skills from Oracle and Accenture. Emmanuel Job brought key Internet technology publishing background.

In addition to the founding team, key earlier contributors were Karen Edwards, who was the former chief marketing officer of Yahoo!; Carl Portale, the former publisher of *Elle* and *Harper s Bazaar*; and Jack Rotolo. They were instrumental in establishing the focus on brands at Glam.

SM: Did you recruit everyone individually, or were they attracted to the company and concept? SA: It was a combination of both. Some of the founders had worked with each other or me before, like Dianna and Fernando. Dianna Mullins holds the record of having worked for me three times in the past. It was a combination of people that I helped bring in and those who were attracted to the team.

Two people I really thank for getting us here are Esther Dyson and Jim Breyer. When the initial idea was conceived, I spoke with Esther and walked her through the concept. She immediately said it sounded like a good idea and told me to stop talking about it and build it. The second person I spoke to was the phone conversation I mentioned earlier with Jim Breyer. He s on the Wal-Mart board, and now Facebook, and has tremendous insight on new media. With his encouragement, I went ahead and personally made the initial investment. Later, when we were doing a Series B, he introduced me to Theresia Ranzetta at Accel, who had independently sought out this space to invest in which is very, very rarein venture capital. The Series B round was led by Accel with DFJ all in a downturn in the Valley. Accel and DFJ were among the few firms that believed in the model and took risks when most firms avoided investing in this space.

SM: How do you define this space ?SA: I defined it as women s brand media. Back then the term Web 2.0 was not being used, and there were very few investments happening. The big idea that Glam was founded on was all about helping brands come online. The first idea was a media company with advertising revenue and additional revenue for enabling product sales on retail Web sites.

SM: You launched Glam.com at the same time as your publisher network, right? SA: We developed the core technology platform for Glam.com 18 months prior to launch, and the Glam Publisher Network 6 months prior to launch. Then we officially launched Glam.com at Fashion Week in New York and Demo in San Diego in the fall of 2005. We launched the Glam Publisher Network about one month later with 12 charter members, who are all still part of the Glam Network today.

SM: How did you come up with the publisher network concept, specifically? SA: Historically speaking, Glam was the first to create a vertically focused publisher network. I give all of the credit to Lisa Stone. She worked for Glam as a consultant before she founded BlogHer. She came up with the concept and understood there was real opportunity in not having just a destination site but a network of publishers. She went to several people in the Valley with her idea, and no one listened to her. I loved the idea immediately. It was realized with the help of Catherine Levene, who actually implemented the publisher network.

SM: What characteristics did you look for in your publisher network? SA: If there is one

word that embodies the selection criteria for Glam publishers, it is professional. We look for high-quality individual voices that are, and want to be, professional publishers. I believe passionately that there are many people in the world authors, writers, editors, designers, video producers, and curators who are creative and professional, but who have not had venues to build their voices, create great content, and build an audience. Glam is a company that helps unleash the power of these media companies and independent publishers by helping them monetize their creative work.

SM: Why did you decide to zone in on women? SA: The question we asked was, Where will the money come from? In our case, the answer was brands. Then we asked the question, Within brand advertising, how is the money structured and focused? What we found was that brand advertising follows consumer spending. It s a really simple connection. In America, 83% of consumer spending is done by women.

SM: I always like it when a pioneering company takes a new approach with a solid business model already in place. SA: I will tell you something about Glam s history we have not talked about. Most startups come to a decision point in the first two or three years after launch, where the original vision needs to be focused to survive. Typically, once they ve used most or all of their venture capital, they try to find and solidify their business model. They then have to either re-start or focus. This is what I call the startup wiggle to find the business model nugget.

Just two and a half months after launch, with most of the capital still in the bank, I gathered the entire founding and executive team for an off-site. I did not want to wait two or so years to validate our corporate strategy. I wanted to take a closer look at our belief system and our assumptions and review how the market reacted after the launch. The key was listening and being brutally honest with the lessons learned. After two days, we emerged with one slide that listed five items we agreed to focus on. There were 20 or so others we had to completely discard.

I can tell you with 100% certainty that Glam would not be around today if not for that meeting. We came back and went to the board with our results. I had planned to do a CEO search at the time, as I had already made the transition to venture capital prior to Glam. Tim Draper had a gut feeling there was something big here and that we would not find it unless I stepped in as full-time CEO. This was a big responsibility and change for my lifestyle, but I did it.

SM: What was your key finding? SA: We decided to be 100% focused on brand advertising, with no links to e-commerce, events, or subscription.

We chose to be vertical in the style segment, with focus exclusively on women as an audience. We chose Condé Nast s Style.com and iVillage/NBC as our initial competitors. Most importantly, we chose to build a consumer brand, Glam.com, and a network of publishers.

We realized that in addition to being an owned and operated set of sites, we wanted the combination of a content and advertising network. We wanted exclusivity in prime-time display and video placement ad space from our publishers. We would focus only on publishers who were professional, with high-quality content across the style space for women, which is fashion, beauty, and content for shopping.

SM: Tell me more about the dynamics of building a brand clientele at the same time as

a publisher base. SA: It is usually a big challenge to launch a new, unknown company targeting top-brand advertisers. In the fashion world, it is almost impossible to do. A new launch requires credibility. We decided to use the magazine prototype, or the TV pilot model, and offer free advertising for one month for select advertisers, as we believed from the get-go that content and advertising needs to be tightly packaged to be desirable.

SM: If you flip through *Vogue* or a similar magazine, you are basically looking at pictures, most of which are ads. That is the dynamic of fashion. SA: It is a dynamic of almost all brand segments, but it is especially true of fashion. We started in one of the hardest verticals, something I will never do again! The quality requirements are incredibly high.

SM: There are benefits to having to meet such high quality requirements. SA: And that is our strength. Interestingly, Gucci, for example, was one of the first advertisers of the Glam Publisher Network. Neiman Marcus was there at launch. That is about as difficult as it gets. We also refused to put any remnant ads in our network. Brand proximity, editorial quality, and audience focus are critical for brand engagement. This is one of the reasons Glam s publishers and brand advertisers are extremely loyal Neiman has been an advertiser almost every day since the launch.

From a monetization perspective, that decision took incredible fiscal discipline. Our revenue last year could have been double if we had accepted remnant Hit the Monkey advertising like all Internet companies do. However, it would only have grown 100% compared to the amazing curve we have today. The payoff two years later is incredible. The brands, publishers, and audience all trust us. Those three are very hard to do.

SM: Asking for exclusivity from publishers indicates you re willing to accept responsibility. SA: I think the way Glam has gained credibility is by always being transparent about who we are. Taking responsibility, being consistent, and providing superb service are the key values of the Glam Network team and the reason Glam is known for deep loyalty, love, and trust from our publishers.

SM: My position on this dichotomy between content destination and ad network is that in the future all media companies will have to do both. SA: We believe we are redefining what a media company is. We epitomize what you just said. All media companies have to recognize that pre Web 2.0 you could own and control all of your assets. Today, fragmentation is so wide that you can t. If you re a small to medium business, it is better to have a site you completely control. But major media companies must do both destination and ad network.

SM: I believe that over the next 18 months media companies will learn to manage both their own inventory and their network inventory. SA: The ones that survive will. At Glam, we recently opened our business model to other media companies for the first time. We never want to be as wide as an Adify, but our model has its niche and value to many traditional media companies such as Lifetime and CBS.

SM: Will you remain focused on the women s vertical? SA: We started with style fashion, beauty, and shopping. We then launched women-focused living, which is home, food, and entertaining. We also started health and wellness, and then entertainment, which has a mix of

women and men. Our channels are dominated by women, but we will carefully explore mixed channels. In addition, we can target within audiences women ages 18 49, teens to a lesser extent, baby boomers, and a multicultural audience. Next year we will look at the same vertical content network model for the male demographic.

SM: How many salespeople do you have? SA: We launched the company with one salesperson, Jack Rotolo. He was followed by Carl Portale. Then we added Scott Schiller, one of the co-founders of IAB. He and Jack created our initial team, which had 18 people at the beginning of Q4 last year. We then added John Trimble, who ran all brand sales at Fox across MySpace, IGN, and American Idol, then Joe Lagani, formerly the publisher of Condé Nast s *House & Garden* magazine, as well as other key people such as Karin Marke and, more recently, Matt Schulte from iVillage/NBC. Today we have over 70 people in sales. Glam has been able to attract incredible talent and is known for having the top brand advertising sales talent.

SM: What kind of quotas do you give them? SA: There are three levels: beginning/junior salespeople just starting in the industry; direct salespeople; and group managers. Quotas range from the hundreds of thousands to the multiple millions.

Unfortunately, when the bubble burst in 2000, most people did not go into digital ad sales. There is a dearth of good people. My goal is to create one of the world s best brand advertising sales forces with two different components: brand sales by verticals, and a full-service agency ad sales force.

SM: Joe Lagani was from the magazine world how does he adapt to being online?SA: Joe came to me with a business plan, said this is what he wanted to do, and made compelling arguments for why we should be in the living channel. I agreed it was a good idea, but I challenged him that he knew nothing about the Internet. He countered by saying he was a fast learner and would hire the right people. He knew all of the brand advertisers, all of the decision makers. So, I took a chance and hired Joe living has been one our most successful launches to date.

SM: If you look at the retail and fashion businesses, every brand that started in women s clothing has gone into home.SA: With Joe as GM, we re building out channel general managers who come from that business. We re doing this because brand advertising is still only 3% on average, although in some of our spaces it is as high as 6%.

SM: It s a bit of a balancing act between brands, which are agency-driven, and channels, which have demographic focus. SA: I believe we need both brand level and agency focus, and we re organized this way. Here again our strategy is different because 100% of our revenue comes from agencies. Agencies don t feel we re a threat, and they have no reason to we re in business to make the digital agency market managers heroes, helping them make brands successful through online campaigns. In display advertising you have to involve agencies for creative input and brand management across multiple sites.

SM: What has amazed me about the last five years of the Internet is the inability to segment, which is Marketing 101. Why is it so difficult to get segmentation? It is the most fundamental and powerful element of marketing! SA: Exactly! Steve Jobs talks about when he

joined Pixar he saw that people in technology think they re creative, but they don t understand how movies are made; then people in movies think they re creative, but they don t know how software is built. Metaphorically, why do I have to be in Silicon Valley and New York every other week for Glam? Because they represent two fundamentally different points of view, and both are necessary for a solution for brand advertising.

When Carl Portale and I visited the top brands CEOs and CMOs over 18 months before the Glam launch, what struck me was the consistent feedback we received from brands: they always start from their target audience focus first, then content, then brand proximity to other brands, along with prime time/pages in a magazine versus non-branded remnant placement. So segmentation around audience and vertical content is key in brand advertising.

SM: I think that s where not only your industry, but the entire big picture is going.SA: With Glam Evolution what I am finding is that our customers are actually a brand advertiser and an agency. If we look at the advertising market at $600 billion in the US, direct response is roughly 15% 17% of that number. Few CMOs even have it reporting to them directly. If you look at television, for example, most direct response ads are infomercials running late at night. Television advertising was once at 33% and is now down to 29%, but it is still the No. 1 buy. Print magazine is at 17%. If you look at the big picture, 60% 70% of brand advertising is in one of those media types today.

Agencies have teams focused on television, print, and finally Internet/digital. When the Internet spend is 3% or below, the learning begins. Given that Web usage is already at 30% of media, brand managers today should be spending 8% 12% of their total spend on the Internet, and roughly 50% of that on search and 50% on brand. In 10 years Internet will be 20% 25%, with brand as 70% of the spend. The reason is simple: if a user is looking for the nearest dealer for a BMW, it is too late in the funnel to try to switch brands.

The battleground for brand has, in consumers minds and hearts, already moved to the Web. Now the brands need to as well.

When we re selling living and we have a national sales force that is agency-focused, we just make sure that quotas are double counted. There is no my world versus your world mentality. Ultimately, the agencies should be involved as television dollars come to the Internet.

In our case, 99% of advertisers have come back for a repeat buy. They come with us, test, and come back with a bigger buy. We bend over backwards to listen to them. We apply and build technology for them we have built all the targeting technology in-house in Silicon Valley. That is what Glam Evolution is. We built it out of necessity. We found if you re not in the performance business, you need to create ways to target, monitor, and report brand engagement and return on investment. Glam Evolution is a five-point targeting system audience, content, behavior, prime time, and placement. We re finding that this delivers an incredible value for brands, as the ads and the content are packaged vertically, giving the best combination of mass reach with niche targeting.

SM: In closing, what should we expect from Glam? SA: We re a growth-focused and

value-focused company. We are intent on servicing our publishers as our main customer. We just reached 500 publishers last week, which is a whole different size and scale.

SM: What kind of CPM ranges do you have? SA: Depending on vertical and targeting, they re in the $10 $35 range. It varies by channel and media. We can go as high as $50 $120 CPM on an integrated advertorial campaign in which there is a very specific brand engagement with a user. That number will continue to grow as our reach grows and our demo focus grows. We will remain vertically focused.

SM: I think your vertical structure will change quite a bit. But you ll still have your anchor vertical to drive your value proposition off segmented areas. SA: You were one of the first people to recognize the value of vertical networks with a consumer focus and a publisher network. As we re building and pioneering this model, the structure will grow and evolve. As an example, GlamTV, which we launched two weeks ago, is fascinating it brings content from traditional media, video platforms like Brightcove and YouTube, and indie producers together and provides distribution through publishers for rights-managed content in which monetization can be shared, much like iTunes and iPod did for music.

That s an example of the level of strategy and pivots that Glam does solving a problem using the distributed model of the Web fundamentally different and right on the pulse of how the Web works today.

SM: I will never understand why people didn t recognize this sooner it s so simple. SA: Judging from all the people who write about it, I think you understood what was happening before it happened. It is easy to get it today after it is proven, but to see it as a category before it emerged is rare. The next phase of this category is new technology and services for publishers and advertisers/agencies. Glam Insider, our intranet only for publishers, is a fantastic dashboard that shows daily campaigns and traffic. Unlike most ad networks, we are completely transparent to our publishers because we believe they should be involved in optimizing the packaging of the campaigns.

As Glam s reach continues to grow, you ll see new channels in the women s demographic, in addition to new audience focus and new verticals.

SM: Thank you, this has been fascinating.

Cloud Computing

Deconstructing the Cloud

Computing may have long ago transitioned from centralized mainframes to distributed desktop PCs, but it s now headed back to another centralized model: cloud computing. Sound like science fiction? Think smaller: cloud computing allows users to access and manipulate data from applications stored on the Internet rather than distributed on-premises computers. Here s a menu of the different flavors of clouds.

Software-as-a-service (SaaS) is the best-known and oldest type of cloud computing hosting applications online, rather than on enterprise computers. A number of public companies like Salesforce.com, Concur (Volume One), RightNow (Volume Two), Omniture, Taleo, and SuccessFactors (Volume Two) have attained critical mass, legitimizing the category. Among private companies, business intelligence SaaS vendor LucidEra is one of my favorites.

SaaS pioneer Salesforce.com has more recently pioneered platform-as-a-service (PaaS), whereby the San Mateo, California based software maker opened its once-private platform to other application developers. Through these floodgates have come numerous small startups aspiring to build their own SaaS businesses. Salesforce s move has prompted many other larger SaaS companies to also consider opening their platforms to developers. In time, I expect all major SaaS vendors will venture into PaaS. Meanwhile, Salesforce.com s Force.com platform is spawning startups at an impressive clip.

The next iteration of cloud computing is infrastructure-as-a-service (IaaS). In the past, users routinely bought backup devices, external storage drives, and so on, to complement their core-computing infrastructure. Enter remote backup, remote storage, and remote hosting infrastructure goes Internet. While these technologies are not new, they have only recently gained recognition as part of the hyped cloud computing story. A big proponent of the IaaS category is Amazon s Elastic Compute Cloud, which allows companies to contract or expand their computing capacity into the cloud. Another IaaS example is San Mateo, California based Fabrik s digital media storage offering.

Next comes data-as-a-service (DaaS). A good example would be Waltham, Massachusetts based Salary.com, which pioneered the data-on-demand category. Salary.com went public in February 2007, raising $60 million. In late 2008, the company has a revenue run rate of about $35 million a year.

San Francisco based InsideView also takes an interesting spin on DaaS by bringing together data from many different providers, as well as data collected by its own artificial intelligence technology, which it then packages with software to build a comprehensive dashboard for salespeople. In a sense, this puts InsideView at the cusp of SaaS and DaaS, making it a truly innovative company.

Another layer of cloud computing innovation has come from San Ramon, California based Sabrix, which developed automatic tax calculating software for companies. Sabrix began as an enterprise software vendor but has since morphed into a SaaS provider that also does business process outsourcing (BPO). In other words, Sabrix s customers have asked the company to not only provide the SaaS, but also take on their tax management function.

Of the above, SaaS-enabled BPO is the most powerful new trend, whose huge ripple effect will rock the outsourcing industry. Pure labor arbitrage models should expect SaaS to become an increasing threat. In time, Sabrix, for instance, might be able to convert labor-intensive services

to technology-leveraged solutions. India, Inc., beware!

But the skyward migration is not exclusive to business applications. Online virtual worlds and multiplayer gaming have also reaped the benefits. In the era of narrowband Internet and personal workstations, gaming had a distinctly different flavor. But today s multiplayer games like World of Warcraft are shaping an entire generation of youngsters: addicted to the Internet, glued to their monitors, terrorizing helpless parents with the intensity of their gaming commitment.

Amidst this tectonic shift in the universe of entertainment, startups are re-architecting the software and hardware infrastructure supporting the industry. Abundantly funded companies like Trion World Network have ambitious goals to turn gaming on its heels by applying the principles of cloud computing. And thus, the myriad forms of cloud computing offer up opportunity after opportunity to innovators as software becomes an on-demand service and the Internet connects everyone to everything.

Ken Rudin, LucidEra

Software-as-a-service (SaaS) has been one of the most prolific areas for entrepreneurial activity in the first decade of the twenty-first century. More than 500 companies have emerged, each ferreting out their own niche.

This overcrowded market demands a sharply focused go-to-market strategy. Ken Rudin explains how LucidEra manages to rise above the noise in the SaaS cacophony by defining a niche within the business intelligence space, identifying sales operations functions within companies as the specific target user.

This is a rather common issue in my consulting engagements: people do not define the user precisely. As a result, the product and go-to-market are vague, lacking teeth, and thus unable to gain a high-velocity adoption rate.

On the other side of the spectrum, armed with a clear definition of the user whether it is the telesales manager at a telecom company or the merchandising VP at a retail company both the product and go-to-market strategy become eminently clear.

Let s listen to how Ken uses this trick in the story of LucidEra.

SM: Let s start with a bit of your personal background family, upbringing, and early career. KR: I was born and raised in New York as the youngest of three siblings. Whereas everyone today talks about the prevalence of dysfunctional families in our country, I think I must have been blessed by being part of one of the few functional families in America.

When I went to school, I remember thinking that learning should be fun. I had some great teachers who really inspired me. I also had other teachers who were very strict and rigid, and I tended to be a little rebellious in their classes. They never knew what to do with me because I got good grades, but they had difficulty keeping me under control in their class.

Despite frustrating a few teachers along the way, I did graduate high school and went on to Harvard to get a degree in computer science and electrical engineering. After graduation, I and nearly all of my graduating computer science classmates ended up joining Oracle in 1987. I worked on some great products there, including managing the team that delivered the first version of the Oracle Parallel Server.

It was at Oracle that I got my first exposure to what was becoming known as business intelligence and data warehousing. A lot of customers were using the Oracle Parallel Server to store their massive data warehouses, so as I worked with those customers, I got exposed to, and fell in love with, the power of reporting and analysis and the value it brings by giving a business the ability to understand what s working and what isn t.

SM: So your professional career began at Oracle. KR: Yes. I left Oracle to get a business degree at Stanford University. When I graduated in 1994, I started a consulting company called Emergent that focused on designing and building business intelligence solutions for large companies. We were acquired by Keane, a public systems integration company, in 1999.

Soon afterwards, I got a call from Marc Benioff, who had just started Salesforce.com. I joined as the SVP in charge of product management and engineering when the company had fewer than 20 people. It was there that I became a passionate convert to the on-demand way of

delivering applications and solutions.

At around the same time, I got involved with NetSuite when they were also very small. I was one of the first members of their original advisory board, and I really had fun working with that company.

Then, through an interesting series of twists and turns, I ended up at Siebel Systems, first as VP of marketing for their analytics product, and then as VP of the Siebel CRM OnDemand group. Competing with my old employer, Salesforce, was an amazing eye-opener that showed me just how hard it is for a traditional software company to become an on-demand solution provider.

Basically, I learned that the larger and the more successful a company is, the harder it is for it to become a leader in the on-demand market. It was true a few years ago, and it s still true now.

SM: Where did you get the idea for LucidEra? KR: The idea developed in two stages. First, after running my business intelligence consulting company for many years, it became obvious that while BI solutions were common in large enterprises, they were rare in small and midsize companies. So I started focusing my efforts at Emergent on selling BI solutions to the mid-market. My message was that if only large enterprises have BI solutions, then they have an unfair advantage over mid-market companies who are flying blind with no easy way to get visibility into what s going on in their company.

Ultimately, however, that initiative to provide BI solutions to mid-market companies failed. Why? Because even though we could build a solution for these companies at a reasonable cost, they didn t have the specialized skill sets in house to manage these solutions once we left.

As one IT manager told me, I bet it s easier to manage a nuclear reactor than it is to manage our BI solution.

So I refocused Emergent back to Fortune 1000 companies where we had been successful. But the idea of bringing BI to the mid-market was still something I really wanted to do.

Later, when I was at Siebel, as my second attempt to bring BI to the mid-market, I decided to embed the Siebel Analytics product which is now Oracle s analytics product into Siebel CRM OnDemand. Customers loved it. And then something unexpected happened: prospects would call and say they didn t really want our hosted CRM solution, but they did want the hosted analytics portion could they just buy that separately? That idea was shot down internally for fear that it would cannibalize Siebel s very profitable Analytics product line.

But it was the aha! moment for me: delivering analytics as an on-demand service made a lot of sense, and the fact that customers were already asking for it meant that it filled a real market need.

So, at that point, I took my two great business passions analytics and on-demand and combined them to create LucidEra.

SM: Great historical perspective, Ken. What was the market landscape when you founded LucidEra? KR: When we founded the company in 2005, the BI market was pretty stagnant. Not much innovation had happened in the prior 10 years. It was basically a lot of

vendors selling expensive solutions that were difficult and time consuming to deploy, impossible to manage and maintain, and hard to use. Instead of focusing on trying to make their solutions simpler to use, each of the traditional BI vendors just kept adding more and more functionality.

Also, the BI vendors were all focused on selling toolsets to people in IT to enable them to build their own solutions. That didn t make much sense to me.

> ***People don t want toolsets; they want solutions. Imagine if you were trying to buy a house, and someone tried to sell you lumber, a table saw, and a bunch of bricks and told you, There! That s all you need to build any house you want! Unless you re a skilled architect and craftsman, you re going to have a tough time building your own house.***

We decided to take a very different approach, and instead of selling a toolset, we created full, pre-built solutions that are role-based, such as sales roles and finance roles, and which focus on answering the key questions that people in those roles ask.

SM: Very interesting. This is something I see over and over again in my consulting. People don t isolate business applications on the basis of roles. They assume one size fits all. This is so not true. The sales user s needs are drastically different from the finance user s needs. You just underscored one of the fatal fallacies of product marketing. KR: Yes, from the BI standpoint, the sales user s requirements are to do with leads, funnels, sales cycle stages, etc. The finance user is concerned about revenues, forecasts, collections, margins. Very different, indeed.

SM: What about data? Did you receive push-back on people being willing to let you take their data and play with it? KR: Not really. In the early days of Salesforce.com only one-fourth of the customers were okay with this model, three-fourths resisted. By the time I got to LucidEra, the market had been trained, and only one-fourth resisted, three-fourths were asking for on-demand solutions.

SM: Describe the value proposition of LucidEra, including differentiation from the rest of the market. KR: LucidEra combines sales and financial data to give users at small to midsized businesses powerful insight into the effectiveness of their entire sales operations process including quotas, pipeline, revenues, and expenses. It should be considered an employee s right, not a privilege, to have this level of visibility into their business. In the existing BI market, the average employee simply does not have this. No one should have to work in an environment where the right information is not readily available.

Our key differentiator is that we deliver a complete reporting and analysis solution entirely on demand.

SM: Ken, but you just shared something else that is key to your go-to-market strategy: you are going after the sales operations function as your immediate target segment. That helps you really focus on a sliver of the BI market with a very specific solution. KR: True. It does allow us to focus from both a product standpoint and a go-to-market standpoint.

SM: Those two are intertwined. Once you ve chosen a target audience, you have to

make sure you have the right product to cater to that specific audience. How big is your market? KR: Since we re re-inventing the business intelligence market, our market is essentially the business intelligence market plus the mid-market, which traditional BI vendors were not able to address. IDC forecasts BI to be $26.7 billion in 2010.

SM: That s without accounting for the mid-market, you re saying? KR: Right.

SM: Talk to me more about your segmentation strategy. KR: We re finding a lot of success with sales operations managers, VPs of sales, and also the CFOs or directors of finance at small and medium-sized companies. Those with a slightly distributed workforce who don t want the hassle of managing the cost associated with traditional on-premises BI solutions have demonstrated the most interest thus far. Some of our current customers include 3PAR, Ingres, KACE, and Black Duck Software. We also find the manufacturing vertical is very interested in on-demand BI services. Since we only started selling LucidEra in March, I m really happy with the adoption rate.

SM: Sounds like your economic buyer is the VP of sales or the CFO, while the actual users are sales operations managers and perhaps also directors of finance. The technical decision makers are also the sales ops/finance director folks. No? KR: Yes, that s probably an accurate categorization of the sales cycle.

SM: How did you penetrate the market? KR: I think it certainly helps to have a compelling solution that people can try and get up and running in no time. It s the best way to get traction. Once people try LucidEra, the proverbial light bulb goes off, and it s exciting to watch.

> ***The amazing thing about the SaaS model is that the product is simple to use, simple to set up, and simple to buy. Why wouldn t you just try it to see if our solution can add value to your business? It s a no-brainer, in my opinion.***

I think another plus we have at LucidEra is a strong executive team that has the right experience to take us to the next level. For example, my own background has prepared me to take on some of the more established big vendors in the space. I saw firsthand while running the OnDemand CRM business at Siebel just how conflicted the company was trying to sell an in-house enterprise software product and an on-demand product. Traditional enterprise software companies have such a different DNA, so players like Business Objects, Cognos, and SAP could never fully execute in the SaaS market.

SM: Are you part of Salesforce.com s AppExchange? KR: Yes, we get a lot of leads from the AppExchange. We also work with other vendors like NetSuite, Oracle Financials, and Great Plains.

SM: That s great they all give you leads! What stage are you at now in terms of the metrics you track? KR: We launched our service in Q2 of 2007, and the response has been fantastic. We ve already signed up our first set of paying customers, which is a great milestone for us.

Initially, our primary goals are based on reaching a certain number of paying customers.

However, we re moving towards goals based on a key metric for an on-demand company: monthly recurring revenue (MRR). A lot of on-demand companies focus on the bookings number, but that can be very, very misleading in a subscription service business like ours. MRR captures all aspects of the business: new customers, renewals, customer churn, discount amounts, and so on. At the end of the day, the goal is to have MRR increase by a certain percentage each month.

SM: How did you finance the different phases of the company? KR: We decided to finance our company through VCs. We have great investors from great firms. But when we went looking for funding, our most important criteria was looking at the specific investor first, and then at their VC firm second.

> ***To me, the person who will join your board is much more important than the firm they re with.***

We wanted to make sure we had board members who were seasoned, who were insightful, and who we would be able to work well with. We ve been very fortunate to have an extremely helpful board.

SM: Are you continuing to look for future investors and what does your ideal investor look like? KR: Currently, the company is going through its Series B funding round. And so far we ve received funding from Benchmark Capital and Matrix Partners.

Our criteria for who we choose to work with is similar to the previous round: focus on the individual, less on the firm. I want board members with great operating experience building companies, not just investing experience. I check references on VCs. I like to work with VCs whose portfolio companies CEOs rave about. Of course, this luxury only exists if you have more than one term sheet.

SM: What do you look for in your VC reference checks? KR: I look for passion, not just some CEO being nice. I look to hear things like, If you have the opportunity to have this guy on your board and choose not to, you re an idiot. I m also looking for VCs who don t pound their fists when there s a problem. Those who don t start triggering executive team changes immediately.

> ***I want VCs who recognize and acknowledge a problem and then ask, We have some challenges how can I help tackle them?***

SM: Do you look for domain expertise? KR: Not really. We have plenty of domain experience on the team.

SM: So who are your VCs? Sounds like they re stars.KR: Mark Kremer from Benchmark and Bob Lisbonne from Matrix.

SM: Describe some of your team-building experiences. Is your management team complete now? KR: Finding the right executive team members can be a nerve-wracking experience. You re essentially giving a huge amount of responsibility to a person who in many cases you ve only known for a few weeks. A key element of your company s success rests in

their hands.

At LucidEra, the VP of engineering was a co-founder with me, and I d worked with him for many years prior to our starting LucidEra, so there was no risk there. But with marketing and sales, I spent months talking to a large number of candidates. Then, when I felt I d found the right person for each of those roles, I asked each one to come in a few times and work with me on specific topics so I could see what it s like to work with them.

Finally, I did a lot of reference checks on them. These weren t the references they gave me instead, through networking I found people who had worked closely with the candidates, and I spoke with them. You get much more honest feedback that way.

SM: What are some of your key learnings from this journey so far? KR: I have two key learnings. First, simplicity is the key to success. Make sure your products are simple to set up and use. Make sure your marketing message is simple to understand. Make sure your sales processes are simple. Make sure it s simple for your customers to do business with you. And make sure you keep your organizational structure simple.

Second, hire people for their passion. If they re passionate about your company s vision, they ll be able to achieve amazing things. They ll overcome obstacles, identify creative solutions, and delight your customers. And they re more exciting to work with   their passion is infectious.

SM: Very insightful, Ken!

Mike Cordano, Fabrik

Fabrik s story is a great example of seasoned operators, Mike Cordano and Keyur Patel, understanding the infrastructure-as-a-service (IaaS) opportunity in storage as part of the broader cloud computing movement. Mike and Keyur are not building the company organically. Instead, they are using a roll-up strategy.

Such roll-ups offer a great opportunity for the technology market to build sizeable companies, especially with the IPO market firmly shut and M&A slowing down. These private companies can get together and, with astute strategic marketing, position themselves to become powerhouse players in specific sectors.

Roll-ups, however, are not for inexperienced entrepreneurs. As Mike Cordano s story illustrates, Fabrik clarified its positioning first and then systematically recruited a management team to execute its roll-up strategy.

Fabrik was eventually acquired by Hitachi in February 2009.

SM: Mike, take us back to your origins. Where are you from? MC: I was born in Silicon Valley. My dad was an engineer at IBM and an early member of the storage team. The storage group at IBM relocated to Colorado when I was 18 months old, so I grew up in Colorado. Dad spent his whole career in storage and disk space companies. He was an early member of Storage Technology, a spinoff of IBM. He had two or three other startup hard-drive companies, two of which he founded. I saw all of that growing up as a child.

I never imagined I would land in disk drives myself. But through connections and other things in life, I ended up doing an internship at Seagate while I was at the University of Colorado. I never imagined I d become a serial entrepreneur like my dad either, but here I am.

SM: Was that internship in Colorado? MC: No, it was in Scotts Valley. I spent my sophomore summer there. My manager during my internship joined Conner Peripherals, a startup hard-drive company, and five months after I graduated he called me up and told me he had a great opportunity for me. So I joined him just prior to the IPO. That was quite an experience.

SM: How long did you stay? MC: I was there for seven years. It supplanted Compaq Computers as the fastest company to a billion dollars, and our CEO was on the cover of *Fortune Magazine*. It was the boom company of the time. I learned a lot about storage and disks, but also a lot about explosive growth.

That s where I developed my early career. I was on the sales and marketing side and went up through the ranks. I spent a lot of time developing relationships with customers from a sales and business development standpoint. Those early years of my career took me from California to Singapore, and back to Texas. I saw a lot of the world. Living outside of the country was one of the most interesting experiences of my life. I was 27 with a three-month-old baby living in Singapore.

SM: What did you do after Conner? MC: I went to Maxtor in 1995. At the time, it was an eight-year-old hard-drive company that was in very bad shape. I went there for two reasons. First,

I wanted to experience the turnaround. This was clearly a turnaround story. The other interesting component was that the job was in Colorado, so it was a way to return home.

SM: What was it about a turnaround that attracted you? MC: The challenge of the situation. I had already experienced a high-growth company at Conner. I wanted to see the renovation and the rebuilding. Unlike the clean sheet of paper of a high-growth company, where everything is uncharted, there is an initial phase of deconstruction before reconstruction. That was intriguing for me.

SM: I ve always been attracted to turnarounds; I ve worked on a lot of them in my consulting career. MC: When I arrived at Maxtor I came in on the sales side. There was zero OEM business in the company. They had a small distribution channel and were struggling on the OEM relationships. In the drive business, it s all about the big systems companies and having those relationships. I did a lot of that at Conner, so building large corporate relationships was my expertise.

Within the first three or four years, I was able to build the company s customer portfolio. I was one of 10 senior managers who came into the company, including a new CEO and CFO, who were largely responsible for the turnaround. We privatized Maxtor in concert with Hyundai; they bought out the company and turned it private. Then we brought it public again in July of 1998 when it was re-listed on NASDAQ. Privatizing a company, getting it healthy, and taking it back out was a very interesting experience.

SM: What was the process of taking it private? Did you use private equity firms? MC: It was 100% Hyundai. It was a very interesting process because their management style, and the agreement they had with the Maxtor management team, was that they would largely manage at the board level. But as long as the plan was tracking, there was a lot of independence to manage the company.

SM: What were the big levers you moved in the five-year timeframe, when you went private and then public again? MC: At the corporate level, we had to restructure the product side of the business. We narrowed the product portfolio. We focused on strategic products, which would enable OEM success. At the same time, we were able to go back and restructure our operations in manufacturing and supply chain to a much lower cost base.

SM: Was the sweet spot still enterprise products? MC: It was enterprise and desktop products. We really wanted to turn the company around using desktop first because of a gap in the market we d identified. We created a new category, now a very vibrant category high-capacity serial ATA in enterprise. We did some very interesting work with Network Appliance to define that category. We were their development partner, and as they started creating it, everybody joined the market. That was our way to attack the traditional enterprise that Seagate had a strong hold on.

> ***My game plan tends to be to analyze the market and look for a gap. I haven t been successful trying to emulate others as a path to success. I look for a market gap and try to find a way to change the rules to our advantage.***

We had a high-capacity ATA enclosure with multiple platters. We could use that enclosure with a 20% design adjustment to cater to the enterprise. We were the first mover in the space, which made it very attractive. We grew so quickly the market, including Seagate, had to respond to our move.

We also introduced the branded products group of the company. The idea was to take our brand directly to the consumer. Prior to the branded products group being founded in 2000, we were only in OEM channel plays. The move into this branded products segment did a number of things for us. Our OneTouch product line, which is external storage, got us directly in front of consumers and is now a category that everyone in the hard-drive world is competing in.

SM: What role did you hold at Maxtor when all the product innovation was occurring? MC: I was the EVP of sales and marketing. The branded products division reported up through me.

SM: After Maxtor went public again, you stayed on board for several more years, correct? MC: I stayed through early 2005. My decision to leave was about wanting to do more things around growth. We were looking at strategic alternatives for the company. When it became clear that growth was no longer part of the strategic plan, particularly in areas such as the branded products group, which I thought had great opportunities, I made a decision to pursue those strategies outside. That led to my departure in early 2005. Shortly after that, I founded Fabrik.

> ***SM: What were your initial plans for Fabrik? What leverage were you able to take with you into that project? MC: The real strategic underpinning of the company is that we recognized a tremendous opportunity to take commodity storage and network storage and layer different kinds of data services on top of that.***

I specifically wanted to go with an appliance-type model. One of the things we experienced at Maxtor was that enterprise-class concepts like network-attached storage do not translate very well to the consumer. It is a complex IT concept. Very powerful, but unusable to the consumer; 90% of the consumer base is intimidated by it.

Our view has been to take very simple concepts, like backup, and apply an appliance concept to that. That enables a simple marketing message, and everything is self-configuring when bought and installed. We love the way Apple does things with services and devices connected. Our concept around storage and data services is very similar.

Inside an industrial commodity company like Maxtor, one of our biggest problems was attracting great software talent. Even though we had the budget and the company had a profile in the Valley, we found that successful software people wanted to go work for Web companies. So we had a structural impediment to pursuing these great value-added services on top of the commodity. Another thing that happened in Maxtor was that it was an engineering-driven company. The budget flows and investment flows were focused primarily on those elements. But when you re thinking about a consumer product line, there s a very important need to focus on branding. You have to commit to ongoing marketing activity to manage that brand.

When you re in a cyclical commodity market, the first thing the CFO will look at during a downturn is variable expenses. Non-core expenses such as marketing are the first to get cut. As I sat and thought about building a company, this influenced the cultural aspirations of Fabrik.

We wanted differentiation around software applications, and we needed to fundamentally commit to managing the brand over time. It was almost an inverted model compared to Maxtor, and that was out of necessity.

Based on my experience to date, I knew the channel worldwide. However, I knew that we needed to focus here in the US. Our aim was to found the company as a software company with a separate strategic initiative to identify a route to market that would bring the devices to customers in a very direct way. We spent the first 15 months developing a prototype system, which was myFabrik.com. It never became a prime-time product, although we learned an awful lot in the process.

SM: What was myFabrik.com s value proposition? MC: The original value proposition was to create a media-management system that would allow users to have all of their media connected to the Web. We did it in two forms, a Web service and an integrated appliance. Notionally, it was an integrated Web server. It was an appliance that would simply serve content to the Web.

We got some very nice initial feedback from the market. Having a centralized location that could intuitively manage all media and be connected to the Web was determined to be a very positive value proposition. We also heard that anything that required data migration was too painful to do. An appliance or Web service both required data migration.

SM: At that point was your assumption that a network-attached server would be sitting in a user s home? MC: That was one of the two versions that we had. Generally speaking, it was very easy to install. It was not a network-attached storage experience where you had to set up permissions and everything else. Two things really stopped that initiative. First, remote access required port forwarding, which was a very difficult installation experience for most users.

SM: There are a bunch of issues involved with turning your home into a hosting platform. MC: Exactly. Not to mention we still faced the data migration issues, and users were not going to go for that. That was the issue that spoke the loudest. It became the fundamental strategy behind where we moved with our service.

The average user has data in his or her own distributed storage network: multiple PCs, perhaps some Web-based storage, and perhaps some appliance that sits on the LAN. We moved to a strategy that gives the user the benefit of consolidation without actually having to do it. We coined this new phrase consumer storage virtualization. We want to give the user the ease of having their content consolidated while we manage it across the user s topology. We create an abstraction layer that allows them to interact with their photos, videos, and files. That s the real underpinning of the current service and where we re heading with it.

SM: How do you deal with the data migration aspect? MC: We re now client and server. We run a client on each of those nodes, which allows us to index the content locally. We have a consolidated database, and we migrate data on demand. If someone wants to publish data to the Web, we only publish the data they want to. We are not grabbing 100% of the user s content and migrating it to some end destination.

SM: You have client-side software, while the storage is in the cloud? MC: Correct. We re then able to present an aggregated view, a consolidated view, to the user. The experience is such that the user has a single interface to manage and access all media and files on his or her network, which could include many devices, in a single view.

SM: How did you go to market with this? Where did you position it? MC: The final feature is total aggregation, which we ll announce and take to market in the fourth quarter. It will initially go with our consumer products, which are sold in retail. The base version is free.

We see a number of ways to achieve monetization. There is a premium version, Joggle, which includes additional services. If someone wants to do backup using Joggle, that cost would be done on a meter basis with a monthly fee. We think we ve built a virtual platform off of which we can now do services. We ll do photo printing services with a partner as well as other affiliate relationships with other Web properties so that we become a funnel to the Web.

SM: That s the evolution: hypothesis through a 15-month experiment, to the point where you re now coming out to market with a different product. However, you do have revenues already. MC: We have three lines of external storage products. The SimpleTech brand is for the consumer; G-Technology is our Apple product line; and we recently launched a small business line under the SimpleTech brand.

SM: Is it all external storage? MC: It is all external storage, with various degrees. What we re doing differently from other companies in the hard drive-business is that we re much more vertically oriented.

> ***Everything from the product definition up through the route to market, we do facing a specific market.***

Our SimpleTech line is very dedicated to a retail channel. We can be very edgy with our industrial design. That s a contrast to others, where a product was designed to be applicable to all markets and then be taken to market through separate channels even though it s the same underlying product. We were the first company to do multicolors and edgy industrial designs for external hard drives because we weren t trying to sell that same line of drives into the small or medium-sized business.

SM: You launched that through Best Buy? MC: Best Buy and others. We re widely distributed in the US. We re tracking towards $200 million in revenues in the current calendar year.

SM: What kind of margins are you experiencing? MC: They re in the mid- to high teens on that product line. It s high volume.

SM: Do you have an ODM manufacturing the line? MC: Our strategy has morphed over time. When we acquired SimpleTech, we had what I considered to be local contract manufacturers. It was not a highly developed supply chain like the ODMs with logistics, manufacturing, and broad engineering capabilities. With our Q1 2007 acquisition of SimpleTech, we ve grown that business about five times in terms of unit volume and revenue. That s allowed

us to pursue relationships with much larger and more sophisticated ODMs, mainly in Asia. We re in the middle of migrating from local ODMs here in California to first-tier ODMs in Asia, which gives us greater product capability but also much bigger margins.

Scale brings us a lot of things. It improves our margin and our ability to manage our balance sheet. We also don t have to finance all of our current inventory.

SM: You were doing two parallel experiments: the cloud business and then this external storage business. At what point did you decide to acquire SimpleTech, and why? MC: When we looked around at data service companies and Web-based storage companies, we knew we wanted a few things to be different. The ability to connect devices to those services in a direct way was a unique opportunity for us. The other strategic benefit is that we felt it would give us relevance. Ultimately, we knew for the types of services we wanted to deliver, people who buy external drives were the perfect target audience. They have lots of content, and they tend to be media-intensive people.

Now we re doing over 500,000 units per quarter. Today we re not totally integrated with the products, but they re very complementary.

SM: The integration will come. MC: It is coming. If you use your imagination, you can see where we ll take it to. Users of Joggle, who buy an appliance out of that ecosystem, will see that it will auto-configure and do things never done in the past.

SM: How big was SimpleTech when you acquired them? MC: It was less than $10 million a quarter in revenue. Within four quarters, we had it over $40 million a quarter; we were able to grow it rapidly through channel and product line expansions.

SM: What did you pay for the acquisition? MC: We paid about $43 million. The deal structure was $10 million over working capital. It was a fairly modest investment for us given the fact that we were able to get such immediate trajectory into the market.

SM: Why did they want to sell? MC: They had two different companies. The SimpleTech division was very consumer-oriented, and they had an enterprise-oriented solid-state business that they wanted to focus on. So they had to make a strategic choice.

SM: How did you find them? MC: We identified them through a corporate development process. It came to our attention that they were looking to sell, so we engaged them through their process.

SM: Help me understand how you ve navigated the financial engineering. MC: The Series A was what you would normally expect. We raised $4 million from ComVentures as a small software startup. That was very straightforward. It got us through the 15-month experiment phase. We then did a Series B and a Series C. Those two rounds together allowed us to acquire SimpleTech.

SM: Did you identify SimpleTech and then raise the money to execute the deal? MC: That is correct. We actually did a Series D not long after the acquisition of SimpleTech to bring in an investor, 3i, out of Europe with the idea that we d make a strategic move into Europe as

well.

SM: Who are the key players at Fabrik these days? MC: One of the key people on the team is Mike Williams. He was the original GM of Maxtor s branded products group. He also spent 10 years prior to that at Apple. He s responsible for all the products of the company.

SM: Has he been with you since the beginning? MC: He joined just before the acquisition of SimpleTech, right before the Series B. Mark McEachen, our CFO, came on board about the same time. He has a terrific background and is well suited for the complex financial engineering we re doing. He has taken three companies public. We re using both debt and equity to finance the company, so we draw on his time at Chrysler, where he used very sophisticated means to raise billions of dollars.

SM: Where is your software done? MC: It s done here. We have development in San Mateo and then a few resources in India.

SM: Anything else I should ve asked, but didn t?MC: I should talk about G-Technology. That was the second acquisition we did in the first quarter of 2008. That really accelerated this verticalization of our market. They put us in the premium creative professionals space. We see them having terrific traction in the post-production environment.

SM: How big is that market? MC: For us it s hard to define. We took a company that was doing about $24 million in revenue, and we think that market is going to grow under the Fabrik umbrella at 60% year over year.

SM: What was the genesis of G-Technology? MC: It was founded by Roger Mabon. Roger came out of the video world with companies like Avid. It was a vertical storage play, and their products were designed for that market. It s incredibly complementary to what we re trying to do, and it gives us another market segment that we re interested in being in.

SM: How much did you pay for them? MC: $10 million.

SM: With $24 million in revenue? Why that price? MC: It was largely owned by the principle, who knew it had run its course and was looking for an exit opportunity. He was at a point where he needed to go raise money or find a partner. It was a stock and cash deal, so he now has a stake in Fabrik, and he s still with the company.

SM: Now it s SimpleTech, G-Technology, and Fabrik all under one umbrella. Are you looking at other acquisitions? MC: Yes. We re actively looking to expand in Europe. Assuming we re successful there, we ll be done with our platform build-outs. At that point, we ll have the scale and the global reach we want. Any future M&A beyond that will happen around technology or value-added services.

SM: So you could pick up a photo merchandising shop or something similar? MC: Absolutely. We have the scale, we have fully optimized the devices side of the business, and now it s time to focus on the layers.

SM: Very good a great story.

Anytime you are operating in a crowded sector, like on-demand, zeroing in on the white spaces within the broader market is critical. Then comes demonstrating to the rest of the ecosystem why and how you differentiate.

For eight years, Salary.com has remained laser-focused on their original business of providing compensation data on demand. Their reward for such sharp positioning: they went public with just $8 million in investment capital.

SM: Let s start with some context about where you grew up lead us up to the Salary.com venture. KP: I grew up in the Boston area. I was a big fan of Ted Turner, one of the original entrepreneurs of the 70s. I went down to Georgetown and then to Wall Street for a few years. After that I went to a management consulting firm before going to Harvard Business School. Coming out of Harvard, I became a venture capitalist for a year at St. Paul Venture Capital, but I decided, at the ripe old age of 27, that I d be better equipped to be a coach once I d been a player. So I spun out into two companies in a row that were funded by St. Paul, and I learned how to manage by being the right-hand man for two different CEOs.

There s a great opportunity to develop talent if you re running a business. I committed myself to staying on the operating side. Since 1991, I ve done seven startups. Salary.com started in 1999 and has been a nice long run and a very successful and rewarding company I ve been able to develop the team, the talent, and a lot of really neat products.

SM: I applaud your decision to stop being a venture capitalist at age 27 with no real operating experience. I m constantly giving that advice to young people. Don t be a VC before you ve been in operating roles. Can you talk a bit about the kind of startups you went through? KP:

One of the things I ve learned operating businesses is that financial valuations come and go, but fundamental operating strength creates sustainable, long-term value.

The predecessor companies that had the most impact on Salary.com were ProCD and InfoSpace. I joined ProCD as the 55th employee. At ProCD we took the national telephone directory and published it on CD-ROM. In 1995 we were one of the first to put the directory on the Internet. When that company was acquired, I went over to InfoSpace and was involved with the founding team. At InfoSpace we also took phone directories and syndicated them across the Web.

There are a couple of business model lessons that I picked up from those two companies. One is that

Content is sticky; you can trade content for eyeballs.

If you have interesting content that people want and need, they will visit your site and look at your pages. The second thing is that content is hard to do. It is suited to the on-demand architecture. The cost of maintaining content datasets should be spread out across multiple

customers as well as to multiple audiences, everything from enterprise down to the consumers.

The third lesson I learned is that if you have an inexpensive offering for consumers or line managers, you can convert those people into true believers in your data and software. When, in the future, they do have a budget because they have a real business need, they ll think of you and pay a premium price for your premium products.

SM: What was the genesis of Salary.com? KP: Right before I started Salary.com I was building software for What Color Is Your Parachute? also in the career management space. There we ended our process with a recommendation as to what would be a good career fit for an individual. The goal was to identify where people would be able to succeed based on their skills, attitudes, and interests. But there were no readily available data sources as to how much jobs or careers in those areas would pay. So we looked around to find resources and to see how the industry was structured.

> ***Around the same time, I had a personal experience that really triggered the idea. I needed to hire a secretary, and I could not get a straight answer from anybody as to how much I should pay the person. That brought the frustration and pain home.***

What we found was that a bunch of consulting firms had an oligopoly. They all had the data and were willing to sell it for thousands of dollars, but they were only willing to sell it to a limited scope of clients who were large enough to pay for consulting engagements. They were not interested in small businesses or individuals having access to the information.

We thought the idea and need was real, but we didn t know how to market the idea, so we tabled it. One day we stumbled on an auction site for domain names and found the name Salary.com.

SM: What year are we talking about? KP: This was in 1999. We purchased the domain name and felt that it was a brand that could break into the data oligopoly. One of the structural issues that oligopolies tend to exhibit is that they don t drive significant investment in making the customer experience better.

SM: Were you still working at another company while hatching this idea? KP: After being involved with InfoSpace in the early days, I founded a company with Cal Brown. We acquired the software rights to What Color Is Your Parachute?, and that company was looking like it was going to wind down at some point. It had reached $4 million in sales, but we were starting to see the CD-ROM category imploding. We had some smart developers and other people in our 12-person company, and we were looking to keep them working productively. That s why we were casting around for the next big idea.

SM: You didn t do it with the $4 million run-rate company you started another instead, right? KP: Yes.

SM: What was the reason for that? KP: We had investors in the first company that had invested in a certain vision. Salary.com was a different vision. Several of those investors did come with us, but some did not.

SM: Who funded the Salary.com idea? KP: We actually raised angel money. I didn t get paid on my InfoSpace project until a couple years later. Then I used those funds to fund Salary.com when the bubble burst. We raised more angel money in 2000.

SM: It was easy to raise money in 1999 not so in 2001. What was your experience raising angel money during that window? KP: I ve never had a problem raising angel money. It was extremely easy in 1999. We did talk to some venture capitalists, but they didn t understand subscription software back then. Because of that, we were viewed as a consumer Internet offering, and we missed venture capital funding for consumer Internet ideas by a month. A year later, we came out with our first corporate product, CompAnalysts, a job analyzer. It was a premium service, a higher-priced database of pay for corporations. Venture capitalists did not appreciate the recurring nature of subscription software models back in 2001.

SM: No, they didn t.KP: It really took SalesForce.com to popularize the business model.

SM: Let s talk about product strategy at that early stage. You launched the consumer brand first? KP: Yes, in June of 2000. We immediately began to syndicate to AOL and Yahoo!. We had both a destination Web site and syndicated partners for whom we powered the compensation portions of their Web sites.

SM: Where did you get the data? With a subscription model, you need the data first. KP: We raised under $500,000 in angel money and were able to hire some compensation analysts who knew how to price jobs. We purchased sources of data, called surveys, that are sold to the general public. With these we were able to calculate the pay for a list of jobs that we thought represented a cross section of the economy. We launched with data on a little over 500 jobs.

SM: It was all content you developed in-house by extrapolating from surveys and other industry data? KP: Exactly.

SM: At the same time you had syndication deals with the Internet portals. How much longer did it take to release the corporate product? KP: It launched a year later. We had to build a much larger database of pay. For corporate use, typically you want to see pay data that covers large and small companies. Pay data also differs by industry. An accountant working in the financial services industry is more important to value creation than in the refining business. As companies get bigger, people tend to make more money for the same job. There are also geographic adjustments. We had to develop analysis tables and a lot of complex algorithms before we could launch a corporate product. The process took us the full year.

When we launched the product in 2001, despite the economy being in slowdown mode, we were able to sell the product almost immediately it was revolutionary for the space.

> ***We were basically competing against consulting firms with a product that could give you a good answer in less than 30 seconds to a question that could take a consulting firm a couple weeks to answer.***

If a company used the surveys themselves and ran analysis, it would take them 30 45 minutes.

SM: What did you price that at? KP: Its list price was $10,000 to $15,000 for companies that ranged from 3,000 to 50,000 employees.

SM: Consultants were charging hundreds of thousands! You managed to offer the same value proposition by dropping the time to solution and the price. What was the competitive landscape like when you started? Besides consultants, was there anyone else in that space? KP: Even today the competition is fairly scant. Back then there was no one doing it. We were alone in the consumer and enterprise business for a solid three or four years. There are a couple smaller companies trying to follow the path we blazed. I ll leave it to others to discuss their success. We ve maintained market success and been in the top 10 career sites by monthly visitors since inception. On the enterprise side, we figure we have over 90% market share.

SM: I want to ask you about a company called PayScale. It utilizes user-generated content to offer the same value proposition. What s your read of this, and to what extent do you augment your data with user-generated content? KP: We collect some user-generated content. We study and analyze it, but we do not use it in any of our products. We do it for research reasons only. HR professionals, who are our main customers, reject user-generated data. The information we collect is based on survey submissions or payroll records that come directly from corporations. That data is deemed much more reliable.

SM: Why does a corporation release salary data to a firm like Salary.com? KP: Corporations want to understand what the market for pay is. They have a big initiative that says they want to know that they pay fairly. They need to know internal and external equity. Internal equity is how much you re paying your people versus what your intended pay structure is. External equity means you want to compare how you intend to pay your people with how those people would be paid by the market. To form an opinion of the market, firms have to give data to an independent third party, who aggregates all that data and reports it back.

SM: You play the third-party role. KP: We play the role of the aggregator. There are a lot of other firms, especially compensation consulting firms, who do that as well. We probably have the largest single data survey for global pay in technology firms in IPAS, a survey that covers all jobs in all the technology firms across 80 countries.

SM: How did you build the company from 2001 onward, in terms of a sales model? You have a consumer model supported by ads, so was it the telesales channel on the enterprise side that carried you? KP: I was pleased to see that by 2002 we had adopted your formula for Web 3.0. We believe you should sell to small businesses and enterprises, and you should use telesales and deliver software-as-a-service products powered by on-demand software. We built a telesales organization and were able to demonstrate our products over the telephone and Internet, avoiding the high cost of sales travel and traditional field sales.

> ***We were able to sell so effectively over the telephone because we provided a live password to the product. We would just talk potential clients through a test drive.***

That resulted in a high conversion rate at a reasonable sales cost. Additionally, our brand became very strong. We have one of the best-known brands in HR, and certainly within compensation we

are *the* best-known brand. We were known as innovators and as a company that made the work lives of our customers better.

SM: Aside from your on-demand aspect, how else do you differentiate from the consulting firms? KP: We don t charge on an hourly basis for customer service or the help desk. Our customers call all the time asking for help pricing a job, and we try to help with those problems. We give about 10 hours of that service to each of our clients annually. It s a nice way to take care of your customers, and it generates a lot of customer loyalty.

SM: What type of ramp did you have revenue-wise, and how was that split between the two businesses? KP: The consumer business has been the slower growing business over the years. The corporate business grew an average of 50% a year. It grew an average of 79% from 2002 to 2007, on a compounded annual growth basis. We basically took every dollar in free cash flow we could generate and put it back into the business from 2002 on. We actually turned cash flow positive in the 2004 fiscal year and have never looked back.

SM: You built this from inception to IPO for a total of $5 million? KP: It was about $8 million in total.

SM: That s impressive. You said you were putting everything back into building the company. What were some of the central areas you needed to invest in to scale sales force? KP: Exactly. For example, one of the ways you can tell a true on-demand software company is if you look at its true cost of goods margin. We have a strong cost of goods margin. In the past year, we started to introduce a heavier services component to our customer base because we weren t offering enough services to satisfy the needs of our biggest clients. Other companies we compete against either aren t built as true on-demand software companies, or they have a very heavy services component. Our cost of goods has been running in the 20% range a very strong margin compared with many of our competitors. That margin includes our 50% growth a year, which is an attractive number given the economics of on-demand software, where you tend to run with very high deferred revenue levels that don t show up in your GAAP revenue right away.

SM: Let s talk about the IPO. What year was it, and what were your metrics at that point? KP: We completed our IPO in February of 2007. A month later, we were completing a fiscal year on March 31 with about $23 million in revenue and had generated a couple million dollars in free cash flow. In the 2008 fiscal year we just finished, we ended just under $35 million in revenue and generated about $7.8 million in free cash flow, a 23% free cash flow margin.

We were a small on-demand company going public in February of 2007, but we were successful because we d proven our ability to grow the business without consuming loads of cash from venture capitalists.

SM: What are you using your IPO proceeds for? KP: We continue to favor a philosophy of growth with internally generated cash. We re using IPO proceeds mostly to acquire small companies that are good strategic fits with our product line. I m probably one of the few people you talk to who thinks going public is great. Despite the recent pressures due to recession fears, I like being a public company CEO.

SM: Why do you like being a public company CEO? KP: As an employee-owned company, we ve been able to grow business and attract good talent without having tons and tons of venture capital. At the time we went public, 66% of the company was owned by employees. I have a really high level of employee engagement and employee alignment. I almost never lose people to outside recruiters. People really like the culture here. It s a culture that s about being customer-centric, being winners, liking what you do, and caring about the business and the people you work with. It s a nice mix one that other stakeholders, like our customers, like to join and stay with. That permeates everything about the company. Being public is part of that. It helps validate that the company s culture can remain independent, and it helps us set a foundation for growth that reaches out 10 20 years from now.

SM: What kind of TAM are you looking at 10 20 years out? KP: We went public at $23 million in revenue. We talked about a TAM for online and offline of over $1 billion. If the market is now approximately $1.2 billion, then with 20% 25% penetration, we start to look like we ve hit mature market penetration in compensation.

One of the things that we ve done over the last several years is examine other business categories. We spent some of our IPO proceeds last year acquiring companies in two areas. One was compensation management, where we acquired the IPAS Survey, which is the largest global survey of technology jobs pay. That enabled us to build out data resources to launch our own opinion data sets for foreign countries. We launched in Canada at the end of last quarter. We ll have other country data sets launching in the future.

Secondly, we re investing in competency models. Competencies are the skills, knowledge, and attitudes that are predictive of success in a position. In a journalist you might have an attitudinal competency for curiosity. When someone is interviewing you for a job, they might ask questions to determine how curious you are. Your measurement for curiosity would map into succession planning. HR people are looking to deploy competencies in their organization structures so they ask the right interview questions and hire the right people.

SM: Did you enter the competency arena organically or through acquisitions? KP: We moved into the competency arena by acquiring some libraries. The ITG Competency Group Library is, in our view, the largest standalone productized library of competencies. We also acquired a consulting firm run by Dr. Stephen Schoonover, who s one of the founding fathers of the competency consulting business. Fundamentally, when consulting firms come in to deploy competency models within an organization, it can easily be a seven-figure consulting opportunity. We need to take that seven-figure opportunity and make it easier to deploy and implement.

We ll build software that wraps around the data to make it easier to deploy competencies inside an organization. We ll have services to add to the mix to solve the problems that pop up in larger accounts. There is a significant opportunity here for us to take a data product and build an on-demand application that takes the market by storm, just like we experienced in the compensation space.

The third business we invested in, with the aim of increasing our TAM, is the talent management suite business. We have a product that does pay, performance, and succession planning. Like our lead competitor s product, it is organically built on the same platform. It is a very competitive market. Our differentiation is product content, as well as our significant competencies around pay and managing pay within the application. We re the ones to go to for pay-for-performance, and we win a fair share of deals there. We re beginning to see that our

differentiation in terms of the content we can provide within the application is also having an impact.

If you add the total TAM for compensation, competencies, and talent management, it becomes a $10 billion plus opportunity. That s been a significant change over the last 16 months compared to when we went public; back then we were just focused on the opportunity within the compensation market.

SM: You re going to be busy for the next 10 years! KP: Building a business is like building a family. You don t let it go easily. The cost of failure is way too high.

SM: What have you learned from this journey? KP: Every phase of growth has its own really interesting and significant issues. I ve personally developed from a driving, in-the-details entrepreneur when we had 20 30 people to someone who has significantly let go and now functions like a coach. I almost feel more like a venture capitalist than I do an operating manger because I m basically putting people in position to make the right plays and decisions. I feel like I m coming full circle in my career as we get to 400 employees and beyond. There is no greater pride and joy than seeing someone far from me in the organization come up with an idea, execute it, and make life better for the customer while creating value for the company. That s the coolest thing, and it s a lot different from being the person who s handed the ball and told to score a touchdown.

SM: Great story, and I look forward to keeping in touch.

India, Inc., Beware

For all the buzz around the mighty Tiger, India remains the world s back office. Its tech industry is a services industry where customers do the thinking while Indians execute today s highly repetitive business functions. According to Nasscom, an Indian IT industry organization, information technology and IT-enabled services employed four million Indians in 2008, accounting for 7% of gross domestic product and 33% of India s foreign-exchange inflows.

But the cloud computing megatrend plays against India s tradition of answering all scaling problems with more bodies.

Here s an example: The tiny Silicon Valley startup, InsideView, helps customers generate sales leads and qualify those leads to access big sales opportunities for customers. In November 2007, InsideView acquired TrueAdvantage, an Indian equivilant, which did the exact same thing, but manually with a team of 150 people. After the acquisition, InsideView transitioned all 2,500 TrueAdvantage customers over to its SaaS solution. All 150 TrueAdvantage employees in India received pink slips.

Yes, SaaS, or even SaaS-enabled BPO, are trends that should shake India to its core. But not necessarily in a negative way. For it opens a whole new range of opportunities for India, Inc., to tap into.

If India hopes to make a lasting climb up the value chain, it must learn to invent technology products of its own. Barring a few exceptions, the glut of venture capital chasing India unearths the same problem: way too much money, and way too few deals. Instead, tech-sector VCs are forced to divert capital to retail, real estate, hotels, and other non-tech sectors.

India s $30 billion IT/ITES services industry, meanwhile, is gradually losing its competitive advantage. Most of the four million people that the industry employs have now arrived, breezing through the milestones their fathers toiled all their lives to reach: a phone; a watch; a TV; a car; a house. And having surpassed these milestones, they ve grown complacent. They take few risks, outsourcing the thinking to their customers.

Indian powerhouses like Infosys and Wipro must diversify their portfolios away from pure body-shopping and process competencies, to technology-driven advantages. They, too, could build or acquire SaaS businesses. But so far that s not happening. The mood is upbeat. Infosys continues to hire thousands of new employees. Nasscom is forecasting 25% annual growth in the Indian IT services industry for the next few years. The golden goose is still laying large, warm eggs, enough to feed the four million, their families, servants, chauffeurs, and cooks. But the workforce is getting comfortable in their cubicles, just as the turkey gets comfortable before Thanksgiving.

Umberto Milletti, InsideView

InsideView, for me, is a near-nostalgic experience. In 1997 I launched my second company, Intarka, based on precisely the same value proposition that InsideView offers: efficient sales lead generation and qualification.

Ten years later, the architectural underpinnings of InsideView s solution are based on the more contemporary on-demand, software-as-a-service model. In fact, it s a nifty combination of data, content, and software, all delivered as a service.

One of the things I made a priority in designing the Intarka product was to interview tons of really good salespeople the eventual users of the product to understand the various tactics they use to prospect. Umberto, it appears, has done something very similar.

SM: Let s get the lay of the land with your personal background. UM: I m from Italy. I went to college in the US and did my undergrad at Tufts and then my master s in electrical engineering and computer science at UC Berkeley. From there, I went to a company called Integrated Systems, which was a 30-person South Bay firm at the time. I stayed there for seven years. It went public after about three of those years. I have a wife and two sons, who are seven and nine years old.

SM: Where did you get the idea for your current venture? Is it aligned with your domain experience? UM: The genesis for this really happened at DigitalThink, a company I co-founded that concentrated on Web-based corporate training. I served in key roles as GM, products; VP, technology; and VP, marketing & product management and also helped lead the company to a successful IPO, growing annual revenues to $60 million. That ultimately led to its sale to Convergys in 2004 for $120 million in cash.

DigitalThink was a high-growth company, but we struggled with sales. We went through four VPs of sales. We kept thinking, maybe we re hiring the wrong people. But the cycle continued until we realized it s not just about hiring the right people, it s about making your people productive and efficient.

I started to realize that it was also about thinking differently the old model of writing content became weaker as the amount of information started to multiply overnight on the Internet. I realized there was a void in the market, a void where salespeople weren t being as productive as they could be because they didn t have the time or data to access rich pipelines.

In 2005, I partnered with Richard Horn to address shortcomings in traditional sales processes. Richard and I worked on what we called opportunity intelligence, which really started to transform sales from a haphazard activity, dependent on cold calls and luck, into a highly targeted, efficient, and effective process.

SM: What was the market landscape like when you founded the company? Competition? Competitive positioning? UM: The market landscape did not include any true competitors then, and it still doesn t today. InsideView represents a unique technology that uses

Web 3.0   type features to address sales issues in the enterprise.

Although they aren t true competitors, sales 2.0 companies like Eloqua, VisiblePath, Genius, and Jigsaw are often compared to InsideView, as they all aim to provide salespeople with actionable leads.

> ***In terms of competitive positioning, InsideView does not take a stance against these companies   instead, we position the company against traditional data providers, such as Hoover s, which are being replaced by sales 2.0 models.***

SM: Describe the value proposition, including differentiation versus the rest of the market. UM: The value proposition for us is really about building a better pipeline. We do that in three ways. We help salespeople focus on prospects most likely to be good prospects, aggregate this all together, and then provide salespeople with ideas that might not be obvious.

That s where our technology comes in. Customers use our technology to strategically target verticals and companies undergoing specific business changes, approach prospects with a customer-centric value proposition, discover decision makers, and leverage introductions to bypass inefficient cold-calling efforts. Whereas the rest of the market may concentrate on traditional CRM models, InsideView helps customers reduce cold-calling and research, revolutionize prospecting, drive higher sales, and build high-performance pipelines.

SM: When I did Intarka, we crawled the Web using an Intelligent Agent architecture, and based on specific query structures, we managed to scout for qualified companies to target based on verticals, as well as by specific triggers. For example, if I wanted to sell to all the companies in the world that manufacture packaging machinery, the agent would find the specific people to contact within those companies. Based on what you ve shown me, you do the same, yes? UM: We do the same. But we have access to a number of services today that we bring together in one place. If you re trying to sell to an executive inside Cisco, knowing that this person was at Sun before, having access to his LinkedIn profile and network, helps the account manager in figuring out how to approach the person. Maybe they know someone in common. Furthermore, savvy sales reps always Google people before approaching them, just to understand their background. We offer all that research as a personalized console.

SM: Yes, what you re describing is a people search engine of sorts, from the context of sales prospecting. I have to say, one place where I got stuck on this was in actually finding the e-mail address and phone number of the target. It was impossible at the time to find this information without actually making a phone call. And with LinkedIn and Plaxo, they guarantee that they protect users   privacy. Has anything changed in this regard? UM: No, but services like Jigsaw are trying to solve the problem by doing a marketplace for contact data. We integrate with them.

> ***SM: How do you calculate TAM? UM: One way to calculate TAM is by the money available to spend on sales intelligence. This includes licenses to database information, such as Hoover s. Today there s about $5 to $10 billion spent on this in the US market alone.***

SM: Assuming data services are your comparable, that s a reasonable assumption. And

what s your business model? UM: Our business model concentrates on a proceeds-per-month licensing model. We start at $100 per month for a seat, and we offer volume discounts to large accounts.

SM: What are your top target segments? UM: From a vertical perspective, we target the technology segment first and foremost. We also concentrate on the business services, outsourcing, HR recruiting, and financial services sectors. The companies we target span all the way from 10 employees to 20,000 employees. Lastly, we target the VP of sales at companies that s the entry point for us.

SM: How did you penetrate the market and gain early traction? UM: We penetrated the market in our early stages through a direct sales effort. We worked very closely with customers, building our first 20 customers. The Salesforce.com AppExchange listing has also helped, as it enables customers to write reviews. They re saying InsideView has been a game-changer for them. Overall, the AppExchange channel has been extremely effective for us.

SM: What stage are you at now revenue, profitability, customers? UM: The key metric we track is customers. There are 25 well-known names, including Cisco, WebEx, SuccessFactors, and Rearden Commerce. Gaining these companies as customers is success to us. How well they adopt InsideView is also success to us. We don t disclose revenue details as we re a private company, but we judge success through the acceleration of customers we ve had from Q1 to Q3 of 2007.

SM: Great reference customers. Must make it easy to sell now that you ve bagged those names. How did you finance the different phases of the company? UM: The company is privately held and venture-backed by Rembrandt Venture Partners and JDM Capital, an associated fund of Greenhouse Capital Partners. We announced on June 5 that we had secured $7.4 million in Series A funding. Emergence Capital Partners, a leading Silicon Valley venture firm focused on early and growth-stage SaaS companies, led the round.

SM: Yes, Emergence has a great commitment to on-demand and technology-enabled services.

It s a lot of fun hearing you speak about InsideView s positioning since this is a marketplace lead generation, qualification, account intelligence, funnel creation that I lived and breathed during Intarka. Good luck with the company; I know the opportunity exists.

Steve Adams, Sabrix

Steve Adams, an English professor turned tech CEO, brings us Sabrix next. Sabrix is pioneering a new category, SaaS-powered BPO, encapsulating tax laws into software.

Entrepreneurs should salivate at the prospect of not only taking highly manual tasks and automating them with SaaS, but returning highly profitable BPO services through such automation.

What Steve has done within the tax domain is replicable in other domains as well, offering nearly endless opportunities for future entrepreneurs.

SM: Steve, can you give me some context about where you come from what s your personal story? SA: I actually came from academia. I have a PhD in British literature and was a university professor for seven years at both Florida State and the University of Louisiana-Monroe. I taught writing and literature.

SM: Where did you grow up? SA: I grew up in the South, mostly Tennessee. I m from a typical Scotch-Irish background with a strong work ethic. I m a bit of an anomaly in my family for two reasons. First, I pursued an academic route, and English was not considered a manly area of study. Second, I abandoned that to come to be in the business world in California, which was a very radical deviation. My two younger brothers are cowboys. One is a horseshoer, and the other a large animal vet.

SM: What happened after teaching for seven years? SA: One of the things about academia, especially in the liberal arts, is there are an extremely limited number of jobs available at any given moment. When I graduated with my PhD in 1982, there were four tenure-track jobs in the entire United States in my area of study. From a generalist perspective, there were 750 applicants for every tenure-track job, or about 250 to 300 for the particular jobs I was competing for.

I landed one of the jobs, which happened to be in Louisiana. Even though I was from the South I didn t like living in Louisiana. What I discovered was that up to the point when you get your PhD, whether you re doing your own teaching or publishing, you re pretty autonomous. You feel like you re in control of your own destiny. However, because of the job cycle, there s no mobility to live where you want. You don t have control of your own destiny, and I didn t like that. My wife was from Los Angeles, and I d kept her in the South much longer than she wanted. So I told her to pick where she wanted to live. She had family in San Diego, and I thought it was a lot better than Louisiana.

I got two job offers within three weeks of arriving in California: one from a publisher looking for a college textbook editor; the other, an entry-level technical editor in high tech. I could have been a college textbook editor for $19,000 or an entry-level technical writer for $27,000, so I chose to be a technical writer.

Once I was in the profession, I knew it was not where I wanted to stay. It took me six years to work my way up to the VP of marketing role.

SM: I find it fascinating that you started as a tech writer and moved all the way to VP

of marketing. Can you tell us more about that experience? SA: The first company I worked for folded into Unisys. They had an advanced R&D group, and I worked for them as a technical writer. That led to my first startup, which was in the mini-supercomputer market. The company was called Scientific Computer Systems. About seven companies were funded, and one survived: Convex, which was bought by HP.

I was doing site preparation guides and installation guides for those companies, very much in line with what a technical writer should be doing. I then looked at some of the marketing collateral and realized it was just so far off message that I went to the folks in marketing and said, I can do a better job than this. They gave me a chance to do it, but on my own time because I wasn t part of their group. They liked the work I did, so I was able to transition over to marketing communications, and from there to product marketing, and then to a marketing job.

SM: What year does that bring us to? SA: I joined Sympact in 1988 and rose up through the ranks of marketing. We were a very atypical adopter of Lotus Notes. We were really intrigued by collaborative notes. We became a reseller and developed a voice capability inside Lotus Notes. That experience lasted through 1994, when Novell acquired WordPerfect. Novell had created Groupware and was looking for someone from the outside to come and develop a channel for the Groupware products. Having been in the Lotus Notes space, I was recruited to join the Groupware Division at Novell in 1994.

SM: Were you based in Provo for that? SA: Yes. I did that for a couple of years. I d been in small companies most of my career, so I wanted to see if I could play in the major leagues. I thought, at the time, that large companies were the major leagues. I have a different opinion now.

I got this opportunity at Novell, and we decided to go there. We didn t particularly want to live in Utah, but we wanted to see if I could rise through the ranks there. I took a director role and gave up my VP role in marketing. There were four VP of marketing positions at the time, so I wanted to give myself three years to get positioned. It ended up taking about three months to get promoted to VP of marketing for Groupware. I spent another 18 months doing it, got my large company experience, and left.

SM: Where did you go? SA: I went to a large company in Seattle called Digital Systems International and rebranded it to Mosaics. Then I was recruited out of Mosaics into Citrix. Again, mostly because of my channel background at Novell. I went to work for Citrix in 1997 1998.

SM: What product were you marketing at Citrix? SA: WinFrame. That was in their fast path, the 1998 1999 timeframe. They had great public markets, and they were 100% focused on revenue and profitability. They enjoyed a very robust public market, but they did it based on revenue and profitability. That was a great place to be. It was in South Florida; however, my family wasn t happy there.

I was not actually looking to leave, but Novell came calling again. Eric Schmidt was the CEO, and Novell had introduced a new technology called DigitalMe. It was a piece of identity management software. It was in 1999, very early in that space. It was a great technology with a definite lack of clarity as to how to bring it to market. I was asked to come back and build a startup within Novell in a general management role. I wanted to get back to California, and here was a great opportunity to do it.

SM: So you arrived at Novell to take charge of the new DigitalMe project. SA: Yes. In March Novell had promised delivery of the product in July. But I started on July 2 and there was nothing to deliver.

We spent a lot of time thinking about what we could do with the technology, specifically how to get it to market.

> ***We made it free to begin with, which allowed users to tackle the learning phase while letting us learn what people valued.***

DigitalMe was the brainchild of Mike Sheridan, one of the Java guys at Sun. I told them to give me 90 days to try and attract the right kind of audience. We then got folks like AOL on board and launched DigitalMe. It was the first germane Internet story that Novell ever had. We attracted financial analysts, industry analysts, financial press, and business press in a way that Novell had not previously been able to. We moved the market cap of the company $800 million on the day we launched.

But no good deed goes unpunished. A few weeks later we were going back to work to figure out how to monetize it, and I got a call from Stewart saying that securities analysts had moved them down from a buy to a hold standing, citing marketing as the reason. I told them I didn t come to Novell to take a marketing job, but I was a good soldier, so I took the marketing assignment as SVP of marketing for Novell, knowing it would be a short tenure. I promised to reposition and rebrand the company, which I did over 18 months. DigitalMe died after I left because nobody focused on it.

SM: What year does that bring us to? SA: Around the end of 2000, which was when I was granted my unconditional release. I really liked the general manager role while I had it, so I decided I d go get a CEO job at a startup.

SM: Where? SA: A Sequoia-backed firm called Uniscape. I was there for about 18 months, and I transitioned it from the Internet bubble era. It was globalization software. You could take all of your content in one language, pass it through our translation engine, and it would come out in whatever language you wanted. It was a 95% solution after that you had to go to a manual review. I sold that company in May of 2002 to a German company that was later purchased by SDL.

In the middle of the transaction, I got recruited to Sabrix. But I couldn t taketheir offer at that time because it wasn t clear if I d have to join the merged Uniscape entity or not. Sabrix was generous enough to wait for me; I finished my transition on a Friday and started at Sabrix the following Monday.

SM: What is the story of Sabrix before you entered the picture? SA: There were three founders who were IT professionals at Techtronix. The CFO there, Carl Neun, was one of the early guys who recognized the need to take disparate systems and centralize on a central instance of Oracle. While there are a lot of people doing this today, he was doing it in 1995. Gary Allen was the IT lead on a $55 million project to centralize all of the applications on a single instance of Oracle. What they found was there was no way to centralize the transaction tax component. There was no product available. He commissioned the team to build it, and they built an instance of it. The tax community is relatively small, and people started pinging them about what they d done

and how they d done it.

The Sabrix founders saw a business opportunity, so the three of them decided to first go into a consulting role. Then in 2000, they took their first round of funding and incorporated Sabrix to build a company to go after the transaction tax space.

Ironically, over the next 18 months, they began to feel that the opportunity was as an application service provider. This was an application most appropriately delivered in an on-demand platform. However, it was the nuclear winter of software, and software startups were collapsing everywhere. To be a small company handling financial transactions in an ASP model was not going to work.

Mohr Davidow Ventures came out and invested in 2001. They really shifted the focus to taking their platform and moving to the enterprise. They completed that around the time I joined on June 3. We shipped the first enterprise software application on June 26.

SM: When you arrived, the company had just delivered a product. But no revenue. SA: No revenue, and no significant go-to-market piece. My goal was to bring a sales and marketing focus to the company and build out the infrastructure for each.

SM: What caught your attention about this opportunity? SA: One of the toughest things is that I was always less intrigued by the technology than I was by the business problem. After having been in a number of jobs where it was really cool technology in search of a business problem, I decided enough is enough. My roots are all in marketing.

One of the most important things I learned was during my marketing tenure at Novell. If we had a Jacuzzi to sell, we d have flipped it upside down and talked about the copper pipes, the heaters, and the motors. What we had to do was flip that Jacuzzi right side up and look at the experience. It s beautiful, the water s warm, the steam is rising. Don t show the plumbing, show the allure.

SM: Yes, I always tell my clients that. Solution selling is much easier than selling tools and technologies. SA: The thing that really intrigued me was a very specific business problem. There was a very well-defined target buyer and a great return on investment for solving that problem. That just does not happen that often in Silicon Valley. It should happen all the time, but it doesn t.

SM: The tax space actually seems like a very solid niche. SA: It is interesting. It is hard to mention the word tax anywhere in the United States. People have an automatic negative response.

SM: You arrived as the first outside CEO how did the founding team react? SA: I think they d been at it long enough that they realized where their core expertise was and what piece was missing. They had had some failed experiences on the sales and marketing side, and they really wanted somebody to partner with them and make their vision a reality.

We talk a lot about vision in Silicon Valley.

Vision is about seeing what others cannot see, which is the exact same definition as

hallucination. So what s the difference between vision and hallucination? Execution that s what I focus on.

I think the three founders would agree, some six years later, that they wanted someone to execute on the sales and marketing side and bring in operational discipline across the board to grow and scale the company.

Most technical entrepreneurs come up through the product side, not the IT side. They were one degree removed. They were IT guys from a hardware company trying to build software. It was a reasonable decision to bring in someone from the software world.

SM: This type of scenario happens often. Intellectually, founders understand the need to bring in an outside CEO; however, it often requires an emotional transition. SA: The question is whether anybody ever completely emotionally transitions. I think the important thing you need to worry about as an entrepreneurial CEO is what role your founders are going to take. My position is that they have a well-defined operational role in which they re held accountable, as with every other person in an operational role, or they re out. Anything else in between is confusing for them and the organization. It just doesn t work well. I was fortunate that I had three founders who could take on and execute real, meaningful operational roles very well. They now have the opportunity to play meaningful roles, add value to the company, and see the growth they were hoping for.

SM: What roles did you put them in? SA: One of them is the SVP of customer advocacy. He was the founding CEO and the one who led the IT project. The value that his IT background has brought to the company is that he can be 100% empathetic with the IT audience we sell to. An R&D guy cannot have that same empathy. So that s been very meaningful.

Another has been a sales engineer who leads the pre-sales organization. He s a unique combination of technical expertise and tax-domain expertise. That hybrid skill set is really hard to find in a single human being. He has built an organization that reflects that hybrid skill set, which is necessary for our sales.

The third left our company about two years ago. He played a number of roles. He was in services for a while, then development, then product management. He really enjoyed the startup process, was fully vested, and wanted to go do a second startup and get another equity slice and start the clock over. He was there for my first five years.

SM: You stated the need to have a unique combination of content and to characterize that content with the technology how did you characterize the value proposition of what you were doing? SA: There are a couple of ways to view the value. From a technology perspective, the unique value we provide comes through content and the value of content, which are the tax rates and rules that are constantly changing. There are over 13,000 jurisdictions in the United States alone and then there are 170 other countries. The tax law is changing somewhere, in some jurisdiction, all the time. But there have been people in the content business for a long time. We took the content and married it to the software. It was the translation of tax law, the rates and the rules, into something that could be manipulated and managed by software that was our secret sauce. That was the technological value.

The business value is, as succinctly as possible: we remove the need for the financial

executive to balance the risk of non-compliance with the cost of being in compliance. You don t have to make a tradeoff. You can be in compliance in a cost-effective way.

The third part of the value is that we really shifted the model of how the business problem is solved. Prior to Sabrix, there was one tax calculator for every application in an organization that needed to calculate tax. If you were a large multinational company and had 60 procurement applications across your company, which is not unusual at all, you would need 60 different instances of software to do the calculations and 60 different instances of content, which meant you had to manually maintain all of it and synchronize all of that data in order to file a return.

We eliminated that and said that architecturally the way to do this is the way the RPs are doing it   a single instance of a tax engine should serve every application in one central location. That drove the ROI substantially.

SM: How did this get handled before Sabrix? Was it outsourced? It sounds incredibly cumbersome. SA: It was fragmented and done in a number of ways. One is manually. It could be done by tax calculators, as there were a few companies offering those. It could also have been done by customizing the ERP itself, but that required loading tax rates and rules into the ERP. In the US, probably 60% of companies have some type of solution; internationally there has been no tax automation.

SM: Do they have huge tax departments for this? SA: They have tax departments, but they re not necessarily large. They re fragmented across internal and external groups. In the US you have state and local providers, but also tax service providers such as the Big Four and boutique firms. The entire business process is fragmented.

SM: How big is the tax practice of the Big Four? SA: Tax practice within the Big Four is separated from tax automation. Tax practices are organized to look at state, local, and international and are primarily focused on tax policy advisory roles. They do a lot of audit defense. Within those very large businesses, they will have smaller tax automation groups that go by different names. They don t report separately, so it makes it hard to tell, but it is clearly a market in the hundreds of millions of dollars. The private companies and boutique firms also account for about $250 million to $300 million a month.

SM: Let s go back to 2002   you arrive at this product. What was your launch strategy? SA: Timing was important. There was a general malaise in the software industry because of Y2K, and then the euphoria of the Internet. A lot of companies bought a lot of software that ended up as shelfware. When the bubble burst, software purchases squeezed down dramatically. In the middle of this nuclear winter along comes Sabrix, an enterprise tax application. Companies had ERP systems   shelfware   and were not interested in enterprise applications in general. We came along and sold an average deal size of $300,000, which was substantial in that time period. We sold it to purchasers who d never purchased or influenced the purchase of enterprise software in their companies.

SM: Who were the purchasers? SA: State and local tax managers inside large corporations. We were not selling to the VP of tax, and we certainly were not selling to the CFO.

We were selling lower down in the organization, and it was a big-ticket item. I m pleased to say that when we put the business plan together in June of 2002, I looked at enterprise software companies funded in the early 90s that had successful exits of one kind or another. There was a fairly clear model as to what a top 10% enterprise software company looked like from a financial metrics point of view. I looked at them five years prior to IPO, during IPO, and after IPO. Those metrics, such as average deal size and revenue mix, became our goal. We set that and have exceeded it every year we ve been in business.

I laugh, because it s interesting doing things the hard way. We did it in the wrong space, at the wrong time, and by the time we came out of the nuclear winter, everyone was saying the only software which should be purchased was software on demand. Yet, through that time, we built a very successful enterprise software company.

SM: It s almost counterintuitive that you were selling so low into the organization since the item was such a high-dollar figure. Instinctively, you would probably want to sell to the CFO. SA: It should have been a C-level executive, but at that time CFOs were focused, from a tax perspective, on effective tax rate, which is driven by direct tax or income tax. As we have seen in subsequent years, many companies have artistry when it comes to managing their effective tax rate, so there wasn t a lot of software automation in the planning and revision steps. Even though this was a large function in terms of financial implications, it was handled and managed lower in the hierarchy. [The 2002] Sarbanes-Oxley [Act] has changed that to a certain degree in that all financial processes, especially those which deal with compliance, now need to be managed very carefully. While in the past, as a large multinational, you could say, My error rate on sales and use is about this, so I ll put monies aside, and if we re off we ll be covered to pay the tax, penalty, and interest. If we re off, we ll just pay the money off. Today, Sarbanes-Oxley says you have to be accurate. It was very counterintuitive, the way we sold.

SM: Was it trial and error that led you to that decision? SA: No. We relied on enterprise software experience and believed completely in our value proposition. We felt if we could get the opportunity to explain, the audience would see the value. The fact that we ve been able to grow and maintain that deal size suggests it s true. There is real value, and we can explain it.

SM: Who were your first customers? SA: They were folks like Franklin Covey, General Electric, and Hewlett-Packard.

SM: You went for the giants first? SA: Yes. Today we have 150-plus large multinationals that have purchased this. I m very proud of our team and our sales team. For a company our age, we have the most blue-chip list of marquee customer names in the world.

SM: Do you have any competition? SA: We do a company named Vertex that s been around for more than 30 years. They initially took the approach of building a single calculation engine and have since worked to develop a competitive product to ours. In those large multinationals, with the value proposition we had in terms of consolidating the tax under a single engine, with a single source of content, and therefore a single system record, we set a new standard, and everybody has been chasing it since.

SM: What kind of ramp did you see when you started selling the product? SA: It was

that typical $1.25 million the first year, $3.5 million the next, and then $6.5 million, $8.5 million, and $18.5 million ramp. In 1997, if you had that profile for the first five years of your company, you would go public at about $25 million in revenue, get a meaningful multiple based on the last 12 months   revenue, and get a slug of cash to start building your business from there.

We hit that in 2007, but the rules are all different now. Today everybody values recurring revenue. In anticipation of that revenue coming in the fourth quarter of 2005, we sat down to evaluate our path. We knew we were on a great track for the previous decade, but things had changed in this decade. How could we use it as a foundation for growing? We had three ideas. We looked at acquisitions that we could not get done. We looked at buying or merging with companies in an adjacent space, though when you re a VC-funded company it s hard to get those types of deals done. Finally, we looked at the opportunity for organic growth by expanding our addressable market. We have exhausted the other two opportunities, so in the interim we re doing market research in the SMB space.

This is the most meaningful set of results I have ever produced from a primary marketing research project.

> ***We talked to over 500 companies, from $20 million to $1 billion in revenue. We thought we were going to go to market with a SaaS model based on our technology and content. But the CFOs and VPs of finance came back to us and said they didn t need software delivered in a different model, they needed us to solve the business model. We discovered that we needed a different offering, which was software-powered BPOs.***

SM: The original thinking was ASP, but it went to market as enterprise software; the latest thinking was SaaS, yet it went to market as a managed tax service. Somehow, ASP and SaaS don t seem to be working out for you!SA: When we had all these conversations with business users, they took our thinking about SaaS and indicated that they would like the benefit of a lower cost of entry and didn t want to use their IT resources to manage it. They also liked the pay-as-you-go model. They told us their real problem is people; they don t have the numbers or expertise. The value they were looking for from us was to address the human issue. That s why I think what we offer is very attractive. Domain expertise differentiates us. We become an extension of the finance department, which increases stickiness and is a formidable barrier to entry.

SM: I actually believe managed services are a trend the market is yet to understand. I think SaaS is going to start evolving towards a managed service powered by SaaS infrastructure. The reason for this is domain expertise. SA: It is either industry expertise or some other form of domain expertise wrapped around the delivery method, which will provide the next set of great opportunities for people in the SaaS space.

SM: How does the P&L structure compare between SaaS and a managed service? SA: You know, I m shocked because from both a gross and an operating margin perspective we enjoy the same kinds of margins that we did in our traditional software business. A lot of that has to do with the amount we ve automated.

Scaling is in the technology, not in human beings.

We still have our traditional on-premises business, which has the financial metrics of enterprise software where the target margins are in the 70% range. And we re finding a similar set of margins on the managed-tax side.

> ***Because we re in a protected niche, there are not 12 other companies in the Valley funded to do the same thing. I don t have to spend $1 of sales and marketing for every $1 of revenue, which is one of the tough parts of SaaS. When you layer on all of the other costs, it gets tough to be profitable.***

The margins of our business, with our protected niche, means we can get to profitability without having thousands of customers.

SM: The whole outsourcing business needs to look at SaaS to get to managed service.
SA: It is a huge enabler. The only reason I get my margins is because of software automation. If you re a services company, it s hard to get into the mindset required to be a product company. If you re a product company, it s hard to build the DNA to be a services company. It s the same thing with BPO companies. If your DNA says, Solve this through labor or wage arbitrage, that s how you solve it. Now you can solve the same thing through automation and enjoy the same benefits.

SM: Great! I think it s a really interesting business. And great that nobody is paying attention just stay focused and keep building.

SaaS-ing Back at the Economy

Which would you rather be: a Wall Street banker whose money, while continuing to flood out, has stopped coming in, or a small niche company built on tightly managed, frugal operation? Today, in the midst of economic downturn, the choice should be obvious.

In the technology sector, whom would you rather sell to: numerous small customers, or a few big ones, particularly those in the financial services sector? That choice should also be obvious.

Consider PayCycle, a Palo Alto based SaaS company whose mission is to make paper-based payroll obsolete. In offering payroll software for companies with fewer than 20 employees, as well as for the accountants who work with them, PayCycle thrives when small businesses thrive.

Using a collaborative model, the company s SaaS guides users through the entire payroll procedure online, from paychecks to W-2s. Founded in 1999 by former Intuit coworkers, Rene Lacerte and Martin Gates, PayCycle generated close to $25 million in revenues in the last fiscal year and is now the fastest-growing payroll company in the world, with more than 75,000 small-business customers.

PayCycle built its business by addressing the payroll-processing needs of small, SaaS-friendly businesses. The company s growth also stems from smart private-label partnerships with financial institutions like Capital One and PNC Bank.

Last spring, when murmurs of an impending recession surfaced, I bet on SaaS as a recession-proof sector. While I still believe SaaS companies like PayCycle remain a more resilient and defensible model than many other higher-cost services in the tech sector, I would not say they are *depression*-proof. But I sincerely hope we re not going there where security and alcohol emerge as the leading investment options!

Some of the robustness of SaaS companies comes from the fact that the sector caters heavily to small businesses. With this broad customer base comes a broader, healthier foundation without the concentrated dependence on the now faltering financial sector. It s not a pyramid, it s a thumbtack; it s all at the bottom, says PayCycle CEO Jim Heeger. That s where the action is because there are so many companies to deal with down there.

Compass Intelligence, a Scottsdale, Arizona based research company, has spoken to this bottom-up approach. Its research shows that small businesses, which account for 99.7% of all companies in the US, will boost information and communication budgets by up to 8% a year, spending $280 billion by 2012. A very healthy, and currently underserved, budget that SaaS vendors are able to tap into like no other.

For years I have viewed the small business market as the new frontier for technology vendors. For years, however, the prevailing opinion in venture circles has maintained that it remains far too difficult to sell to small businesses. That they are too fragmented. Enter software-as-a-service and, among others, Jim Heeger, CEO of PayCycle, a company that has mastered the art of selling payroll services to the smallest of businesses.

Jim, in particular, is an authority on building businesses around value propositions offered to small business customers. Before PayCycle, he ran Adobe s Creative Professional Suite division and spent a number of years at Intuit, captaining various pieces of Intuit s accounting software business, also focused on small businesses.

If you want to learn the game of building a very-small-business-focused venture, hang onto every word Jim Heeger offers.

Note: In June 2008, Intuit acquired PayCycle for $170 million.

SM: Jim, I d like to start with some background on where you come from. I know you ve been involved in some very-small-business-oriented plays, which were vastly unsexy until recently. JH: In our own minds, we liked to think they were more popular. We ve had some really good success working with small businesses, and it s been a lot of fun. The most notable are Intuit and Adobe. I was at Intuit for a long time, from 1993 2000, then Adobe from 2002 2005. In both cases, I was working with very small businesses. In the case of Intuit, it was all kinds of small accounting businesses, and in the case of Adobe, it was small design shops and studios creative people that were typically working with us.

SM: Let s first talk about Intuit, which was the first case study of a company selling successfully into small businesses. What was the lay of the land when you got to Intuit? JH: I guess, first of all, I would say that I think there have been a handful of companies that have been successful in the small business space for different reasons. What was unique about what Scott Cook and others did at Intuit was to apply the consumer products model to the desktop software business.

It was about low prices, great customer satisfaction, and the virtual loop of listening to customer feedback to create a better product, which in turn earned more customers.

This virtual cycle they were able to create out of customer satisfaction was all about listening to customers very carefully. That s the DNA I picked up and used at other places, including here at PayCycle. The key insight around the small business space was realizing that the checkbook metaphor used at Quicken was being picked up by a lot of small businesses and used as a tool to keep track of their finances. Way before I got into it, Ridge Evers was looking at the behavior of small businesses. He was at Intuit and recognized the opportunity. From that came the idea of really focusing on small business accounting software as a wide open niche.

SM: A key issue with small-business-facing products is how to reach customers, given

that it s such a fragmented market. What did Intuit do there? JH: It was a direct marketing play. Historically, as computers came down from the enterprise level, they went to the mini-computer level. There were a lot of channels used to sell accounting applications and manufacturing applications during the enterprise days.

> ***For us, to reach the really small business market, it had to be, rather than a sales play, a marketing play.***

Most of the SaaS models in the enterprise today are still sales models. We, at PayCycle, are a SaaS, but also a pure marketing play, and it is the only way you re going to reach the very small business market.

In the payroll space in particular, we re competing against service bureaus such as ADP and Paychex, which are historically sales-based organizations.

SM: You don t do any sales, not even telesales? JH: Correct. We don t have an outbound telesales effort.

SM: Was that true at Intuit as well? JH: For the most part. Later on, with some add-on products, the annual support models in particular, there were some telesales. However, telesales was never a major driver. The major difference is that Intuit had a retail channel. By the time I got there, seven or eight years into the game, they had figured out how to drive their upgrade traffic into the retail channel. A lot of people were trying to figure out how to sell their upgrades direct to improve the margins. Intuit did just the opposite, which was to drive the traffic into the stores because it was good for the stores, and it created a great retail presence that they still leverage today.

SM: What was Wall Street s view of Intuit at the time? It was a model they were not used to yet. JH: I did a rotation as CFO at Intuit, although I wasn t really a finance guy, so I m not sure how I got that job. I would not get that job today! You couldn t take a risk on a person who didn t have a finance background for the CFO of a NASDAQ 100 company, but in those days I was able to pull it off. Intuit was sort of a darling of Wall Street in those days because the idea of recurring revenue streams in their business model was really attractive.

SM: What was recurring? You weren t selling subscriptions, were you? JH: It revolved around the upgrades; there was definitely a strong upgrade cycle. There was the original printed check business which ran for a couple of years. Then the TurboTax merger in 1993 that was definitely an annuity business.

SM: TurboTax had to update the tax forms in the software every year. JH: Exactly and it still does it that way today.

> ***SM: How would you define the portion of the small business market that Intuit was focusing on? Was it under 100 employees, under 1,000 employees? JH: Under 10 employees.***

There is something in the order of 22 to 25 million small businesses. It depends on how you count

them, but the vast majority are mom-and-pop businesses. We used to figure there were several million potential Intuit customers out there. Today, when I think about PayCycle, we also target the very small businesses. We are targeting businesses with fewer than 20 employees. The difference between our business and the businesses we ve been involved with before is that in the payroll space we are specifically targeting employers. That s a very well known number in the US you can get it from the IRS.

SM: What is that number? JH: There are five million small business employers, our target market. If you go above small business employers, there are a total of 5.9 million business employers in the US. Of the 5.9 million, 5.2 million have fewer than 20 employees. The remaining 700,000 entities account for larger business employers. It s not a pyramid, it s a thumbtack; it s all at the bottom. That s where the action is because there are so many companies to deal with down there.

SM: We ll come back to PayCycle in greater depth, but let s take a quick detour and talk about Adobe. I remember we met at NEA when you were doing Fotiva, near the end of 2000. Why did you take on Fotiva? The timing was difficult. JH: Timing was terrible. It was in the middle of the nuclear winter, and we were trying to fund a digital photo startup that was consumer oriented, so I guess that was a bit of a joke. It was a very bad time to try to raise money, but a very good time for the idea. There were probably 150 digital photo startups on the ash heap of the Internet bust. What people came away with after all of those wash-ups was that you still had to manage your digital content on your desktop; the cloud was not ready for this type of application.

Being able to own your media on top of your desktop was still pretty important. What I ended up doing, in parallel with trying to raise money, was hunting for strategic partners to distribute the product. I focused on Adobe and Microsoft in the US, as well as Japanese camera manufacturers who were putting out software with their cameras.

I was in Japan in September of that year. I got there on September 10, 2001, and got a call in my hotel room from Adobe saying they were interested in our product, but that they wanted to buy us. Of course, September 11 hit the next day.

When we came home, we talked with Adobe for several weeks and ended up selling later that year. For that time period, it was a home run. The product came out the door as Adobe Photoshop Album, and it was quite successful.

SM: You decided to stay with Adobe for a few years after selling Fotiva, correct? JH: Initially I got out and spent a few months looking for the next smaller thing to do, but the market had dried up so badly there were no B and C round deals going on, and that s the stage I like to get involved with. Bruce Chizen kept pushing me to come over and run the creative business in Adobe.

It was interesting because I went back into a role very similar to the one I d left at Intuit in the sense that I was running a multi-hundred-million-dollar software business with a successful install base.

It really felt like a true sabbatical, in the sense of what professors do. They go off and study a different topic, and they learn something completely new, and then they come back to their own area refreshed, with a different perspective. That s how I felt at Adobe. I was in a similar role, but I had a completely different perspective because the products we were selling and the customers

we were selling to were so different. Then I came back to PayCycle, and that again was back to my Intuit roots.

SM: Let s start talking about PayCycle where you are now. This is your old team from Intuit, right? JH: The team I came to work with at PayCycle is all people I ve worked with before, except one person. So they knew what they were getting. The two founders of PayCycle are guys who worked in my group at Intuit; they were one level removed from me. One was the technical guy, who wrote all of Intuit s original software for payroll, and the other was the business guy, who worked the payroll business.

They left in 1999 to start PayCycle, and we were not too happy with them. They were going to be doing nanny payroll back then. That was the days of Zoë Baird, who was a candidate for attorney general until she got up in front of Congress and it became clear she had not paid taxes on her childcare person. PayCycle was going to be in the Zoë Baird business and keep people out of trouble in case they wanted to become attorneys general.

SM: How did PayCycle position itself around Intuit? JH: I don t think they had to position themselves around Intuit in the early days because it was about household payroll, and that was not a market Intuit was going after.

SM: Does PayCycle still have the household payroll business? JH: Yes, as a matter of fact we still have it, and I m a user. I pay our housekeeper with it.

SM: How many customers do you have using it? JH: About 2,000. It s not the majority of the business. Most of our business is small business.

SM: Somebody actually funded this nanny payroll idea? JH: August Capital.

SM: That s surprising and in challenging timesJH: I think the nanny payroll idea was funded by some angels and re-funded after the model was polished. The first round of institutional funding was in late 2000, by August Capital. One of the things that was pretty impressive about this was that Rene is a pretty compelling guy, and he did a good job raising money at a very difficult time. He raised his first round in December 2000 and the second round in October 2002. He was on either side of the nuclear winter, and to fund anything that looked like this was very tough.

I knew these PayCycle guys were out there. I d watched them for a long time, partly because they worked for me, and partly because it was impressive that they were able to get that type of funding in the environment they were in. In the end, the thing that attracted the guys who funded this early on was not so much the buzz around SaaS as much as it was the recurring revenue model.

SM: Exactly, because SaaS was not a popular model back then. JH: Right. What attracted them was definitely the recurring revenue. They realized the size of the market, and the revenue stream, if Rene and his team were able to execute.

SM: Okay, so August Capital funded Series B, and you came in after Series C? JH: Actually, I came in in 2005, after Doll Capital had done a Series D, adding another $9 million.

SM: How far along was the company when you arrived? JH: We had 60 70 people and about 13,000 customers.

SM: Pretty Solid. JH: It had revenue of $3.5 million the first year I was here.

SM: And how does PayCycle sell? JH: Direct marketing.

SM: There s no retail play this time? JH: We have a small partner that does some retail work, but it s a relatively small part of our business. There is an outfit called VersaCheck, which does check printing. We ve integrated with their solution, but that s a very small part of our business. We want to be where people want to buy it. There s some portion of people who will go explore retail, so you want to be there.

SM: Can you talk more about direct marketing? What s the flavor that works best for this type of business? JH: It s all a Web-based, on-demand business. We get customers three ways. First, from e-marketing paid and organic search. That accounts for about 33% of our customers.

We spend a lot of time focused on being on search engines.

SM: Yes, search engine marketing has become a very important piece of customer acquisition strategy. What is the second method? JH: Second,

> ***Small businesses will go to a trusted advisor to get advice on payroll because it s not an impulse purchase. They ll go to their accountant, so we ve focused a lot on CPAs, bookkeepers, and accountants of various types. You get to them by blanketing a half dozen trade magazines with articles and advertising, and you go to a bunch of trade shows.***

The IRS has some shows for accountants. We ve done a good job getting the word out to the accountant community, and that accounts for another 33% of our customer base.

The final way we find customers is through partners. We started historically with software partners. We cooperate and compete with Intuit in many ways. Originally, we did their online payroll for QuickBooks, but they ve since come out with their own version. We still do QuickBooks for Mac. We do Microsoft Money, their small business edition, and we do payroll for their product. We do payroll for a number of accountant software packages. Increasingly our attention is turning to financial institutions. We were pretty excited 18 months ago when we landed Bank of America.

SM: Financial institutions seem like a great distribution channel for small business payroll. JH:

> ***I think the distribution strategy is to be where people are likely to buy payroll. Be on the Web, be at retail, be at the accountant, and be at the banks.***

SM: How many customers now? JH: We just passed 50,000 customers this year, which is

pretty exciting.

SM: What does that translate to in terms of revenue? JH: Our brand of product is about $43 a month, or about $500 a year. It s equivalent to what you get from ADP or Paychex at about one-third of the cost.

SM: The fee is for all of the employees, no per-employee fee? JH: Exactly. We ve tried to make this as easy as possible; easy to use, easy to manage, easy to get support, and easy to buy. Part of what makes it easy to buy is in making it very simple to understand the cost. Normally you get a quote for a payroll period, so if you pay twice a month you ll pay double the quote every month. Ours is a flat monthly fee for up to five employees and a small fee once you pass that level. We don t charge you for W-2s or all of this add-on stuff.

SM: I ve used Paychex for the bulk of my entrepreneurial activities. Right now I m using all contractors. JH: That brings up another service. We have a great 1099 service, which you can use at the end of the year for a flat $40.

SM: You have 50,000 customers   where are you in terms of revenue? JH: If you do the math, it puts us in the mid-teens. That s up from $4 million when I got here in 2005.

SM: When you look at the 5.2 million employers, how do you feel you re positioned? How does that split between Intuit, ADP, and Paychex? JH: The traditional payroll players are ADP, Paychex, and a whole host of little ones. Together, they have about 800,000 small businesses signed up on their various services. ADP and Paychex are not really embracing the Web. Intuit is. We re a completely Web-based play.

SM: Out of 5.2 million small businesses, only 800,000 are using a software service for payroll? JH: It s under 16%   that s why this is such an attractive space. It s unpenetrated. All 5.2 million of those people have some solution, but our belief is that a lot of them are doing it manually, and they ll benefit greatly from a simple solution like ours.

We probably get 40% of our business from new employers. The rest are coming from all different places. They re just looking for a better way to do payroll.

SM: Is there any kind of vertical segmentation in this mix? JH: No, it s all over the map. There is no dominant industry or demographic. It s very fragmented, very consumer oriented. Every employer has reporting to do. There are some segments, such as distribution and manufacturing, which are not represented very well.

SM: I would expect retail to be very well represented. JH: Small stores are definitely well represented. Also, we have a lot of business with consultants, doctors, and so forth. In terms of segmentation, we ve spent a lot of time understanding the behavior of these people. The people who found us on the Web have been more technically savvy and are much more self-help.

SM: They re better customers for you. JH: Very much so. One of the challenges, quite frankly, as we go deeper into the mix is to continue to get smarter about how we provide support for people who are not as savvy.

SM: That s good insight to carry to the audience. I ve heard this about the GoToMeeting product as well that they have no vertical bias at all. They re also trying to focus on very small businesses and are finding no vertical alignment whatsoever. Switching topics you raised four rounds of financing.How much does that total? JH: I think to date that number is $38 million.

SM: And you re profitable in terms of your operations?JH: Yes, and there are still funds available in the bank. Just recently we demonstrated profitability.

SM: Do you think the financial institutions deals are going to accelerate revenue? JH: Absolutely.

SM: Do you think you can hit the $50 $60 million range in the next year? JH: It won t go that fast. We re in the $15 million range right now; that was for the fiscal year that ended in May 2008. I don t know if we ll be able to double on top of what we have because there s this big base to manage.

SM: If you had someone like American Express and you teamed with them, what could happen? JH: Even with big financial partners, our belief is, in order to make this a unique experience that s going to enhance their business and bring us a lot of customers, it has to bring something truly unique. It s not just a distribution deal. Something in the relationship with the partner has to be unique. We tend to do a fair amount of integration.

In the case of Bank of America, we ve gone deep into their small business online-banking application. We re at the point where we ve done two versions with them, and this is a much deeper level of integration. When you go into their online-banking application, you log in once with your credentials, and we re just a tab in their small business offering. It looks completely integrated to the user.

SM: Any thoughts about the various nuances of software-as-a-service? In recent years it has gone a bit berserk, but mostly in a good way. JH: It s like every other trend I ve seen, where everyone jumps on the bandwagon.

SM: Some unique businesses are being built, though. JH: Very true. On the other hand, everybody and their brother wants to call what they re doing SaaS. What s unique about our space, and what we re doing for very small businesses, is that we are, I believe, the leader in having the most customers for a SaaS product.

SM: What is synergistic to you? Is there something you might like to acquire? JH: I imagine we will think about those types of things. My thought, when I got here, was that we were too small to focus on acquisitions.

We are now getting to the scale where we can start thinking about additional products and services. I mentioned this 1099 service, which is a good example of something where we ve already achieved several thousand customers who ve signed on for an add-on service. That s important. The focus for the next three years is still on scaling this up to a couple hundred thousand customers. It s when you think of years three through six that you have to demonstrate add-on products and services, especially if you re positioning for financing or an IPO down the

road.

SM: This has been a really neat story thanks for your time.JH: My pleasure.

Brian Jacobs, Emergence Capital

Few of today s venture capitalists have ever assumed the substantial personal risks of entrepreneurship themselves. Even fewer have actually built successful companies. They re accustomed to posh Sand Hill Road offices, fat paychecks, and existing brands built long before they came on board. Theirs is an increasingly plug-and-play sport.

Most VCs also lack an investment thesis. They raise funds based on reputation, assuring their limited partners, Trust us, we know what we re doing. Of course they do they re selling the credibility of existing brands. In contrast, entrepreneurs cannot hope to gain the ear of VCs without an investment thesis. And, by definition, their brand is yet unheard of.

Brian Jacobs is one of the founders of Emergence Capital a relatively new fund that came into existence with not only a firm investment thesis, but quite a contrarian one at that.

SM: Give me some personal history, first, Brian. BJ: I ve been in the venture business for 20 years. I was initially an engineer working in the Valley before getting into the venture business in 1988 with Security Pacific Venture Capital. When they merged with Bank of America, I was recruited to be the third partner at St. Paul Venture Capital in Minnesota. I was there for 10 years, and I opened their Silicon Valley office in 1998. I was investing actively through the bubble period and into the bust. It was in 2002 that I felt it would make sense to launch out on my own and form a new venture capital firm.

SM: 2002 was an interesting time for the venture industry. BJ: It had experienced a whipsaw effect where the huge opportunities in the bubble caused the venture industry to expand. New firms were created, and the established firms expanded to the point where they were much larger than before. St. Paul grew significantly and gained a lot of access to capital through the insurance companies, which were our primary source of funding. We were encouraged to grow and take advantage of the opportunity.

I participated in that growth; I entered as the third partner, and by 2001 we had 12 partners.

When the industry started to collapse and the opportunities started to shrink dramatically, St. Paul and many other venture capital firms found themselves overextended. I think we re still seeing some of those effects today because a lot of established venture firms have had to re-trench, downsize, and in some cases have broken apart. A lot of venture firms were going through this soul- searching in 2002: What do we really want to do now that we ve seen unprecedented gains and then an unprecedented collapse in close succession?

As a partner at St. Paul, I was very much involved in those discussions, but I was getting frustrated that it was taking so long to figure things out. I saw a huge opportunity in Silicon Valley and recognized that my partnership couldn t take advantage of it they were consumed with the restructuring needed from the bust period.

SM: When you re talking about the restructuring, are you referring to large funds finding themselves with too much money? Unable to fund early-stage investments? Not finding enough

late-stage opportunities? BJ: Certainly, some of that. If you think back to 2002, about 20 funds had raised over $1 billion. We were one of them. Our largest fund was $1.3 billion, raised in 2000. At the time, we thought with the explosive growth we were seeing in the bubble it might be possible to invest $1 billion and return $10 billion.

By the time we hit 2002, it was very clear it would be extraordinarily difficult to invest $1 billion, let alone return $10 billion. The right size for a venture firm had to be dramatically smaller. If you were a firm with 12 partners, and at our peak we had over 90 portfolio companies, it was very difficult to change direction and go where we needed to be. I recognized that a quicker way to get well positioned for the new environment was to start something brand new rather than transform something grown for a different purpose, during a different era.

SM: Even so, 2002 was not a great time to start a new fund. BJ: No, it was a horrible time to do that!

SM: Tell me more about that experience. BJ: I knew a few VCs who had tried to raise a new fund in 2002, and most of them gave up. They concluded that the market was so bad there was no way they could succeed in raising a fund. The investors and venture funds were not interested after losing lots of money over the last few years. My partners and I thought very carefully before we decided to go fund-raising.

SM: Can you give me some background on your partners? How did you find them, and why did they share this crazy idea that in 2002, in the middle of nuclear winter, you ought to go out and look for funding? BJ: When I decided to explore raising a new fund, I obviously started talking to some of my contacts in the Valley. One of the first people I talked to was Jason Green, who was a partner at US Venture Partners. I had a lot of respect for Jason; we had worked in the marketplace, in cooperation and in competition with each other, during the previous five years. I knew we had similar ideas regarding identification of new venture opportunities.

We had both done a lot of investment in the services area. Specifically, we both looked at technology companies that were building service businesses versus product businesses. When Jason and I spoke, I was surprised to learn he was having similar ideas and had also come to the conclusion that a large venture fund was not well positioned for the future. We both agreed that services-based investing was so different from product investing that traditional venture firms had a hard time grasping the value.

Jason and I both had relationships throughout the Valley with individual partners who appreciated the model, but we had partnerships who were not fully supportive. Jason had also started conversations with an entrepreneur named Gordon Ritter, who had led some important service companies as an entrepreneur and was also thinking about investing in this category. So we coalesced together as a partnership and talked about whether or not we would work well together as a team. We spent about six months working together to test and see if we d be a good team, and we concluded we would.

SM: Let s delve into your investment thesis.BJ: Most of the technology industry has been based on companies inventing some technology and selling it to their customers. The customers buy technology and get value out of it by implementing it and automating a business process. In the late 90s, there was a flurry of acquisitions of technology by major companies trying to use technology for competitive advantage.

What a lot of companies experienced was difficulty extracting the value they believed they would get. It was very hard to actually use technology after it was purchased. Billions of dollars were spent integrating the technology to the specific uses of the customers, which also took a long time to do. By the time the technology was implemented, the requirements had often changed or the technology was obsolete. There was a lot of frustration among customers.

SM: There was a well-known piece of the services industry consulting services. But that s not what you have in mind when you say services. BJ: Correct. We re talking about technology companies that use their technology to provide a service, usually using a network to deliver that service. It s really the advent of networks that allows an automated service to exist. Without the Internet or mobile networks, you need people to travel to a customer site in order to provide value. With the advent of worldwide networks, you can have a small startup in Silicon Valley serving customers all around the globe. It s very cost-effective because the distribution of that service is now literally free.

SM: What did you call this model? BJ: We agonized over how to describe this, but we finally concluded the right term was technology-enabled services. They are service companies, but they re not labor-based service companies they re technology-enabled service companies.

SM: What type of investor did you pursue, and what was the reception of your thesis? BJ: Before we started fund-raising, I mentioned that we spent months making sure we had the right fit amongst our team. We knew if we didn t believe 100% in ourselves, then investors wouldn t either. Before we started raising money, we concluded that one of the only ways to test our partnership and how well we would make decisions together was to make actual investments and they had to be real investments. So we pooled some of our personal money and made some investments. The first we made was in Salesforce.com. We negotiated the deal in December of 2002, and the deal closed the first week of January 2003.

SM: What stage was Salesforce.com at? BJ: They were a private company; they had grown nicely and were in the $40 $50 million revenue range. We knew some of the executives there through Gordon Ritter s relationship with Mark Benioff, and we negotiated to buy some shares at $1.67 per share. Today it s about $55.

SM: What were the other companies on your radar? BJ: There were a handful of companies that were typically formed in the bubble but had survived when many others failed. What we found was a lot of the companies that failed were these technology product companies that couldn t get anyone to buy their product after the bust.

The service companies had advantages in down economic times. It s not a big capital expenditure; it doesn t take a long time to implement; and companies can try it first.

We d invested in a number of these companies and had a few others we pointed investors to. WebEx was already doing well, and they were one of the few other companies we pointed to as successes.

We also included some of the consumer services in our category of technology-enabled services. Many of the companies that failed in the bust were either content companies or e-

commerce companies. We were more supportive of companies that had subscription business models or transaction-based business models.

SM: Can you give some examples of companies using these subscription or transaction models? BJ: EBay and Travelocity are two. These are companies providing a service over the Web, but they re getting paid for the service. That was critical to us.

SM: You had a bias towards subscription service versus advertising, which at that point hadn t yet ramped up.BJ: Exactly.

SM: What happened next? How did the market respond? BJ:

> ***We concluded we were so passionate about this opportunity that we were going to raise money even when others were unable to.***

We started fund-raising in late Q1 of 2003. While we were doing all of this preparation, there were a lot of things going on in the world that we weren t really planning on. I believe we were invading Iraq in March 2003. This was not in our playbook, but we had already committed to making the fund a success. We had left our jobs, had made these investments, and there was no turning back. Initially, the reception was modest at best.

SM: Can you talk about specific people and funds you went after and what the target fund amount was? BJ: Our first target was $100 million. We used our contacts to meet people who invest in venture funds. Typically, they re university endowments, funds of funds, pension funds, and insurance companies.

We wanted to go after the best investors in venture capital. There were a bunch of European pension funds which hadn t traditionally invested in venture capital and had just started funding US venture firms, but they didn t have a track record of supporting firms through decades. If you talk to people who have founded other venture firms like Kleiner Perkins, Sequoia, or Benchmark, most often they were initially funded by Yale, Princeton, and Stanford. These endowments have very long-term horizons. They re prepared to invest for decades. By establishing a base like that, we felt we would have the wherewithal to grow Emergence to an industry leader.

SM: How did they receive your investment thesis? BJ: Like I said, there was a flurry of new venture fund formations in the bubble, but most of them didn t do well, and by 2002 and 2003 there was little appetite for a new fund. But we wouldn t take no for an answer, and we kept coming back and explaining more and more why this thesis was different and why it would be successful. While we were fund-raising, Salesforce.com continued to grow and continued to get higher and higher visibility. It went public in the summer of 2004, around the time we closed our fund. It took us a year to raise the fund, and we stuck to it until we were able to raise $125 million, which was more than our target.

SM: What happened after you closed the fund   did the thesis check out? BJ: Salesforce.com went public as we were closing our first fund, and that proved to be a home run for Emergence. We d made a good bet and delivered a very significant return   we were able to

tout that to investors and entrepreneurs. What we discovered was the theme we had chosen was very much taking hold. The term software-as-a-service began to emerge as a new software company model following the Salesforce.com approach.

Initially we weren t well known, but we did get some press through our Salesforce.com investment, and a lot of entrepreneurs who were starting SaaS companies really wanted to partner with Salesforce.com and learn from their experiences building that type of company. That helped us because many of them wanted to work with the venture firm that had helped Salesforce.com.

SM: The fact you were involved in Salesforce.com was well known in the entrepreneur community? BJ: Even in 2004 and 2005, there was a significant contingency in the software industry that did not believe in the software-as-a-service model. The conventional thought was that it was a fad, not a big thing. There were only one or two conferences that had a focus around SaaS. Emergence was naturally drawn to those and naturally asked to speak at those conferences.

The first one was sponsored by the SD Forum down in Santa Clara. They weren t even sure if there would be enough people showing up to have a conference, yet when we showed up, there were lines outside the center. It was standing room only. There was pent-up demand for SaaS. Naturally, we were featured on a lot of the panels, and we were able to spread our message.

SM: What was going on in the rest of the venture industry? Did other VCs start to position themselves around this? BJ: For a few years we saw limited activity from other venture firms, yet there was still a lot of investment. There was typically one partner in each firm who had invested in services and understood some of the opportunities we were seeing. We continued to partner with these individuals.

SM: Would you name some? BJ: Sure. People like Bob Spinner at Sigma, Tom Blaisdell at DCM, and Kevin Efrusy at Accel.

> ***SM: What strikes me is that most of the top-tier VC portfolios do not have a significant amount of SaaS. BJ: Part of the dynamic of what caused us to want to form Emergence is that a large venture fund needs to be diversified. It would be very difficult for a large venture fund with $1 billion to invest in one sector only.***

When you re managing a pool of that scale, you typically diversify and invest across sectors. You have partners with expertise in communications, healthcare, and so forth. Typically, there are one or two software people in each firm. Those particular partners that are following the trends in software are great, but they re outnumbered in their firm when compared to Emergence, which is 100% focused on software.

SM: The surprising part of the story, and one of the reasons I decided to cover it, is that I haven t seen too many major trends in our industry that all of the VCs didn t run after. VCs are like lemmings; everybody runs after the same trends. But it seems that from 2004 to 2007, people missed the SaaS wave chasing Web 2.0. BJ: I think that is part of it. I also think that software is a product. Software-as-a-service is a service. If you look at every other category of investment in the venture business, they re products. Communications systems, semiconductors, biopharmaceuticals, and software are all products. The knowledge that exists in venture firms is how to build a product company quickly. It doesn t apply to service businesses.

It s very different.

SM: What is different between the two, in your opinion? BJ: First of all, the people you hire in a service business are different than in a product business.

A product business is transactional. You sell something, you get the money, and the relationship is over. A service business is about serving 24/7.

SM: You have to secure the renewal. BJ: Exactly. It only makes sense if the person comes back for more. We know from experience that people who have been successful in product businesses are generally not successful in the service business.

SM: To be fair, large software deals are also reliant on customer satisfaction. Though they haven t always been. Siebel is notorious for selling products that were never implemented. But by the time we got to the mature software industry, people realized they had to help customers derive value from their products. BJ: I m not saying there isn t value in products. It s simply a different mentality. We see this all around the Valley at the end of the quarter. What are you going to do to get the deal? You re going to discount; you re going to make promises; and you re going to try to force a sale. That s not the way service businesses sell. They have to create win-win. You have to have trust in your provider. In a product business, as long as you get the product, you don t really care what happens to the business after.

The revenue trajectory of a service business is very different it s laying out recurring revenue streams. You have to value these companies differently. You develop the technology differently. You compensate the salespeople differently. You have different bankers to talk to about going public. These are very different animals.

The challenge that Jason and I felt in our former firms was that we would bring a good, strong service business to the partners, but the other partners were inherently product people. That s true of most firms. We have great respect for other SaaS investors, but we know their partners do not have the same appreciation for the realities of building a service business. It s harder to create a strong SaaS practice when you don t have the support of all of your partners.

SM: Tell me about some of the deals you ve done since coming into existence what s unique about them?

BJ: Since we started Emergence, we ve had three IPOs. That s pretty good for a young firm.

Obviously Salesforce.com was one. Then we invested in a software provider in the human resources space called SuccessFactors, who went public in November of 2007.

We also invested in a company called HireRight, which provides pre-employment background screening as a service. This isn t a pure software company. It s a technology-enabled process outsourcer. They don t really provide their customers with an application, but they outsource an entire business process, and that process is heavily automated within HireRight, so they are competing with traditional labor-based services. They went public in August of 2007.

We ve also invested in numerous SaaS companies that are still private today, such as Intaact in the accounting space, Genius in the marketing automation space, Pivot Link in the online business intelligence space, Ketera in the procurement space, and several others.

SM: Your investment thesis continues to be SaaS, or technology-enabled service. How long do you think this will last? BJ: We think this is a very long-term trend. Service businesses have been around since the beginning of economic activity on the planet, and we don t think they re going away anytime soon. The core decision any customer must make is if they want to buy technology, and if they do, they must own it and maintain it to ensure it continues to deliver value to them.

Their alternative is technology-enabled service, partnering with a company that will provide them the technology they need. In that case the provider s role is to continue to upgrade it, maintain it, and ensure it s delivering value.

> ***In many companies there isn t a core competency around making their technology systems work. A retailer typically has a core competency around merchandising and marketing, not around running IT systems. We believe that in most markets the majority will choose to outsource some functions.***

SM: In many ways the comparable is BPO. BJ: We think SaaS is a form of outsourcing. It s outsourcing the management of an application. As I mentioned, HireRight is an example where they ve written a software application that does this function. The users are not folks sitting in the client corporation, but are instead internal and know how to use the software to deliver the end result to the customer. In many ways the BPO is a larger value proposition than SaaS, though there are tradeoffs. Typically, the margins are lower in a BPO, and of course we re looking at those BPOs that have technology leverage. Their margins are supported by their use of technology.

SM: An example is when InsideView acquired TrueAdvantage and then laid off 150 people who were doing the same thing manually. My thesis is the Indian BPO industry is very much at risk because of the SaaS trend, and if they don t get their act together and respond to that trend, they re going to get punished.BJ: I think that s true, but we also see the opportunity for an Indian outsourcing firm to subscribe to a SaaS application and enable their BPO.

SM: Absolutely. BJ: They can use their labor component to provide a complete outsourced business process.

> ***SM: The issue resides in the numbers game. There s a lot of fat in the Indian BPO industry because they don t use technology effectively. BJ: There are going to be natural forces that force them to embrace technology.***

SM: Is there anything I should have asked but didn t?BJ: One thing that I think might be interesting to your readers is that while we use this umbrella term technology-enabled services, there are three or four different categories of these services worth explaining.

I ve talked about SaaS and technology-enabled business process outsourcing. The other two categories are consumer services and information services. Our investment model applies to the consumer side as well as to the commercial side. We regularly look at consumer investments as well. And as I already mentioned, we do have a preference for subscription or transaction-based revenue models versus advertising models because the advertising model is more of a media

service.

The last category is information services, and InsideView is a good example of this. The customers aren t buying an application; they re buying information they want, and of course there s new data collected every day. The amount of data is growing exponentially, creating new opportunities for startups who figure out ways to harness that data, including user-generated content, which can be very effective in collecting massive amounts of data.

SM: PayScale is a good example of that. BJ: Another is a company called Bill.com, which provides a bill-payment service. PayScale is an example of data that has been pulled together in a way that five years ago would have been impossible.

One of the interesting things is the blurry line between these categories. Many SaaS companies are collecting massive amounts of data. They store the customer data of their subscribers, and as those data stores grow, there is value in those databases that can be realized in additional revenue streams.

SM: Assuming the customers agree. BJ: There are privacy issues and licensing issues. Salesforce.com has more sales data on their servers than anywhere else on the planet. They don t have permission from their customers to use it in any other form, but we know of other SaaS companies already thinking about how they want to use this data eventually. They can provide it back to their customers in the form of benchmarking, best practices. There s value for the customer in allowing those uses. Information service companies are also recognizing applications they can provide to take advantage of the data they re already selling to their customers. The lines are blurring more and more between these categories.

SM: What s in your portfolio in those latter two categories? BJ: We mentioned InsideView as an information service. We also have a company called Krugle, which provides a search engine for software developers. Most software developers start with a base of code, often an open source project they download as the basis for a new project. It turns out that software developers often try to use Google to search code for pieces of libraries or snippets of code they want to use.

SM: It s a vertical search engine for software developers. What s the revenue model? Those typically use advertising. BJ: They have a public search engine that is advertising supported, but they also power the development communities of several large technology companies. So IBM and Yahoo! use Krugle as their search engine to support their developer community. They also sell an appliance that allows large corporations to search their internal spaces. That s on a subscription basis.

SM: It seems your investment thesis is also contrary to the fact that the Valley profoundly dislikes selling to small and medium businesses. BJ: That is correct, and that s one of the reasons we felt a new venture firm could address some of these issues in a way that an established venture firm could not.

There s no question that most VCs would state publicly that they hate selling to small and medium businesses.

Yet what we observed was the more natural path for services was to start with small and medium businesses. If you think about ADP, it s a technology-enabled business process outsourcer, and it started years ago. Initially, their value proposition was that large companies had bought mainframe computers and were automating their payroll, which small companies could not afford to do. Having a company that could buy a mainframe and sell it on a service basis to small and medium businesses, they could automate the business process to an underserved market.

When we looked at Salesforce.com, we saw a very similar phenomenon. They weren t selling to the largest companies at the time; they were selling to small and medium business. The service model allows service to companies that could not afford the old approach.

Think about the problem of selling to a Fortune 500 as a startup: If you have a product, you can go do a transaction with a large company where they buy the technology and are no longer dependent on the provider. With a service provider, that s not the case.

> ***I don t think Cisco or HP would outsource a critical business process to a startup if they were the first customer. You never crack that problem, although that is the regular approach for product companies. Service companies need to start with smaller companies who aren t going to hold the bar as high as a Fortune 500 company.***

As a service company builds a larger and larger base of customers, they become suitable to sell to larger companies. That s exactly what ADP did, and that s exactly what Salesforce.com has done, and we see that all the time in the SaaS market.

SM: You announced this million-dollar challenge for SaaS startups developing on Salesforce.com s Force.com platform. What are you seeing in response to that? BJ: We have a great relationship with Salesforce.com, and as you know their big initiative now is their Force.com platform, which allows developers to use the Salesforce infrastructure to write and deploy an application without reinventing the data center or development infrastructure that Salesforce has already developed and scaled.

This is a new way to build a company. It s riding on someone else s platform and relying on them to deliver it to customers over the Web. We think it s very exciting and a bit uncharted, but it very much fits into our focus area.

We re now taking registrations for the million-dollar challenge. Then at next November s DreamForce, we ll award a $1 million investment to the best Force.com application. This was announced in mid-January, and we already have approximately 50 applicants.

SM: Does that force companies that build on the Force.com platform towards an exit into Salesforce.com? BJ: I don t think we know the answer to that yet.

SM: I can t see Oracle buying something built on the Salesforce.com platform. BJ: As the platform evolves, we ll see if it is a truly open platform, where a competitor to Salesforce would feel comfortable buying. There are clearly some different camps on what the right platforms ought to be, but we regularly see companies being bought that are built on the .NET platform where there s a fundamental reliance on Microsoft.

Salesforce will face that same exact issue either they ll have an open platform and reinforce the confidence of developers to work on it, or their platform won t succeed to the same extent.

SM: This has been a very good discussion. Thanks for taking the time.

Brian Jacobs offers an excellent segue into the topic of bootstrapped cloud computing by bringing up the Force.com platform.

Several years ago I met Kirk Krappe, a long-time Silicon Valley guy, who was fed up with his experiences with VCs. As the CEO of contract management software company Nextance, Kirk had raised close to $50 million in venture capital before both he and the founders got completely diluted trying to navigate the dotcom bust in 2000.

Jaded, Kirk and one of the founders of Nextance decided to do a SaaS startup in the same domain, but this time without taking any venture capital. And this time built on the Force.com platform, using AppExchange for lead generation, a technique that both Ken Rudin and Umberto Milletti underscored as well.

Fast forward two years, and their new venture, Apptus, is pulling in close to $3 million in sales by offering the same functionality as Nextance, but cheaper, and as a SaaS.

The secret of a successful, cost-efficient SaaS venture, however, remains efficient customer acquisition. A strategy that I have started seeing as an effective mechanism for market penetration is to combine open source with SaaS. DimDim, discussed later, built an open source online collaboration platform and delivered it as a free, on-demand service. In fact, DimDim s free SaaS offering became so popular that not only were customers knocking on their door, VCs too came with checkbooks readied.

Sridhar Vembu, whose story you read in Volume One, has also effectively utilized the free open source strategy in bringing Zoho to market. VCs again came knocking, only to be turned away, checks uncashed.

Within Jim Heeger s customer acquisition strategy lies yet another extremely critical lesson: search engine marketing both pay-per-click and organic are important lead generation avenues for SaaS. Organic search, in fact, drives 88% of Web traffic, versus only 12% through sponsored ads. This makes organic SEO an essential pillar of cost-effective search marketing. But for SEO to be effective, you need to know exactly what you are selling and to whom.

These examples illustrate ways to intelligently deploy cash while building value and developing an early customer base.

With today s bear market climate, early stage financing will continue to be scarce. To get ventures off the ground, every technique of frugality will be called upon. Of these, building a product without breaking the bank and acquiring customers on a shoestring are the two that will determine success.

Avoid spray and pray; zero in with precision. Target, then shoot.

Collaboration

The year is 2020. A top researcher at a major drug company is on the brink of a breakthrough in cancer treatment. He is stymied, however, by one specific computational modeling challenge. He desperately wants to tap the expertise of the company s hundreds of researchers scattered around the world, all of whom are researching different computational biology questions. Specifically, he needs the small handful whose expertise are best aligned with his problem evolutionary biology. But he can t find them.

Close your eyes for a moment and try to solve his problem. Humanity s next great achievement victory over cancer is at stake.

Any answers?

Now, let me tell you about a small Palo Alto, California based company called Tacit, which creates expertise location solutions that could solve this problem easily, elegantly, and without a hitch.

Tacit s software, when installed in an enterprise, interacts with the e-mail system on every employee s desk, learning their expertise. No, it is not LinkedIn, where individuals feed in their resumes, announcing their expertise. Tacit s artificial intelligence algorithms work in the background, reading e-mail exchanges, noting whom you correspond with, how often, and on what topics. In this way, it creates a personalized profile of your areas of knowledge.

In our drug company example, the researcher s online collaboration environment (including, say, instant messages, WebEx exchanges, Skype conversations, video conferencing calls, and so on) has this sort of tacit knowledge built in. All it takes is a keystroke, and the researcher can draw up a list of the top five computational modeling researchers in his company, whether they re in Bucharest, Bangalore, Beijing, or Boston. Of these, the system can also recommend those with more specific expertise in areas such as cancer cell mutation in the evolutionary biology context.

This scenario uses, as its example, one technology that is already a fact, while the other is still some distance away: Tacit s expertise location technology is ready and waiting; humanity s answer to cancer is yet to be discovered.

A few years back, I did some strategy consulting for WebEx, one of the core companies to give enterprise collaboration a kick in the pants. WebEx was later acquired by Cisco as part of the latter s unified communication agenda. Innovation from the WebEx team has slowed, as it typically does after acquisition, but imagine how powerful it would be if WebEx combined this sort of expertise location with its capability model. And not only helped us collaborate, but also helped locate collaborators.

One of WebEx s big drawbacks has always been the fact that it required a client-side install, making for a cumbersome beginning. Enter Burlington, Massachusetts based DimDim, a next-generation service most succinctly described as WebEx 2.0.

DimDim offers richer media-handling abilities and a better real-time collaboration graph. Whereas WebEx needs a phone and a computer to complete the experience, DimDim has spread far and wide on the strength of its simplicity and comprehensive functionality, not to mention significantly lower price.

Another small San Francisco company, ON24, is taking WebEx on from another flank. ON24 has been running large-scale webinars, or online seminars, since 2003. It handled over 18,000 webinars on its technology platform in 2007, involving 1.4 million unique attendees. In 2008, the

company expects to handle over 25,000, with 1.8 million attendees. Customers include publishers who produce trade shows, as well as corporations who use webinars for lead generation and marketing programs.

The main difference between ON24 and competitors like WebEx and Citrix is in the size of the meetings. If you are trying to do something with 20 to 25 people, you re better off with one of them, says ON24 CEO, Sharat Sharan. But if you want to do an online webinar with hundreds and thousands of people, your best bet is ON24.

It s not just about cost savings: ON24 offers opportunities that aren t available in the physical world. Imagine attending a conference of 5,000 people. How do you figure out whom to meet of the thousands roaming the conference floor? And even if you do know your targets, how do you find them? Online, ON24 s platform can give you an attendee list and context on any specific person with the click of a mouse.

Still in its infancy, the company already boasts revenues in the $30 million range. Just the beginning, with a TAM in the billions. While corporations are much further along in adopting webinars, it will take time to educate conference organizers to move away from physical trade shows and to focus online.

According to the 2006 Meetings Marketing Report by the International Congress & Convention Association, corporations spend an average of $107 billion sending employees to conventions and meetings. The number of such meetings including groups and small seminars held around the world last year totaled 1,243,600, reports the ICCA.

The environmental waste involved in such meetings is unimaginable. According to the Environmental Protection Agency, each conference attendee typically consumes eight gallons of jet fuel, contributing 0.50 metric tons of CO2 to the atmosphere. The EPA also calculates that a typical convention-goer staying at a hotel generates about 20 pounds of trash per day compared with 4.6 pounds at home and is responsible for using 200 gallons of water a day.

The collaboration market is expected to reach $9 billion by 2009, which explains why we have so many players carving out different niches, building interesting angles of entry. Several of these companies will likely cross the $100 million revenue threshold by 2010, which means that in 2011 we should expect to see a series of initial public offerings in the collaboration-software market.

And in the process, I hope they kill the business trip, swinging the behavior of global business towards a cleaner, greener standard.

Sharat Sharan, ON24

In my consulting life, I have worked extensively with companies in the throes of repositioning. While the intellectual exercise of repositioning a business is exciting, the human aspects are nothing short of painful. Products not selling. Layoffs. Investors threatening to pull the plug. An environment of panic and distrust.

In this story, Sharat Sharan describes how a financial media company was successfully reincarnated as an online Web conferencing player.

Sound difficult? I would say it s a nearly impossible feat without gifted leadership at the company s helm, including its board of directors. Most often, when an investment thesis falters, boards start itching to pull the plug. But the repositioning of a business is not for those seeking instant gratification. It is a painstaking process, requiring block-by-block reengineering.

Such is the case of ON24, where in the wake of sinking complexity, Sharat has gone simple.

SM: Let s start with where you started, Sharat.SS: I grew up in New Delhi, India, and my dad was a senior military officer. We had a lot of change every two years as we moved from place to place. This taught me how to make new friends and how to adapt to survive, in a way.

I got my BS in electrical engineering and had an opportunity in 1984 to go to the best management school in India or go to the US for graduate studies in computer science. I decided to go to the US, where I got my master s degree in computer science from Virginia Tech.

After graduate school, around 1986, I started at Online Computer Systems, a software startup focused on CD-ROM-based systems. This was in the beginning of the information revolution, and Online Computer Systems was a leading player.

I then joined AT&T Labs at the height of the organization s prominence, focusing on telecommunications and wireless for five years. I was originally part of the technical staff at AT&T Bell Laboratories, and then I became product manager for AT&T s International Switching Business before I moved to business development at AT&T Wireless Systems. While working at AT&T, I earned my MBA from the University of Chicago in 1989.

I then joined Hearst New Media after Alfred Sikes, former FCC chairman, joined as president. This was around 1993 1994. At the time, Hearst New Media was forging interactive media before most people knew what interactive media was.

During my time with the organization, I was able to advance quickly to group vice president of Hearst New Media Group. I helped build some of the largest new media businesses, including Hearst Home Arts [now iVillage/NBC], Houston Chronicle Interactive, and Hearst New Media Center.

I was also responsible for the investment that Hearst made in Netscape and was an early advisory board member to the company.

By 1996, I was driven to start or join a startup company. As a senior-level executive with a large company, I was interested in building out a company from the early stages. I decided to relocate to Silicon Valley and start ON24 as a co-founder in 1998.

SM: Where did you get the idea for ON24? Did you have domain experience in the segment? SS: When I joined ON24 in 1998, we had two to three people. We were using streaming audio and video, but the business model had not been developed. I saw that as an opportunity because streaming was in its infancy, and I believed it could only grow.

In 1999 and 2000, we started ON24 as a financial multimedia venture, but we shut this portion down in 2001 after the dotcom bust. Since then, we ve grown to be a leading provider of webcasting and rich media solutions. We re in a very different business today than what we started with. Most of our team is new. The two co-founders left when we switched gears so dramatically. It was like starting a whole new venture based on our understanding of streaming video.

SM: In terms of competition, what was the market landscape like when you repositioned the company? SS: The competition wasn t in the number of companies, but rather the acceptance of steaming media within the marketplace.

> ***During the downturn in 2000 and 2001, our business model was challenged, but our original business enabled us to create a brand for ON24 within the financial services and technology worlds. We leveraged this brand as we started to migrate our business model in 2001.***

We see companies like WebEx and Citrix in deals, but they re fundamentally a meeting- or collaboration-oriented solution, against our inherently large online events-based positioning. If you re trying to do something with 20 25 people, you re better off with one of them. But if you want to do an online webinar with hundreds and thousands of people, your best bet is ON24.

SM: Describe the value proposition, including differentiation versus the rest of the market. SS: We re in a unique position as we provide a wide range of webcasting and rich media marketing solutions. Unlike Web conferencing, which is more for small collaborative meetings, our solution looks at holding online events for hundreds and thousands of people. Since launching our first product in 2002, we ve maintained a leadership position in this category.

> ***When I speak to our customers, they cite our scalable and reliable technology platform, ability to innovate, and outstanding professional services as reasons why they work with us.***

There may be companies that have components of our solutions, but from a comprehensive solutions offering and customer service level, this is what truly sets us apart from everyone else in the marketplace.

The other issue is that WebEx and other Web meeting providers have a large phone component in tackling audio. We deliver audio and video, both purely through the Internet. This is the only way we can support thousands of people in one session.

Most of our customers use ON24 for lead-generation webinars or online training type sessions. We do everything for these customers, from registration to tracking to lead scoring.

SM: How do you calculate TAM? And what is your business model? SS: When looking at adoption of broadband worldwide, combined with the need for global communications, the

TAM is large. Over the last few years, we ve seen webcasting emerge as a key tactic for corporate marketing initiatives and lead generation. And with the emergence of video, we ve seen even more customers wanting to add video to the mix. For us, how can you calculate this? There is no way to determine the possibility it could be in the billions!

Now, from a business model perspective, we re a hosted platform requiring no software downloads, plug-ins, or hardware installations. We take a top-level approach on how to provide companies with an end-to-end solution, including tools for pre-event promotion, event delivery, and post-event reporting and analytics.

SM: How do you charge? SS: Two ways. We have a hosted self-service solution, which costs about $60,000 and supports 25 30 events a year, each with 500 600 people. We also have a full-service solution, which includes professional services and costs 30% 35% more. Our ASPs vary from small pilots under $10,000 to hundreds or thousands, and in some cases, we have million-dollar deals.

SM: What are your top target segments? SS: We focus on six core industries: publishing, technology, life sciences, government, financial services, and continuing education.

SM: How did you penetrate those markets and get early traction? SS: After we got our first few reference customers Credit Suisse, Merrill Lynch through direct selling, we systematically put together various categories of partnerships. Some of these include your corner production shop that s doing a webinar video for Cisco, for example.

All these marketing and production shops, once they ve developed the content, need the infrastructure to actually deliver the webinars. This has been a very natural channel partner for us.

SM: What stage are you at now in terms of revenue, profitability, and traffic? SS: We re at a very good stage. We have more than 600 global organizations in publishing, technology, life sciences, government, and financial services that rely on us. These are large companies that have a need for our solutions, such as Business Objects, Cisco Systems, Hewlett-Packard, IBM, and more. We also work with 85% of the B-to-B publishing industry we re a platform of choice for them. By this, I mean publishers like CNet, Ziff Davis, Tech Target, and CMP Media each do hundreds of events with us.

Since refocusing the company in 2001 and 2002, we ve grown very rapidly. In October 2006, we were ranked No. 14 in Deloitte s 2006 Silicon Valley Fast 50. We were also ranked No. 252 on Deloitte s list of fastest growing companies in North America. Since being on the Deloitte & Touche list, we ve experienced 40% growth year over year.

We have about a 120 people, and we re slightly profitable with a revenue level of about $30 million. I m not trying to generate cash, so most of our profits go back into expansion at the moment.

This past year, we launched a new service called Insight24, which is a business-to-business rich media network. Since launching, Insight24 has grown to include over 5,000 rich media content pieces from more than 160 companies. And with Insight24 s growing syndication network, it reaches over eight million business and IT users on a monthly basis. We re very optimistic about the opportunities that Insight24 will bring, as well as the growth of our core

business.

> ***One thing we learned by being in this business is that large webcasters spend $25,000 to $30,000 developing content for their webinars. Of those who access these 70% do it live, and 25% 30% access these as on- demand, after one week. But beyond that, the $25,000 to $30,000 investment is pretty much wasted.***

So, in our Insight24 marketplace, we re trying to aggregate such content and make it available for syndication to various publishers who have relevant audience.

The business model is revenue sharing based on transfer of leads.

SM: How did you finance the different phases of the company? SS: We originally started as an online financial multimedia network, aggregating and syndicating financial multimedia. In the beginning, we had angel investors before receiving $30 million from venture capital firms. Since then, we ve used an additional $10 million. Our three venture capital investors are USVP, Canaan Partners, and Rho Ventures.

SM: What financing stage are you at right now? Will you be raising more money? SS: At this time, we re not planning to raise additional financing. This might change if we decide to make some acquisitions.

SM: Describe some of your team-building experiences. Is your management team complete? SS: Our management team is more or less complete. With that said, I m always looking to add one or two more people. From a people perspective, I m constantly looking at roles to fill in to support the growth of the company. At the moment, one key position that I m recruiting for is a VP of marketing.

You see, we made a transition during the downturn that 99% of companies failed to make. We had to do a complete overhaul of our team, business strategy, everything. Since then, at every stage, I ve tried to make changes that keep us staffed with the right kind of people for the level of growth and scale we re dealing with.

SM: What is your growth strategy? SS: We continue to explore growth opportunities that align with our vision of providing webcasting and rich media marketing solutions for a company s global communications needs in pre-event promotion, event delivery, and post-event reporting and analytics. This includes growing internationally with our offices in London and Beijing, which we recently opened. So far, 85% of our business has been in the US.

We re also developing new products and services that map back to our business model. For example, we saw an opportunity where companies were developing rich media assets for a specific campaign. Once the campaign was over, the companies moved on to the next campaign, but they still had all of this content. That s when we thought of Insight24. Through Insight24, we provided our customers and non-customers a way to extend these investments and increase ROI.

From a growth perspective, I believe it s important to have the right strategy and to execute against it. We always focus on the numbers and being able to produce against that. Whether it s with a new service like Insight24, or our continued expansion internationally, I see constant innovation and international business growth as a challenge and opportunity for us.

SM: What are some of your key learnings from this journey? SS: The journey has been very interesting. Many technology startups didn t survive the dotcom bust. We were able to weather the downturn and adapt to the environment. We adjusted the management team, adjusted the focus on applications, and with a bit of luck, we ve been able to flourish over the past few years.

Another important learning, which is part of Marketing 101 or Product 101, is how we, as a company, can develop close relationships with our customers. In a category like ours, in which people were initially concerned about the complexities of audio and video, we had to constantly listen to customers about the types of applications they wanted. Without knowing what they re thinking about, we can t adapt our offerings to support them.

For example, lead-generation webinars didn t exist. And now, nearly 50% of the webinars we host are for lead-generation purposes. New applications are always evolving.

We stay close to our customers to understand their needs and to develop new applications that address those needs.

In the end, the biggest learning is to keep adapting.

SM: Excellent! Thank you, Sharat.

D. D. Ganguly, DimDim

Once again, in DimDim, you ll find yet another strikingly simple positioning. D. D. Ganguly articulates several dimensions of differentiation against his major competitor, WebEx, taking on a major market opportunity in online collaboration.

Be it richer, be it simpler, be it faster, or cheaper, or better architected or be it all of the above the major brands are no longer invulnerable to new offerings.

SM: D. D., let s start at the beginning of your story. Where do you come from? DG: I grew up in Jamshedpur, a small town in Bihar, India. The one thing that amazed me growing up was that Bihar had, by far, the minimum per capita income in the entire country. There was rampant corruption. But in that state, Jamshedpur had the second-highest per capita income in the country.

SM: Because of steel? DG: Yes, because of Tata Steel and other companies in the Tata Group. What was very clear to me growing up, apart from the normal Bengali mentality that business was bad, was that people thought unless you re unethical you cannot make money in business. The problem that I saw was that here was a person, Jamshedji Tata, who was perfectly ethical, who had done great things, not only for the business he was creating but also for society. Unlike most of the Bengalis I knew, I was deeply influenced by the social impact of business. If I had grown up in Kolkata, I m sure my thinking in regards to business would be much different not so pro business.

SM: What you re talking about is an interesting ethnographic phenomenon. Being a Bengali entrepreneur myself, I know we re a rare species. Somehow there is a mental model among Bengalis that business is bad. But what was your family like? What views did they support? DG: Thoughts about going into business were not prevalent in my family. When I was very young, they must have thought I was just a little boy chattering who would eventually grow up and do the sensible thing.

When I was six or seven, I remember asking my father a question to which he replied, Men can do what men have done. That has stayed with me all these years. I really believed that if human beings had started businesses, there was no reason I couldn t go out and start a business.

I went to college and studied computer science at the Indian Institute of Technology. I came to the US to do my master s at Syracuse, where I was a fellow. But I studied more piano there than I did computer science. I did get a few papers published, but I clearly spent more time studying piano. I then went to Boston, where I worked for a Bengali entrepreneur. He ran a networking consulting company. I worked with him for four to five years, and he helped me start my first business. He helped not only in the form of angel financing, but also in providing emotional support.

I remember the first company we started was called Advanced Internet Management. It was the same founding team as DimDim. The second day he came in and told me that he hadn t

funded the company because he thought it would be successful; he d funded it because he liked me and wanted to help me out.

He wasn t trying to put me down or anything; he was just trying to keep me from stressing out.

> ***He also told me I would face three problems. First, I wouldn t be able to build the product I was trying to build. If by some stroke of luck I was able to do that, I wouldn t be able to get the first customer. If by some even stranger stroke of luck some idiot bought my product, I wouldn t be able to ramp the business. In very simple terms, he was talking about technology risk, go-to-market risk, and scaling risk.***

His help was tremendous in getting AIM started.

SM: Let me make sure I have the facts right. How long did you work for him in his networking consulting company? DG: I worked for him for four and half years.

SM: Then you decided to start your own company? DG: No, I went to work for a subsidiary of Dow Jones for about a year and a half. Then I was able to start AIM.

SM: What was the value proposition of AIM? DG: It was very simple, but there is a long story behind it. The simple version is that in e-business, downtime costs money. Our goal was to help minimize the downtime.

SM: And the Internet was in full swing by this time? DG: Exactly it was 1997. Those were the happy years; lots of VC money going around. We decided to take very little money and structure it as a debt, which we repaid from product revenues. When we sold the company to Computer Associates in 2001, we owned the entire thing ourselves. That worked out well.

SM: What did you do when the company was sold? Did you stay on and work for CA? DG: Yes, I stayed on and did some strategy stuff, and then moved to India to start their India technology center.

SM: What year was that? DG: That was back in 2003. I had never worked in India before, so it was a very interesting process. I grew that company from zero to 1,400 people in about a year. But that wasn t fast enough; we wanted to grow even faster.

SM: How did you absorb 1,400 people with any degree of coherence? DG: It was tiring. Just hiring that number of people with strict quality standards was a huge challenge. We had a huge interview panel of very good people who would go to various cities every week. We would have large classrooms of people take written tests. The tests were evaluated that same day, and those with scores high enough were then able to go through the interview panel the next day. That s how we ramped. It was definitely a huge operations challenge.

SM: Did your AIM team transition with you? DG: Yes. Most of us were engineers. Some of them later heard about DimDim and came to join us as well. Most of our engineers were from the IITs.

I d sent out an e-mail to my IIT network. People saw that e-mail and sent notes. That s how I built that team.

SM: That brings us to DimDim. DG: In 2005 I decided I was tired of the large company stuff and wanted to go out and do something else. It was the same team, Prakash Khot, Jayant Pandit, and me. We were looking at a bunch of different ideas. Our only requirement was that it had to be big.

We were collaborating using Hotmail and Skype, so we knew text-based collaboration was moving to rich media collaboration because we were doing it, tediously.

Hotmail was all about text-based, non-real-time collaboration. Skype provided real-time voice collaboration. Between Hotmail and Skype was chat, which was gaining popularity. But trends were definitely moving towards rich, real-time collaboration.

That s what s at the heart of DimDim. It s about democratizing rich media and real-time collaboration, and because we re democratizing that space, we selected two activities that aren t going to be replicated by the legacy players in the business. We re an open source company, and we provide a free-hosted offering, meaning SaaS.

SM: Your major competitive advantage is being a free platform as well as an open-source platform? DG: Yes. As you can imagine, Microsoft or WebEx Cisco are not going to become open-source or free-hosted solution companies anytime soon. Because of that, if you go to the Web today and do a search on DimDim, we have a higher number of hits than GoToMeeting. They spend more money on advertising, including TV advertising, yet we have more hits than they do. The blogosphere is really buzzing about DimDim.

SM: You have four primary competitors: GoToMeeting, WebEx Cisco, Microsoft Live Meeting, and Adobe Connect. Are there any others? DG: Those are the main ones. Our primary positioning against them is that we re a very rich Web-meeting environment.

SM: You do full video conferencing as well? DG: We provide audio and video in the product. It s all done in the browser, without any installations required on the recipient s side. That is key. There are three things that are unique about DimDim, which we ve verified by interacting with our customers and partners, with open-source communities, and with the free-hosted community.

First, it s about ease of use and usability. Second, it s about openness. And third, it s about portability.

H&R Block is a client of ours. The application they ve built using DimDim integrates their tax portal into a real-time environment. Think about the legacy H&R Block as the asynchronous Web going towards real-time Web with DimDim. That s what s happening. As a client of H&R Block, you can go to their Web site and see if your tax advisor is online. At that point, you can click to start a chat session. At any point after that, the advisor can, with the click of a button, show 1040 documents to the client. That s all happening without having to install any software.

We re both technologists; it doesn t matter to us if we have to install something on our computers. We go through the steps with ease. Regular users do not.

SM: I also think part of the problem with systems where you have to install a client is that the client-side applications typically have a lot of failures. Many client-side environments kick in, and then all types of things go wrong. DG: Ease of use is key. Openness is also key. It s not only about being an open-source company, but also about being an open-culture company.

When H&R Block came to us, they had already downloaded the software and used the documentation to build a prototype of what they were thinking about. They wanted further refinement. They wanted the enterprise version for reliability. An open culture also means that all of our engineers know about all of our customers issues through our forums. All of our customers and our prospective customers know about any issues with our software as well.

SM: Because you are so open, all of your customers and potential customers not only know about the benefits, but also potential drawbacks to your software. What has been the impact of such open policies? DG: If you look at a traditional software company, the customers are at the top of the funnel, and all of that information gets channeled to one product manager. Hopefully that guy is very wise and filters only the appropriate information. But there are many challenges to that model. In most software companies, the engineers drive the entire development process, and the voice of the product manager is often ignored.

In our scenario, the engineers see every single request coming from the customers. Marketing also sees the information coming from the customers. Because of that people can, as a group, identify trends in customer requests and determine what actions to take.

SM: You share customer feedback information openly, but there s still a process to put it together and facilitate the process, right? DG: Sure. We have a quarterly plan we go through where we establish what tasks will be accomplished during the quarter. But we manage it in a formal manner instead of with a single product manager.

Affordability is also a big key for us. If you think of an application for someone like H&R Block, there are going to be thousands of people coming in. They want a pricing model that s effective for them, so we enable that to happen.

We re also seeing people use peer-based social networking in a rich-media environment over DimDim. This is particularly popular in education models. People can discuss any subject over various media. That community found out about us because of the open-source nature of DimDim.

SM: Is there a constraint on how many people can simultaneously participate in this communication? DG: No. We have thousands of people in one room.

SM: Can you do video with thousands of people? DG: Video is reduced to four videos simultaneously.

SM: So you can have four skins at any one time? DG: Correct.

SM: This is really cool. I love the range of possibilities it opens up if you think about how many different and interesting applications you can build using DimDim as a platform. You talked about a few use cases above, but there s a lot more, especially in the domain of distance learning. Great entrepreneurship opportunities as well. DG: Indeed.

SM: You started building the product in 2005 when did you launch? DG: We launched the open-source version in September of 2006. The free-hosted version went into private beta in November of 2007, at Demo. We opened up the public beta two to three months ago.

SM: Can you touch on your funding strategy? DG: This has been very interesting. When we first started, our plan was actually to raise money in June of 2007. We accelerated this because VCs came to us after reading about us in some blogs. We spoke with them and closed a round.

SM: How much did you raise? DG: The first round we raised $2.4 million. This was from Index Ventures in London, Nexus Capital in California and Bombay, and Draper Richards. After the Demo launch, more VCs approached us. Our plan was to raise money in the third quarter of this year, but we closed a $6 million round a few months ago.

SM: What is your investment thesis? How does DimDim make money? DG: There are three different versions of DimDim available. One is DimDim3, which comes in an open-source edition and a free-hosted edition. Then there s DimDim Pro, which at $99 per year is priced to drastically undercut WebEx. Finally, DimDim Enterprise is the dedicated version, which actually has two versions, and it goes up from $1,500 per year, based on the number of users. It can be on the customer s premises or hosted in our data center. We make money from DimDim Pro and Enterprise.

SM: I understand your open-source go-to-market strategy, which is a viral spread, but what s your hypothesis on where DimDim Pro and Enterprise are going to gain traction? DG: All sales to date have been inbound inside sales.

SM: How big is your inside sales team? DG: Two people. It s completely amazing what they can do. Right now we re moving towards tracking yield per salesperson, so we track revenue per salesperson and divide by the total cost of the company. We re operating at 40x, and the recommendation we ve received is 2 3x.

SM: Have you noticed any pattern in the folks who are coming to you? DG: Yes. We see three different sets of people. First is education. Ohio State University is a big client. We just put up our customer page that lists all of the other universities. Harvard Medical School is also using DimDim.

SM: What s the education segment using it for? DG: One use case is teacher-led instruction, and the other is study groups. The goal of these institutions is to make education a lifelong process. Education from the university does not end after four years. If you studied at MIT, wouldn t it be great to extend your learning process whenever you wanted, or to reach back and be a teacher in the school? Those are the two use cases. Even when you re on campus, it s

good for alternative education.

SM: I love the education use case. There is amazing potential to build numerous applications and businesses both in higher education and K 12. What is the second market? DG: The second market is service providers. If you re an audio service provider, you want to increase your revenue per user, and our product is a natural extension for that. If you re an audio conferencing equipment manufacturer, and you provide a box for an audio switch, then you can sell another switch, a Web meeting box.

The third segment is less well defined. These are the large Fortune 500 organizations who want to take their internal collaboration to the next level. If you re hosting your own collaboration servers, you can do richer collaboration with our offerings.

SM: Where are your teams located? DG: We re distributed. They re all integrated teams. Engineering is in Boston. There are also a good number of folks in India.

SM: I presume your plan is to scale inside sales? DG: As we have gone ahead and hired salespeople, we ve looked for people who not only have the capability to do inside sales, but also people who can do field sales. Once an account goes to a site, there are certain accounts that need more touch. We know if we nurture those accounts, we ll be able to scale those businesses even more.

SM: What have you learned through your two ventures, especially DimDim, which is quite an ambitious project? DG: Learning throughout AIM was very steep. I realized on my second or third day that I didn t know anything about business at all. I started learning aggressively. I learned about negotiation, business valuation, and communication. I remember the first e-mail I wrote at AIM. When I had it reviewed, the entire e-mail was deleted and completely rewritten. I was a bit ashamed that I couldn t even put an e-mail together, so I started studying business writing. I learned so much at AIM.

At DimDim the learning has been more focused on working with professional investors, which has been a big change. There s also been some learning involved with running a larger organization on the scale of DimDim. But what I enjoy most is that I see a lot of people who aspire to be entrepreneurs, and they join DimDim because of that. I think it s great that we re able to attract people with that mindset.

SM: Are these entrepreneurs in India or here in the US? DG: Entrepreneurs in India. We have a couple of people here who also have aspirations to start their own businesses, but they re already pretty senior people. There s still some growth in them, but it s more subdued and doesn t happen in the leaps and bounds like it does with the younger folks. I see them grow, but the younger employees have huge jumps in their growth. Those jumps are very fulfilling to see and really add a dimension of satisfaction that I wasn t anticipating when I started all of this.

SM: And how is your piano playing? DG: I stopped a long time ago. Once I moved to Boston and started working, I tried to pick up the violin on the piano you cannot play Eastern classical music.

SM: Is Eastern classical what you used to play? DG: When I started it was Western

classical, which is when I realized that my heart was set on Eastern classical. That s when I tried to pick up the violin, but that is a very, very difficult instrument. You don t try to learn it at 22 or 24.

I do sing a little bit still. Not well, but I enjoy it.

SM: And I ve enjoyed this so much. It s delightful to meet a serious Bengali entrepreneur. We are a rare species. I wish you all the best, and congratulations on your success.

Content Publishing

Lost Talent Found Online

Technology has left no industry unchanged. From telecommunication to entertainment, news to transportation. Now comes book publishing s reinvention.

Archaic beyond belief, the industry treats its central asset the author like an unwanted houseguest. To no small house, either. The book market in the United States alone is estimated at $32 billion a year; the rest of the world, an additional $36 billion.

Plenty to go around, one would think. But with retailers taking almost 50%, and publishers getting squeezed it s cause for celebration if they make 20% the author is left nearly empty-handed.

On a book that costs $24.95, the author gets at most $1 to $1.50, says Eileen Gittins, chief executive of Blurb, an online print-on-demand publisher of photography books.

The first major technology-enabled change in the industry came when digital print-on-demand presses became affordable. Although printing on demand is 30% more expensive than offset printing, it doesn t have the minimum run requirements of 500 to 700 copies.

Self-publisher iUniverse, which uses a print-on-demand backend, gained legitimacy after Amy Fisher, the Long Island Lolita, used it to publish her memoir. When it hit the *New York Times* best-seller list, selling more than 34,000 copies, iUniverse was on the map.

However, for print-on-demand authors looking to gain serious readership, the big question remains unanswered: How to market and distribute their books.

Enter Amazon.com. Some surveys suggest that online booksellers could become the largest channel for book sales by 2009, and Amazon, the largest bookseller in the world, is certainly the 800-pound gorilla in that market. To understand why, you have to look at the technology that powers Amazon s Web site. Yes, Amazon offers the best prices, but what really keeps customers coming back is the outstanding user experience. This personalized experience was made possible by Amazon s acquisition of a small technology company, Junglee, in 1998. Junglee, which powers Amazon s now-famous recommendation system, uses a technology called collaborative filtering to figure out what additional books people will like. It s a fantastic way to market and merchandise with contextual and personalized offers that have a direct impact on the promotion of a particular book. Through years of consolidated data on its loyal customer base, Amazon consistently produces great recommendations. Quasi-irresistible recommendations. And we reward them with our wallets.

Several recent moves shine some light on where Amazon s ambitions may lie. In 2005, it acquired the print-on-demand company BookSurge and Mobipocket.com, an e-book software company. In November 2007, it launched the e-book reader Kindle, which Citigroup analyst Mark Mahaney called Amazon s iPod. And in April 2009, seeking to strengthen its presence on Apple s iPhone and iPod Touch, Amazon acquired Lexcycle, the company behind Stanza, an e-book reader.

Amazon now stands poised to revolutionize the book business through vertical integration. The numbers: assuming that Amazon already pockets 50% of the retail price of a book, it could directly engage with authors, bypassing the middlemen the agents and publishers and suddenly, 30% 40% of the pie is freed up. In this brave new world, Amazon becomes retailer, marketer, publisher and agent, pocketing 60% of the revenues while offering an enormous 40% to the author a far better, fairer world, says this author.

Amazon recently announced what could be viewed as its first step in this direction, requiring all print-on-demand publishers to use its BookSurge service for books sold on Amazon. Over the next few years, Amazon will likely use its attractive market position to build direct relationships with authors while publishers and agents are forced to reposition themselves in this new ecosystem.

And this is not limited to books alone. All across the creative domain music, film, games opportunities lie in wait for talented content producers to access a readership, an audience, using Amazon and other such direct channels like Shutterfly, PlayFirst, Blurb, iTunes, and of course, the Web itself.

For the longest time, creative professionals like writers, photographers, filmmakers, and musicians have been at the mercy of the editors and owners of significant and prestigious media properties like the *New Yorker*, the *Wall Street Journal*, *Fortune*, *Forbes*, *Business Week*, the *Economist*, MTV, HBO, ABC, and more. But a handful of magazines, studios, and TV channels cannot begin to support and lend a voice to the enormous creative spirit that exists in this world.

Today, a new era of democratic electronic media publishing is announced by millions of voices an hour. Democratic new media publishing is the name that I give to all user-generated electronic content being published on the Internet today. Twittered, blogged, podcasted anything and everything at the click of a post-and-publish tab. The nerds have, in effect, set free the artists in droves. Now it is only a matter of time before the artists understand this small gift and its enormous potential.

Kevin Weiss, iUniverse

Kevin Weiss compares the current state of the print-on-demand publishing business to the pre-IBM era in personal computing. Once IBM came in, the industry was legitimized. Personal computers entered the home, the business, and today the café, the train, the everywhere.

Kevin runs a very simple business: a print-on-demand self-publishing service for authors. But what s fascinating about this discussion is how an industry outsider like himself sees opportunities to change the industry, pioneer new, win-win models, and eventually give voice to an increasing number of authors.

SM: Let s start with your background   before the business.KW: I grew up in the northeastern part of the United States and went to Princeton University. After graduation, I went to Manhattan and worked for IBM. I spent approximately 17 years with IBM in a variety of jobs, mostly on the sales side. I did go into corporate strategy for a while, then software, which took me to Austin, Texas.

In 1995 an opportunity came up to work for an enterprise software company called BMC Software. BMC had just come off a good growth year at over $400 million. I stayed there five years, and when I left, we had finished our fiscal year at $1.75 billion. It wasn t because of me, but I was happy to be part of such an incredible growth story.

SM: How did you get introduced to Author Solutions? KW: Bertram Capital, one of our investors, was started by Jeff and Ken Drazan. Jeff and I went to college together. AuthorHouse, which was the largest self-publishing company in the world, was their first acquisition. They followed that up with the acquisition of iUniverse.

Jeff called and asked if I would be interested in helping with this company they just bought. Eventually he asked me if I would be willing to take over, which I wasn t sure about because I didn t know anything about publishing. He said I d know what I needed to after six months!

Sometimes things just feel right, and this did. The publishing industry was flat, had been doing business the same way for a long time. Then I saw Author Solutions was posting 20% growth by doing things I thought were unique. It was a huge opportunity, and I felt we could be disruptive without knocking the boat over. So I took over as CEO in December of 2007.

SM: We should establish some context for iUniverse, Author Solutions, and your portfolio of companies. What is the history between iUniverse and Author Solutions, and how did Bertram Capital get involved? KW: AuthorHouse is a company that was founded 10 years ago in Bloomington, Indiana, and iUniverse is a company founded eight years ago in Lincoln, Nebraska. AuthorHouse was likely the first company to create Internet-based solutions targeting new publishing models.

SM: You re talking about self-publishing, correct? KW: Correct. Interestingly enough, iUniverse established a similar business in Lincoln shortly after AuthorHouse. It was established a bit differently and had a more advanced platform. The founder wanted to use production services out of Shanghai, so he established a production services group there and had day-to-day

operations headquartered in Lincoln.

Bertram formed Author Solutions and bought AuthorHouse. They then wanted to roll up the second-largest player into their portfolio. Accordingly, they bought iUniverse which, when combined with AuthorHouse, gives Author Solutions enough resources to concentrate on organic growth from here on out.

Those two brands have been responsible for over 80,000 titles, by 50,000 authors, over the past 10 years. They ve been responsible for over 10,000,000 books sold, predominately in the US. Last year alone, Author Solutions was responsible for one out of every 17 books in distribution in the US and was responsible for one out of every 12 books sold.

SM: Is it all print-on-demand? What s the Shanghai operation doing? KW: The Shanghai operation focuses on design services that you would see in any publishing operation.

As our name implies, we deliver solutions for authors. We try to deliver solutions that allow people to go from the left, which I call free, to the right, which I call very expensive. Basically, we give authors the ability to do business anywhere, anytime, and any way. We re heavily focused on customer satisfaction.

> ***We have an offering called Wordclay, which is a do-it-yourself solution that allows authors to submit their manuscripts and publish free. I m 100% serious when I say publish free; they don t pay a penny.***

The only things they buy are their books. We launched the product in January of 2008. By the end of April, we had approximately 20,000 registered users, 4,000 manuscripts in process, and 400 500 live titles.

I m not sure how long we want it to survive as a standalone brand, but I do know that the platform is one we ll bring to market as an OEM play. We issued a press release at BookExpo America, where we announced 11 partnerships. We ll have over 30 by the end of June and 100 by the end of the year. These are deals where we completely re-skin the Wordclay application for a partner; it could be John Jones Publishing s online platform. We supply the power and intellectual capital for the application, and they supply the users. Our partners can use that platform, jettison out of the platform, or even buy it as a service.

SM: Your plan is to enable all types of publishers to have an online service? KW: Not the publishers, the small printers. Printers could use this as a front end to what they re doing. Communities like Writers.net or Gather.com could make use of that as well. What we re doing is giving people an opportunity to monetize what they have.

The publishing industry, outside the large trade publishers, is actually quite good. There are more than 1,000 qualified publishers outside the US. Some of these publishers have a real art and skill regarding certain genres. They ll do 12 to 20 books a year. Now they don t have $1.5 million to create a high-value solution, but we come along and provide such technology.

SM: Wordclay is only one of your services, yes? KW: We re a full-service publishing company. We do everything that s required to create a quality book. We have a portfolio of editorial services, custom cover and back design, ghostwriters, marketing for authors, and more.

SM: What is your competitive landscape like? KW: In the self-publishing world, we re the

largest company. One competitor is BookSurge, and another is Lulu. Those two are companies to be reckoned with. Lulu is terrific. We do a little bit of what they re doing, but we don t brand. They ve done an incredible job of branding who they are. Nobody knows Author Solutions.

SM: People do know iUniverse that s a strong brand. KW: Some people know Wordclay, but I m not going to spend millions branding it. I would just as soon focus on printers and publishers.

SM: You gave me a lot of impressive numbers how do BookSurge and Lulu stack up? KW: Nobody goes public with those numbers. We ve taken a look using surrogates. For example, we go to Amazon and do an analysis of titles published by Lulu and BookSurge. BookSurge is significantly smaller than we are. In 2008, we ll publish 17,000 20,000 titles and do somewhere in the neighborhood of three million books.

SM: Is Lulu between you and BookSurge? KW: Lulu is bigger than BookSurge, no doubt about it. I bet in 2008 Lulu will do 1.5 1.8 million books sold. That s a good size, and they re a good force. They do a lot of other things as well.

SM: How big do you think the self-publishing, or publish-on-demand (POD), market is? KW: McMillen, Random House, and HarperCollins have all asked that question. My answer is that it s as big as anything else out there. There could be as many as a million manuscripts sitting around waiting to be published; people are simply unaware that POD exists.

At a dinner party with 12 people around the table, I would guess that no more than two would understand how to publish a book if a major house has turned them down. I think this is similar to when IBM got into the PC business. There were established companies like Compaq and Tandy, but when IBM came in, they put their stamp of approval on the PC market. We re in a similar situation, waiting for a large publishing house to get into this space. I believe that will happen sometime soon, and once it does, the market will explode.

SM: Do you think they ll take their existing deal flow and channel it through soft-publishing channels? KW: They may do that. You re also going to see them actually get into this business. The core business I m in can run at about 14% 17% EBIDA. Traditional publishers can t get there.

SM: What are the traditional publishers P&L? How are you disrupting that business model with 14% 17% EBIDA? KW: I don t disrupt their model. In fact, I don t want to play in their space. Traditional publishing is like a VC portfolio. Major houses may publish 2,500 books a year, but after about 250 books, they begin to lose their shirt. They have to pick the winners in a space to be successful. They advance royalties, and their entire business model is based on volume sales, which is particularly difficult in a soft economy.

We make money on the very first copy. We make money on the services to put together a world-class book. That s the reason major publishers are going to have to get into this industry, whether they want to or not, because they have to do a little more on their portfolio management.

I ve never encountered a business that had so many leads come in just to get kicked to the curb. People submit manuscripts to publishers on a regular basis, and it s amazing how they re discarded.

SM: From a writer s perspective, your model creates an interesting opportunity. If I self-publish and sell a significant number of copies, I could bring my book to a major publisher and tell them I have a proven product on a defined scale. KW: You have something that is working, and they know it. The major houses know what you re selling. There are systems out there that track what s going on with ISBNs, and they ll come and find you and try to sell you on the idea that they can do a better job than you can.

SM: Is that what you see with the titles you talked about earlier that have sold 30,000 50,000 copies? KW: Some of them. We just had several authors get picked up. This year we ve had three cases so far. Elle Newmark wrote *Bones of the Dead,* which was a Premier Plus, Publisher s Choice 2007 award winner purchased by Developmental Editing. Lisa Genova was signed by Select, after writing *Still Alice*. Finally, Terry Fallis was signed by McClelland & Stewart, after writing *The Best Laid Plans*. These deals were very substantial, and we re extremely happy for the authors.

SM: Where do you see most of your writers? Is there a particular genre or segment? KW: We cut across every single genre.

SM: In terms of marketing if you re an author without an existing platform, how do you market your book outside of friends and family? KW: That s the biggest complaint that writers have. We ll launch something focused on author marketing by the end of the year. It is not easy you have to really invest the time.

A lot of people think they just need to get listed on Amazon, but it s definitely not that simple.

There are more people writing today than reading. So we ve created tools and tips for authors. What we re doing now is creating templates. Authors can find some for different genres on Wordclay. If they want to write a story of their life, there s a template to help. The more we encourage people to write, the better we re all going to be. We re not going to satisfy our investment community if we get people to write in a free offering and the writer sells just one book. I want to use the template approach because it s good for everybody.

SM: What s your strategy with regards to India s huge reader market?KW: India is a challenge from a distribution perspective. I ve seen how they sell books in India, and I don t know how to get to the guy who lays out 300 books on a street corner.

We are in advanced talks with a publisher in India to OEM Wordclay and re-skin the entire application for them. We re going to use them as our entrance to the market and penetrate that market with partnerships.

SM: Let s change gears to your financial story where are you in terms of profitability? KW: We ve spent an enormous amount of money getting this do-it-yourself publishing platform

implemented this year. And we are in the midst of a multi-million-dollar investment in core technology to build the world s most state-of-the-art publishing solution. We re doing it on Salesforce.com, built on Force.com. That will go live in July. Those two things have put us behind the eight ball in terms of profitability.

SM: What are you trying to do with the Salesforce platform? KW: We re using it as the workflow engine to create an entire infrastructure system that will allow book publishing in an automated way. The ability to move a piece of work from manuscript submission to final piece with all the interface points of editorial, design, review, and use of Internet-based technology this is all being built on Salesforce technology.

I would do it again the same way, although perhaps not as fast. We re way out on the edge here in terms of what we re doing. But Salesforce has terrific technology. For us, it creates a platform. I m not going to buy every self-publisher out there. However, because I have the lowest cost of delivering services in the US, I ll start offering my services to competitors. This will help them remain competitive, and I m fine with that. There is a cap to how much any of us are going to be able to charge. Services will never be high margin. I just need to make sure we have a fair profit for the industry. So we use the Salesforce platform to remove costs on backend infrastructure, and instead we spend money on people who can spend their time helping and interfacing with authors.

SM: Will your publishers be paying a fee to gain access to the service? KW: Yes, they ll pay a fee to use the service. In this business, if you don t have critical mass, it s really hard to drive customer satisfaction and get costs in line. We have 20,000 books this year. We are able to provide critical mass.

> ***Small publishers do not have critical mass, but what they do have is enormous skill in specific genres and market segments. That leads to a natural partnership, which facilitates increased business for both sides.***

If you believe the market is infinite, and I do, then I don t have a problem playing with everybody.

SM: What is your revenue level like right now? KW: We should cross the $50 million mark this year. We ll have single-digit profitability nothing I m excited about.

SM: It doesn t have to be hugely profitable right away. KW: If I m running a business, I have to get ourselves profitable so we can show the mainstream publishers this is something they should be in. That s why I have a target range of 14% 17% for operating margin. Then I can show mainstream publishers that they need to be in this business. They don t have to spend money attracting customers, because our model can do that. It could provide them with 10,000 15,000 new manuscripts a year.

SM: I think your biggest issue is to educate the market. Your service is excellent for authors. Rather than spending their time chasing down an agent, they can go directly to you and secure enough of a market to attract publishers. KW: You never know what you re going to get when you sign with an agent. Many authors don t understand that. We spend a lot of time

with our authors. The good news for us is that over 90% of our authors say they would do this again. You can ask them how they felt when they opened the package with their book inside; they all say it s great. The key is how they feel about it 90 days later I want that mark to be 100% as well.

SM: If you can crack the code on how to market the book, then you ll really get traction with authors. That s the big problem, because there s so much noise in the market. Most authors don t know how to segment their market or build a marketing strategy. But the Internet has made it possible to do great niche marketing. KW: I would agree with you. Absolutely. We re working hard to tackle the marketing problem. It s not an easy one to tackle. We have some solutions available today, and we re working hard to bring new ones to the market soon.

SM: What have I missed? KW: We haven t talked about our overseas facility yet. I recently did a press conference with the governor of Indiana, where I announced the closure of our Shanghai facility. We re moving that work to Bloomington. I know we can be more cost-effective having those folks here. We can also do a much better job working with authors one-on-one. The authors never talk directly to anyone in Shanghai. Now they ll have the ability to talk directly with our team. And that entire team will be working together. I want galley design to talk to the publishing services associate who works with customers on a day-to-day basis.

We did the same thing back in January when we moved the iUniverse brand from Lincoln to Bloomington. We ve had no issues whatsoever hiring college-educated, talented people. This year we ve hired 130 people in Bloomington alone. We re just a tad shy of 400 employees in the company.

SM: When you shut down Shanghai and move that workforce to Bloomington, how many people are you talking about? KW: We re going to hire approximately 30 people. We continue to expand, not just because of consolidations, but because we have the ability to grow organically.

SM: What is your take on Amazon s announcement about their print-on-demand publisher network, where the printing is done organically? KW: Amazon is doing what s best for their business. They re extracting a fair amount of profit from the supply chain. They re going to be able to print everything they need to print, when they need to print it. The thing that s lost on everybody is that what they re really doing is cutting out Ingram. I don t know how many print-on-demand books they sell at Amazon every year, but when you look at what happens at University Press of America, it s fairly substantial. I don t know what it truly meant to them, but it could have represented $10 $15 million in margins.

> ***SM: The opportunity Amazon has by doing this kind of vertical integration is actually quite substantial. KW: I keep telling the mainstream publishing industry they need to wake up. Some major author is going to say they re going direct with Amazon. What is it Amazon keeps 65%, and the author keeps 35%? Amazon will make more, and the author will definitely make more.***

SM: All these agents, publishers, and intermediaries are going to get cut. And suddenly

authors may actually claim some of the fruits of their labor. KW: A handful of authors make a lot of money, and the rest make hardly any. Take the *Harry Potter*s out of the industry, and it s really not all that attractive for one to be involved in.

I think Amazon must be careful, too. Choice is an important thing. If they eventually freeze the market to the point where there s no choice for people, the results will be negative. I m all for making money I think it s very important but if they change the industry to the point where nobody else can be in publishing, then I think that would be very bad.

But I also think mainstream authors need to think through the model they ve followed in the past. There are lots of sharp, talented people like you who have something to say. If we can find a cost-effective way for authors to do that, perhaps it will make more people read.

SM: I hope so we all have our fingers crossed.

While iUniverse focuses on traditional publishing, the world of photo books, prints, and photo merchandising is yet another bourgeoning market where companies like Blurb and Shutterfly are staking claim.

To be fair, online photo, though young, is already a hugely crowded industry. But one where Jeff Housenbold has separated Shutterfly from the pack through water-tight segmentation.

SM: Jeff, let s start with your personal background. JH: I grew up in Brooklyn, lived in New Jersey, Philadelphia, Boston, New York, Washington DC, and now out here in San Francisco.

SM: Why so many locations? JH: Mostly in New York and New Jersey as a child. Later I was a strategy consultant, and my wife worked at Bain as well, so we switched cities frequently. Then the Internet boom started, and I graduated Harvard Business School. I went into strategy consulting in the entertainment and media space and co-founded the media strategy practice at Accenture.

SM: Based out of New York? JH: Yes. A lot of my clients were traditional media companies and publishers, and they were still trying to figure out the CD-ROM world and this new thing called the Internet. How they should transform their traditional business to this new medium. I quickly became the firm s Internet guru, and that led to my eventually leaving consulting and joining Winstar.

SM: What year are we talking about? JH: That was in 1998. I became the head of corporate development for Winstar to build out their media platform. It was the largest competitive local exchange carrier. They wanted to create not just the pipes, but the content as well. We went out and bought a number of TV programs, radio programs, and film distribution channels, and we had the largest private DVD distribution company in the country. We had nine different Best Pictures in our portfolio, and then we started buying, building, and investing in online companies. We got involved in everything from moms online to PGA tour sites. They were early incarnations of Web properties.

SM: What happened after that? JH: CMGI called, and I went to be the COO of Raging Bull, the leading finance portal. We competed with Motley Fool, Silicon Investor, and Yahoo! Finance.

Eventually we sold it to AltaVista, who in turn sold it to Lycos, and they merged it into Quote.com. It s still part of the Lycos family, now owned by Telefonica. When I became the COO, Raging Bull had seven employees and was founded by three 20-year-old kids who d dropped out of college to give it their all.

SM: Were you still based in New York? JH: At this point I was in Andover, Massachusetts, at the CMGI headquarters. We grew the company from 7 to about 85 people. We had more than

five million unique visitors and billions of page views each month, all talking about online financial information.

SM: Had advertising revenues kicked in at that point? JH: Advertising was working, but it was more in the form of lead generation. All of the online brokers were just starting out. Fidelity was online, DLJ Direct as well, and they were paying us lead generation for opening up brokerage accounts. It was certain forms of sponsorships, which were working, and we were also selling banner advertising.

> ***We had over 100 columnists working freelance for us, from Forbes, Fortune, Business Week, and Industry Standard. They liked writing for us because in their traditional media world they couldn t interact with their readers.***

Today there are blogs, but back then they were able to write for us either under their name or under a pseudonym and interact with their readers instead of just one-way publishing. We were very successful in getting a lot of content on the site without having to build up an editorial staff.

SM: What was the timeframe of this work with Raging Bull? JH: This was in the 1998 1999 timeframe. We then raised a $20 million round with CNet, and CMGI put in money, and we started doing some television on CNet TV. We had a financial hour and hired some on-air talent. It was a really interesting time. We sold the company to AltaVista for $250 million they were the last portal that had filed to go public.

I ran Raging Bull for a while after the buyout, and then the CEO asked me to move out and run mergers and acquisitions and business development. We then reorganized, and he asked me to become the general manager. I had everything but ad sales and engineering, so about 600 people, about a $380 million P&L. I had marketing, business development, product development, program management, the editorial staff, and Web site design for all of AltaVista. This was a time when we had about 48% of the search market, and Google had less than 2%. Then the bust happened, and I did four rounds of layoffs, which equated to about 400 employees. Then I received a call from eBay, so I went and joined eBay.

SM: What did you do at eBay? JH: I started out running mergers and acquisitions, and then I conceived and started the business-to-consumer group, which was all about getting large companies to sell on eBay, versus mom and pops. I signed up Dell, Wal-Mart, Lexmark, KitchenAid, and Home Depot.

Since the economy was in a downturn, they had a lot of excess inventory and were selling it on eBay. I took this business unit from $0 to $70 million in 10 months. Meg Whitman then asked me to run customer acquisition and retention. I did that and grew that team from six people and about $30 million to over 150 people and close to a $400 million budget on a worldwide basis. It s the largest online advertiser today. I did the first deal with Google I was Google s very first AdWords customer in the world.

SM: EBay is the largest Google customer, right? JH: They re in the top three. It really depends on the month. Expedia is up there, as is another travel company. In that role, I also did a $150 million AOL deal, a deal with Microsoft, and Yahoo!. I was at eBay during the hyper-growth stage where over four years we went from $450 million to about $5 billion in revenue.

SM: What year was that? JH: That was January 2005, and I wasn t looking for a new job. I had been at eBay for almost four years.

SM: Why the interest in Shutterfly? JH: I was my high school and college yearbook photographer, and my wife and I spent $1900 on Shutterfly the year before I joined. I was a big customer and had been using it for five years.

> ***The headhunter I had been using to find the CEO of a board I was sitting on called me and asked for some names for the Shutterfly job. He called back a few weeks later and said the names were great, but he wondered if I was interested.***

I told him no thanks, I was happy at eBay. He convinced me to go have breakfast with Jim Clark. Jim had founded Silicon Graphics, Netscape, and WebMD. We had breakfast, and it turned into lunch, which then turned into dinner with other board members. An offer followed a couple days later, and after a couple weeks of diligence, I accepted on Christmas Eve and started in January 2005.

SM: Before we move on with your Shutterfly story, can you shift gears for a second and tell us the history of Shutterfly? JH: Shutterfly was founded in 1999 by two employees of Silicon Graphics Eva Manolis and Dan Baum. Eva was a product person, and Dan was a technology person. They teamed up and asked Jim Clark to fund it, which he did.

SM: What was their initial vision for Shutterfly? JH: The vision at the time was that people were starting to buy these new things called digital cameras, but their pictures were stuck in them. They created a site that allowed people to get their pictures out of the camera, literally. Their early adopters where white men, technophiles, spending $2,000 for a 1 2 megapixel camera. That was in 1999. They started programming in April, and the site launched on December 11, 1999.

The same day we launched, oFoto launched, and four months later Snapfish launched. It was an interesting time. It was still mostly a film world as there were very few adopters of digital cameras, and it was all about how to get a 4×6 print out of a camera.

Shutterfly hired a woman, Jayne Spiegelman, who was the CMO at Good Guys and the head merchant at Macy s. She came in as the CEO and grew the company to close to 300 people. She raised $60 million and went through it in the first year doing a big deal with Yahoo!, a portal deal with AOL, and spending on online advertising, all of which was common in 1999 because people were going out and getting real estate deals to be on the portals. When the bubble burst, they brought in a turnaround CEO, Andy Wood, and he came in and slashed headcount down to 70 and got the company to roughly break even.

SM: What was going on in terms of numbers, metrics, and traffic? With $60 million, how much traffic and revenue did she manage to generate? JH: Back then a lot of the portal deals were great for the portals, but not for the people paying for that anchor tenancy. The business was on fire, but it was on a small base. Adopters were sharing digital photos electronically. Instead of sending an attachment in e-mail, we took the high-resolution image, put it on the server, and sent a link that pointed back to the site, which was unique at the time.

> ***They burned through the cash and were literally standing on Friday counting the number of orders they were getting to see if they had enough money to make payroll.***

SM: It takes a lot of money to pay 70 people. JH: It is a lot. Keep in mind, though, that more than half of those were in manufacturing hourly workers, running machines, versus software engineers, costing over $100,000. The board then hired Dave Bagshaw as interim CEO. He stepped in and ran the company for a little over a year, while they did the search and found me. The year before I joined, we did $54 million in revenue. We were slightly profitable in 2003 and 2004. The board felt that user adoption was becoming mainstream, and there was a real asset in Shutterfly. Jim Clark was a real believer in the space and the company.

SM: Let s talk about the landscape when you took over. What were your initial challenges and objectives? JH:

> ***The challenge was, when I walked in, we were largely undifferentiated from the competition; it was all about 4×6 prints and price. We weren t helping people do more with their images and memories. We fell much more along the old paradigm: drop off a roll of film, develop prints, and place them in clear sleeves for users to put in a binder on a bookshelf.***

I brought a different perspective and said, My wife and I use Shutterfly to stay connected in this dual-income, geographically-fragmented, time-compressed society where we have friends and family all over the world. I thought of it as a social connection, a way to share life s memories with friends and family.

The other part was that we were very early adopters of digital presses. The benefit of digital presses is that in the old printing world you would have to run large volume to amortize the setup costs. On digital it s all variable. Every unit that comes off is different, making it great for variable short runs. So it helped tremendously that we were early adopters of digital presses.

> ***SM: Your vision was to move beyond the traditional print model and become the center of a lifestyle. JH: I also saw us as building a personal publishing platform.***

Yes, we have consumers doing all the beautiful cards, books, and calendars, but we also have lots of small businesses, charities, schools, nonprofits, jewelry manufacturers, real estate agents, cosmetic dentists, rock stars sending books to fan clubs, and former presidents using it for their charities. It truly is a personal publishing platform.

SM: How big are these orders? What kind of ASP and volume? JH: Books range from $30 to $200 a typical consumer might order between one and five. One of the famous Grammy-winning rock stars just sent 8,000 to her fan club 8,000 times $30 is a nice order. It s a nascent, organically growing part of our business.

It s a lot like when I was at eBay people started selling cars in the Diecast Collectible category. We could not figure out who would buy a car without kicking the tires, but we watched and six months later eBay Motors was created, which did billions of dollars in gross merchandise sales this year.

So we re watching and starting to incubate. We re trying to help personal publishing. We ve struck deals in the scrapbooking arena where people are moving away from physical

scrapbooking and moving into digital scrapbooking, where they can start and stop easily, work collaboratively, create and edit, and have multiple copies. That s a vertical we re going after.

> ***We have children s authors who don t need to get an agent and go to New York. We have poets doing poetry books. The use cases our community is coming up with have inspired us.***

SM: The self-publishing aspect is comparable to what Blurb is doing. JH: Yes, Lulu and Blurb are in that space. When I think about our stack of core competencies, our real point of differentiation is that we ve built a great Web front-end user experience and a great backend manufacturing experience. Our online photo-sharing competitors don t own manufacturing. We have an incredible just-in-time variable print-on-demand capability.

In between those two, we re gluing it together with our brand, and we want to be the premium brand. For example, Snapfish has come out and said, We want to be the Wal-Mart of the industry we re all about price. Instead, we ve said we want to be the Nordstrom, where we have a higher service level, and we don t offer every product under the sun, but we have a great capability to help our customers select their designs. We have higher white-glove service and customer care, and better quality.

Kodak is stuck in the middle as Macy s some departments are nice, where others are more value-oriented. They re trying to span a broader target demographic, where we re trying to go after the profitable 40% 60% of the market and to my knowledge Kodak and Snapfish have never been profitable.

SM: With your brand, you re going to be able to target horizontally across a wide range of lucrative verticals. JH: Exactly.

> ***We re going after the $31 billion digital photo industry, the $7.5 billion greeting card industry, and the $7 $8 billion stationery market where you do wedding invitations and baby announcements. We re going after the $6 $7 billion calendar business, as there are 500 million calendars sold in the US each year. And we re going after the $1 billion photo-based merchandise business, which includes mugs and mouse pads.***

We re able to take our assets horizontally across those in a much more efficient way, incubating more businesses. Some of these businesses and institutions preschools and private schools don t have a huge staff to build traditional yearbooks, so they re using us.

Youth sports and youth activities are another big vertical. At the end of the soccer season, they re making a yearbook as a gift to the coach. And moms and dads are giving them to grandma.

I get asked a lot, How do you compete against the Flickrs and the Facebooks? The answer is that we re not trying to! We see a set of concentric circles, and your interactivity and sphere of influence and targeted relationships can be viewed in that model. It starts with yourself, expands to immediate family and closest friends, and then to a broader group of associates.

If our children play on the same soccer team and you re taking game pictures, then we can have interactive, shared memories.

> ***SM: You re focusing on personal memories and experiences. JH: Exactly things which are near and dear. And we ve always been a password-protected environment. I***

am not going to put the pictures of my three young boys across Flickr for everyone to see.

SM: Nobody cares anyways. JH: No, they don t. My son scoring a goal is interesting to him, his grandparents, and me, and that s about it. We ve always been about a closer sphere of influence, about shared memories, things that are near and dear.

We re extending that into shared experiences in a couple of ways. We recently bought Nexo, which was kind of a Web 2.0 startup that competed with Yahoo! Groups. What differentiated them was that the two founders are great technologists; this is the fourth company they ve founded together. They were using Yahoo! Groups and found it limiting. Essentially, it was an e-mail list server, and they realized their kids were in all of these activities, and they wanted to be able to set up a Web site quickly and get everyone to use it without having to answer technical questions. They ended up as kind of a technology in search of a business model beyond Google AdWords.

We had launched Shutterfly Collections about three years ago, so we were a business model looking for the next generation platform; it was a perfect marriage. For my kids soccer team, I could set up, with a couple clicks of the mouse, a team soccer page. I could go grab a calendar module so the coach could put practice and game times. I could pull a roster so people know the kids numbers, what positions they play, and how many goals they ve scored. And I could go grab a poll to use for things like where to do the team picnic.

What the two founders of Nexo did was they made it both a Web-based environment and an e-mail based environment. You get an e-mail with a poll, and it auto-updates on the Web sites. We re now extending the notion of Shutterfly from being a closed environment and a one-to-one service, to being a group environment, so you can make collaborative creations like photo books.

SM: You have some other initiatives in that area as well. JH: A week ago we launched Shutterfly Gallery. What we found in talking to our customers was that they love our designs, they love our form factors and content, but a lot of people say they re not that creative.

It s like cooking. A lot of people aren t imaginative enough to come up with a new recipe, but they can make a beautiful meal with an existing recipe. The gallery lets users post their photo books for the community to view.

Say I ve just come back from a trip. I can go to the gallery, click on Travel, type in tag word family vacation, and it s placed by location. Others can then come in and see that I just came back from a vacation in Italy. The community can rate on a five-star basis, can read my profile, see what inspired me, and why I chose the 12×12. Then they can just click a button that says, Make one like this, and it will keep the templates, formats, fonts, and designs while all my pictures get sucked out.

The business benefits for Shutterfly are that making a photo book takes some time. Some people do it in a half hour, and others make it a labor of love, taking four or five hours. It s much less than the 150 hours my wife spends doing traditional scrapbooking. The templates not only increase velocity, but they decrease the creativity required. Not everyone is a creative genius, but they want to produce nice looking books.

SM: What are your margins on the photo book business? JH: We don t disclose margins, specifically. What we report to Wall Street are prints, which are all prints from wallet size to

20×30, as well as personalized products and services that s how cards, calendars, and photo books are counted. What we have said is that they re in a fairly narrow range next to each other. There is a misconception that prints are not a profitable business. We not only own our manufacturing and have the lowest costs in the entire industry, but we have the highest prices because of our quality.

SM: Is manufacturing here in the US? JH: It is. We have one facility in Hayward, California, and another in Charlotte, North Carolina. Between the two we have 175,000 square feet of manufacturing and about 50% of our 470 employees in those manufacturing facilities. We have the lowest costs and the highest price because we re the premium brand with the best quality and the best return policies.

SM: You can t be in the other businesses without the print business.JH: That s right, it s the cash cow. We re using that to fund the innovation on the personal-publishing side. But we don t break out the margins, specifically.

SM: Why not? JH: Mostly for competitive reasons at this stage. We have said that our gross margins have been 54% 56% over the past several years, and the range is 40% 60% so everything falls into the mean. There are a couple of products out of the spectrum, but for the most part they re close to the mean. As we continue to evolve and expand, we will, over time, give more visibility to Wall Street, but since we re the only company that is public Snapfish is buried inside HP, oFoto is buried inside Kodak, Flickr inside Yahoo!, and Wal-Mart and Target don t break theirs out so for competitive reasons we try not to give away any of our secrets.

SM: You re taking these children s book authors, poets, and so forth, and offering them a self-publishing option, but how do they market and distribute their books? Are you offering anything to facilitate that? JH: Today, we don t offer a marketplace for them on Shutterfly. They tend to have a Web site and use guerilla marketing and local craft shows, downtown Menlo Park, the streets of Manhattan they re going to 4H clubs and local bookstores, creating their own advertising.

SM: The marketing is their responsibility. JH: Marketing is up to them today.

SM: Do you have a distribution relationship with Amazon? If I publish my book on Shutterfly, can you distribute it on Amazon? JH: You can. But we don t facilitate it through APIs. What we did when we launched galleries is we allowed you to take that About Me page and that flash animated flipping of the book, and you can take that snippet and put it on Facebook, Amazon, or your own personal blog. We ve now created a forum where you can publish outward and simply embed it in a lot of other places. We partner with Amazon, Buy.com, Target, P&G, Columbia Sportswear, and lots of different partners. You can imagine doing a deal with travel sites, allowing people to post their travel photographs.

SM: Travel is a context that has great relevance for your business. JH: We think about that opportunity a lot. What s nice about our business is our customers engage with us frequently throughout the year. We drive our business in a couple of ways. First, you have your typical holidays. You have Valentine s Day, Easter, Mother s Day, Father s Day, and then larger

holidays focused on gift giving, like Halloween and Christmas and Hanukah, with an emphasis on photo books and holiday cards. Secondly, there are life events that happen all throughout the year. People have babies, weddings, Sweet 16s, lots of different events. Then there are everyday moments that become life s memories. For example, your baby s first steps, the family vacation, personal achievements, and celebrations. We re fortunate that memories happen in lots of ways.

> ***What we re doing through our business development efforts is finding partners in each of those respective verticals, who have the same focus on customer, innovation, design, and quality.***

In retail, our partner became Target; 75% of our customers are female, 25 50 years old, college educated, brand conscious, and brand loyal. They don t care about technology other than how it makes life easier and faster. Target was the perfect partner.

SM: How is your Target relationship doing? JH: It s doing well, and that s what their brand has stood for: females, design, and customer-centricity. The Target relationship has four or five dimensions. The first is for our customers we offer broader choice for the occasions where they need a picture in an hour or same day. They can order prints on Shutterfly and pick them up at Target. The second is we enable the Target.com photo site. All of their customers get the power, benefits, and innovation of Shutterfly. The third thing is a co-marketing relationship. Target is doing a number of things for us in the photo center you ll see Shutterfly branding in pamphlets and signage on the walls, increasing awareness of all the things you can do with your memories. Target has also included us in their freestanding circular, which goes out to more than 50 million households. We also do e-mails back and forth through our respective opt-in customer base, and we sell pre-paid cards that come in gift boxes.

SM: Has that been a big customer acquisition driver? JH: What s interesting about our business is that 72% of our customers come directly to Shutterfly.com. When you look at the totality of our relationships from Target, Amazon, Google, and Yahoo!, none of them account for a very large amount of our new customers, but in total these relationships are an important way to drive awareness and sales.

> ***A key element to our retail strategy is the ability to translate a virtual company into a physical product.***

For example, you can touch and feel our books in-store to see our amazing quality. For us in the early stages it s about awareness, not about how we drive a ton of commerce through retail.

When you look at the total available market, there are 113 million households, of which 58 million have a digital camera and Internet connectivity. And that number is rising. Only 6% of that 58 million have purchased a photo book, card, or calendar to date. Will it ever be 100%? No, but imagine when it goes from 6% to 60%, and we re the market leader as the premium brand, driving the market.

Our biggest competitive challenge is simply awareness that you can do these things with your images. Partners like Target, Sony, and Amazon are really about building awareness and getting trial. Our marketing machine then takes over, and we up-sell and cross-sell through our product assortment and merchandising capabilities.

Our focus has been on how to build a platform so it would be efficient for others to plug in and partner with us. A good set of APIs will allow us to partner more effectively with other sites. You can then plug into a vertical add network and let them distribute our online advertising more effectively, based on the contextual relevance of the content. We focus on storytelling: you can tell your story about surfing; you can tell your story about your vacation; you can tell your story about your kid s first steps. We re really thinking about platforms and leverage across everything we do.

SM: Why didn t Flickr elect to work with you? JH: At the time, we were competing with Yahoo! Photos, and Flickr chose a small company who had signed up a number of sites who in the early days thought they were competing with Shutterfly. But they don t have the same scale or quality we have. My understanding is that the sell-through on any of these sites is less than a few million dollars. Many players have tried to play in our space, but they have trouble making it a business. Yahoo! Photos shut down with 100 million accounts and $4 million in revenue. Sony, which is a great company with regard to quality and design, didn t have the brand in the services and photos space. Best Buy has tried, AOL has tried, but all with limited success. There have been over 1,000 venture-backed companies who have moved into the photo-sharing space and failed. The venture-backed small companies tend to create features or functionality, but not companies. They may have a cool slide show with neat graphics, but they haven t monetized.

SM: It s clear that monetization in the photo vertical is either in hosting, like Flickr, or in print and photo merchandising. I ve always said Yahoo! should buy Shutterfly. JH: Deconstruct that even further. If you look at PhotoBucket, they had $6 million in revenue for photo hosting, and my belief is that hosting over time becomes a commoditized product. At eBay we used to have IPix host the photos, and we were paying them all this money. Then we just spent a little money, built a team internally, and were able to do it ourselves.

SM: That s definitely going to be a commodity market. The interesting thing is that Flickr is a very nice photo-sharing service, community wise. JH: If you look at the Forrester report, and I may have these numbers slightly off, but they said something like 0.8% or 1% of all Flickr users generate 99% of the content. Flickr is more like YouTube a few people publish, a lot of people view, and it s an advertising-based model. When Flickr was out of money and they couldn t make payroll and they started shopping themselves around, Yahoo! was the exact right buyer. They re an ad network, and they created a viewership model not dissimilar to radio and television, overlaying the power of all the Yahoo! users and its ad network on top of that model.

SM: With all these other names in the mix, can we look a little deeper into what differentiates Shutterfly? JH: There are some small guys creating features or functionality, but it s much more complex.

> ***We re the only site that doesn t down-sample and compress your images. With others if you upload too many images, they shrink the images to thumbnail resolution, so you lose the quality.***

Facebook is another example of a company that did a lot less printing than you d think it s only thumbnail resolution.

We think there s great opportunity for us because we have the cheapest storage in the industry, much cheaper than Amazon s S3. And our secret sauce in this area allows us to hold the high-resolution image. We also don t force delete, whereas our competitors will delete your memories if you don t come back and spend a certain amount of money in a certain timeframe. We ve always had this customer-centric approach, where it s not about photos or this month s revenue, it s about a lifelong relationship.

I have 93,000 photos. I m probably an anomaly today, but roll the clock forward five years from now, and you ll probably have 93,000 photos and 1,000 video clips. What brand are you going to trust to hold your memories? It s going to be the one that has never deleted them, never forced you to sign in or register.

Your hard drive might crash, your house might catch fire, and if something like that happened, your memories are safe with us.

SM: It s not just that, it s the friends-and-family sharing you talk about. I wouldn t put that type of thing on Flickr. I use Flickr for the public display of pictures, but that s a very select set out of the Shutterfly set. JH: When I look at the business models in this space, you have the hosting guys and a lot of other startups doing mash-ups and sharing, but they re not making money. Then you have people like Sony and Yahoo! who can t make money in the printing space because it s not their core competence or focus. Then you have the CNets, which should have been MySpace and Facebook with their Webshots asset. And the traditional companies, like Kodak and Fuji, who have a mentality that they sell chemicals, ink, and film. That s what HP is doing with Snapfish. They ve said publicly that they want to sell more ink. What we ve said is that we want to build a deep personal relationship with our customers in a place where they trust us with life s memories. Howard Schultz has built a great business with coffee where people said it was only a commodity, where people said consumers would not pay more. IPods are not the best MP3 players, but the user experience is great. We re building a premium lifestyle brand in the vein of Starbucks, Nike, or Apple.

SM: In terms of this culture, are you looking to bring others under the umbrella? Partnerships with companies like Groople or Slide.com? JH: Again, Slide down-samples and compresses the images, so it s hard to actually produce e-commerce from it, and they want to hold onto the images in their database instead of passing them on. However, I think there could be a mutually beneficial relationship between the two companies where we each focus on our strengths.

We ve seen the first wave of consolidation with Kodak buying oFoto and Snapfish selling to HP. In 2007 you saw the second wave of consolidation. PhotoWorks sold, Yahoo! and Sony exited, and Disney-backed PhotoTLC went bankrupt.

I think the next wave of consolidation will occur when these companies start to realize there s an inherent cost of storage and that people want to do more than just look at images on a screen. They re going to start looking at companies they can partner with, best of breed, and we ve built a brand of trust and are not owned by a big company. We also have a monetizable model where we can share revenue back with these partners. We re seeing that now with our 48 active business development deals. When I joined, we didn t even have a business development team.

SM: How do you see CafePress or the Zazzle-type model? JH: I know those guys well. With CafePress, Fred and I are friends. I see them as an adjacent market. We re not competing

head-to-head, primarily because their business is less about memories and more about T-shirts. I would venture to guess that more than 70% 80% of their revenue comes from their T-shirt business. Their demographic tends to be more evenly split male/female. And they seem to be younger a lot of the T-shirts they re producing are politically or humor oriented.

SM: Zazzle and CafePress are not going after personal memories or families. JH: Not in the same sense. It s personal publishing. They use different backend technology. From an e-commerce standpoint, there are a lot of similarities. We advertise online, run an e-commerce company, own our manufacturing and supply chain, and provide customer service. But it s an adjacent market. The question is, do we start moving more towards the middle, and is there an opportunity to partner or acquire some of those assets in the marketplace? It s an area we watch, but not one we think of as overly competitive.

SM: Do you see much churn in your customer base? JH: I ve been here three years, so 12 quarters; 75% 77% of our revenue in each of those quarters is from repeat customers. That s a really good testament to the loyalty of our customers.

> ***I get asked a lot about what we re doing to steal Kodak and Snapfish customers, but the reality is that I m not trying to steal their customers. We only have 6% market penetration as an industry, so I m worried about the other 94%, and then the 40% 60% within that who care about quality, ease of use, and great design.***

SM: Plus it s a headache to transfer photos from one company to another. JH: There is definitely a perceived switching cost. One of the benefits of Nexo is if someone chooses to use Nexo for the soccer team and you might be a Shutterfly customer while another mom might be an oFoto customer Shutterfly is still going to get some revenue from that other mom because she s going to buy the book on Shutterfly. She ll also get introduced to the quality and see the difference with custom covers, print on spine, quality of printing, and so forth. We re then able to attract her into the Shutterfly family without spending hard dollars on trying to switch her.

SM: Are you all US right now? JH: Primarily. Only 1% 2% of our sales are outside of the US, predominantly to US military bases, Canada, the UK, and Australia. More than 20% of our electronic sharing is outside of the US; mainly to India and China. When I went on the road show, I said 2008 was probably the year of international, but it will more likely be 2009 or 2010, given the large domestic opportunity in front of us.

> ***What I learned through my experience at AltaVista and eBay, where we moved into other countries, is that you never go as quickly as you want, but going quickly is not always the best answer.***

SM: Especially if the user experience turns out to be poor as a result of logistics failures. JH: When we launched eBay UK, we first launched it in American English, not the Queen s English, and it suffered. You have to not only do it, but do it right. What s nice about our space is that what we re dealing with is human-centric, not American-centric. It s people s memories.

SM: And the TAM is huge. JH: It s a $150 billion TAM worldwide, and $50 billion in the

US.

SM: I m not worried about the growth opportunity at all.JH:

The key for me and I think for any small business in any space is how do you focus? What are the three to five things you re going to do really well to stand out from the crowd?

The temptation is to pursue some other cool new feature, which is a distraction. But the questions you have to ask are: Does your customer want it? ; then, What order does your customer want this in comparison to everything else? ; and finally, Can you make money from it, and can you do it better than the competition?

We didn t always have the DNA and discipline to know what our four or five corporate objectives were. Now though, if something doesn t match up well against that, then we put it in a parking lot for good ideas, but not top priorities. That has been a large part of our secret sauce of success: hire great people, focus on what they re doing, and involve the customer as part of the feedback loop.

SM: Great thanks, Jeff. As you know, I love your business!

Gaming the Recession

No discussion on the content industry would be complete without a chapter on gaming. From its humble beginnings as a niche phenomenon, the interactive gaming business has steamrolled its way into the mainstream.

Industry sales climbed to $22 billion in 2008, with entertainment software sales comprising $11.7 billion (a 22.9% jump over the previous year), the Entertainment Software Association (ESA) claims. In December 2008 alone, the gaming industry logged $5.3 billion in sales no paltry sum considering that a mere ten years ago this would have equaled sales for the entire year.

As with the expansive services industry, gaming has also branched in multiple directions from its console-based beginnings. Multiplayer games (MMOGs) have become increasingly, virally, popular. As have casual games, a genre leveraged nicely by PlayFirst, publisher of the hit title Diner Dash. According to John Welch, CEO of PlayFirst, 200 million players play casual games all over the world, with the industry expected to hit $13 billion by 2012.

What I find encouraging in PlayFirst s story is that each of their in-house titles cost under $250,000 to develop. A reasonable and very bootstrapable investment considering the 200 million consumers hungrily awaiting future offerings.

Indeed, other entrepreneurs have built gaming companies on the cheap. Mytopia s brother-and-sister founders, Guy and Galia Ben-Artzi, started their company in 2007 on the premise that platforms were converging towards games that could be played seamlessly across different screens. The Palo Alto-based (Israeli-engineered) company has launched eight popular games across its own Web site and social networks like Facebook, MySpace, and Bebo, largely bootstrapping their beginning.

In fact, Mytopia exemplifies the opportunities created by two massive social media cultures: social networks and smart phones, each with their own intricacies, complexities, and most importantly, vast potentials for bringing to market games on the cheap. On social networks, for example, understanding how to utilize each platform s viral mechanisms is almost more important than quality of content, Guy Ben-Artzi says. On smart phones, figuring out how to deal with platform fragmentation is the main challenge to covering so many different operating systems. We spend about half our resources on making new content and distributing it, and the other half on dealing with the half dozen operating systems that make up our world.

But you, as a new entrepreneur, don t need to go to such an extent for your first game. You can pick one social network or one smart phone and build a game for that platform alone. Get 100,000 players at $1.99, and you ve generated a revenue stream capable of carrying you to the next level.

Shervin Pishevar, a gaming industry veteran, believes the current environment is ripe for individual game developers to bring new games to market. In fact, Pishevar says, Apple s announcement of a new OS that supports micropayments will be a boon for those developing games for the iPhone.

Pishevar s company, Social Gaming Network, plans to make good use of Apple s newly unveiled Virtual Goods Platform. Instead of charging $19.99 upfront, Social Gaming Network can now initiate players for free and then charge them in increments of, say, 99 cents, building a revenue structure that gradually draws players into a virtual-goods and points-buying cycle. Social Gaming Network s virtual pet game (Fluff on iPhone) has already generated millions of

dollars on MySpace, but it needs this platform to really succeed on the iPhone.

One point of caution, though: Apple already has 6,000 games on the iPhone platform, of which some 2,000 are free. As you plot your course through this crowded market, be sure to do your due diligence to make sure no time is wasted building something that already exists, or worse, has a big following.

That challenge brings us back to the issue of positioning and differentiation. John Welch of PlayFirst offers a great clue: Our Diner Dash was the first casual game to both inspire and educate players by giving them a story describing why they were playing: help the lovable heroine, Flo, who quit her high-stress financial job to open a diner in a broken-down shack, and fix it up by earning tips, to ultimately run a five-star restaurant. Now, hundreds of millions of people have played as Flo people we can channel to new games that will emerge under the Diner Dash brand, such as Wedding Dash.

Yes, it is the story and characters that distinguish a game, much like in great works of fiction. This depth of character, story, and brand building is our most visible differentiation today, says John. So remember, to differentiate your own game you will need to conjure up unique stories and characters, artfully weaving them into the hearts and minds of your public.

By all means, let s play our way out of this recession. But to get people to play, entrepreneurs must tap their storytelling talents, developing a new breed of Harry Potters, of Indiana Joneses, of Flos, whose charisma can captivate an otherwise wandering consumer mind.

John Welch, PlayFirst

Gaming is no doubt an inviting entrepreneurial opportunity, but it is also treacherously crowded. John Welch offers a detailed account of how he managed to distinguish his company, PlayFirst, amidst this cacophony of me-toos.

SM: Let s open with your background.JW: I grew up in suburban western Massachusetts, which offered a lot of space as compared to the Bay Area. I was either running around outside or playing with LEGOs or video games. I loved to swim and ski on both water and snow. We lived in the halo of two world-class cities, Boston and New York. We never went to New York City when I was a kid, but loving the Red Sox and hating the Yankees was a way of life. The Red Sox 2004 World Series victory and the three Patriots Super Bowls were incredible for Massachusetts; we waited a long time to win at a sport we didn t invent! (Basketball was invented a few miles from where I was born, in Springfield.)

My parents were huge proponents of education. Neither attended college, but they were at least as responsible for me getting into MIT as I was. I liked school well enough, but I hated homework with a passion. Actual learning was fun, but anything I considered rote memorization or busywork really ticked me off. My dad would tell me that he didn t care if I went to college, but he was going to make sure I had my pick of them when the time came to decide. It would be my choice to go or not, but I had to get the grades to get in, or I d feel his wrath. Going to MIT shaped the rest of my life, so I m very thankful my parents pushed me to achieve all I could.

I became an entrepreneur at an early age, not entirely by choice. I found out later that the amount of money I made mowing neighbors lawns barely covered my dad s costs on the equipment and upkeep, but he wanted me to learn to make and value money. As I reflect, I realize he also wanted me to realize how hard it is to earn money directly versus a more leveraged model and for that you need education.

SM: Mowing your way to MIT! JW: I used my mowing money to pay my half of the cost for one of the first Intel 8088 processor personal computers. I guess I didn t use my old TI-994A enough, so my parents were convinced that the new toy would just gather dust unless I had some skin in the game. Their only other really questionable belief as parents was insisting, Video games just rot your brain. I now earn my living making video games. But they were right about pretty much everything else.

I learned the value of networking early. My parents happened to meet a manager at Digital Equipment Corporation. I squeezed a summer internship out of him pretty much on the strength of going to MIT in the fall, and at the age of 17, I became one of the youngest people ever employed by Digital. I made more money than ever before, went on my first business trip, played a lot of Nethack, and learned a practical thing or two about software long before most other people.

After finding my way to and through a math degree at MIT, I went to UMass to pursue a PhD in computer science. I thought academia would be some nirvana where everyone worked together for the betterment of society. Ha! Academics are vicious to one another, and get this you could work on a dissertation project for years, and then someone publishes something too close to yours before you do poof! Back to square one. So, while I liked the program and my adviser, I

decided to grab a master s degree and head out into the real world.

I found competition in the business world to be healthier, or maybe at least a bit more honest, because you re supposed to be competing.

> ***Capitalist markets promote true meritocracies. There is no clearer example anywhere than on the Internet, where you re judged by millions of people who are one simple click away from never visiting you again. That keeps you honest or it should.***

My first full-time job was as a systems integration consultant at the Boston office of Andersen Consulting, where I built my client relations skills and started forgetting much of what I knew about writing software. After two years, I struck out on my own as a consultant and landed the most technically challenging assignment I ever had: writing software to translate programs written in Ada to C++. It wasn t very much fun, and the Internet was starting to get hot. Most importantly, perhaps, it so happened that my roommate and I were both single at the same time. So, we decided to leave the land of chowdah, sticky summers, and frigid winters and head west to the glimmering shores of California s Silicon Valley.

I met my future wife, Alissa, during the first few hours of the exploratory visit to San Francisco, which pretty much cemented the move. Being from the East Coast, I didn t realize that San Francisco wasn t the California on TV, but by the time I figured that out, I was pretty settled.

SM: Where did you get the idea for your current venture? Did you have domain experience in the segment? JW: I co-founded my first startup in 1997, with that same roommate from Boston. While trying to raise capital and recruit a head of engineering, the potential VP ended up recruiting us into SegaSoft Networks. I became the director of product development. We started from scratch and made an amazing start to building what would have looked like Xbox Live Arcade, had it shipped. But our system was eventually sold to Nokia and became the gaming network for the N-Gage.

After that, I moved next door to Macromedia to help spin Shockwave.com out as the premier Internet entertainment destination. We quickly built an audience of well over 10 million monthly unique visitors. This was before most normal people had Internet access, let alone broadband.

I found myself in the fortunate position of leading the team building the first purely digital Internet game service. On May 1, 2001, we launched a downloadable game product that was a composition of 10 Midway games including Spy Hunter, Rampage, Defender, Joust, and Tapper. The game was free to try, but a $20 credit card charge was required to purchase and own forever. The reasons to buy were to play full-screen, off-line, and have access to the arcade operator settings that controlled difficulty. Those arcade machines were meant to eat quarters quickly, which could be very frustrating, whereas we wanted to sell people an experience optimized for longer sessions. The user experience was simple, compelling, and sold beyond expectations. A new industry was born!

SM: Sounds like Shockwave was a great place to experiment and learn. JW: It was. I built a friendship with the principal software architect of the project, Brad Edelman, who is now co-founder and CTO of PlayFirst. I also met three other great people who now work at PlayFirst.

Unfortunately, Shockwave spent most of its $50 million in venture financing not on games

but on making cartoons with Hollywood folks like the South Park guys.

> ***The idea was to give the talent free reign, as well as millions of dollars, and see what they came up with. What they delivered was so filthy we couldn t even air it on the Internet.***

The joke was on us. We also had two chefs on staff and hired a new person every day. The company nearly went out of business when the bubble burst, which is exactly when things started to go right.

We went from 400-something people on staff during the acquisition of AtomFilms, to 33 people. Everyone expected us to fail. Instead, we got smarter and rebuilt using more efficient and leveraged models. The company also became more fun to work at. We worked smarter not harder, though we still put in long hours occasionally. A year or so after I left, they sold to Viacom for $200 million. Today, Shockwave.com is one of PlayFirst s top partners.

A few months after we launched the first premium game download on Shockwave.com, things started to get hot in Seattle, where Web game developers PopCap and GameHouse launched downloadable versions of their Bejeweled Deluxe and Super Collapse games on RealArcade. I brought their games over to Shockwave.com as well. Other developers sprang up, as did other competitive Web portals. Game on!

> ***The zero-dollar consumer revenue in 2000 and less than $1 million in 2001 grew to tens of millions of dollars in 2002, and it now exceeds $1 billion annually. Casual games are all the rage, having replaced mobile as the hot category of gaming.***

In fact, casual is now the dominant form of game monetization on mobile platforms. It s no longer crazy to say that casual games will someday be bigger than the core game industry in every market globally and on every game-capable platform in each market.

Brad and I saw this coming and started PlayFirst in early 2004 with the vision to build a business that would both ride and propel the wave of casual gaming. The proposition was simple: start the first casual game publishing company; build a portfolio of high-quality content; build a distribution practice across all of the important channels, including a direct Web site; and once these ingredients are in place, push the envelope in terms of user engagement and new business models to create a compelling, unique, and incredibly scalable user experience. That time is now.

SM: What was the market landscape like when you founded the company? Competition? Competitive positioning? JW: There was no formal publisher in the casual games space prior to PlayFirst s entry.

> ***It was like authors not only writing books with no editors and no research staff, but also having to scurry around from bookstore to bookstore selling their wares.***

We looked at how publishing worked across forms of media such as books, movies, music, and of course games, and we realized there was an opportunity to become a publisher of casual games.

Some developers became our partners, such as Gamelab in NYC, whom we financed to develop the original Diner Dash game. Some were our competition, vying for shelf space on the major portal sites. We now license games from many non-affiliated developers to sell on our Web site. The craziest thing about the casual games industry is that everyone, both partners and

competitors, competes with everyone. This is starting to change, though, as some of the more mature companies are starting to specialize and diverge. Competition is becoming more fierce in some areas and less so in others.

SM: Describe the value proposition, including differentiation versus the rest of the market. JW: There are now a lot of casual game developers and publishers.

> ***PlayFirst has a unique depth of focus on story and character building that has helped produce some of the top IP in the market.***

Our Diner Dash was the first casual game to both inspire and educate players by giving them a story describing why they were playing: help the lovable heroine, Flo, who quit her high-stress financial job to open a diner in a broken-down shack, and fix it up by earning tips, to ultimately run a five-star restaurant. Now, hundreds of millions of people have played as Flo people we can channel to new games that will emerge under the Diner Dash brand, such as Wedding Dash, which just launched on www.PlayFirst.com.

This depth of character, story, and brand building is our most visible differentiation today in Diner Dash titles as well as in our newer hits, Chocolatier and Dream Chronicles. The big new direction for us is how we ll expand out from the $20 single-player downloads to embrace new models of game play and monetization. Stay tuned!

SM: So, your games are more character and story intensive, targeted towards the mass market, not teen and young adults, as in the video gaming industry. Is there some thematic cohesion in your games as well? Like this Flo story the story of an entrepreneur? JW: No, but we do make stories and characters approachable, with more mass appeal and not so much teen appeal. Also, the character of Flo, our Diner Dash heroine, is going to be reused and referred to in subsequent titles.

SM: Like Mickey Mouse in Disney. How big is the market? How do you calculate TAM? JW: The casual games market is expected to hit $1.5 billion in 2008. More than 200 million people play casual games via the Internet today, with about 60 million downloads each month.

> ***Analyst firm DFC Intelligence predicts that casual games will become a $13 billion industry by 2012. This is amazing validation that casual games are truly the future of gaming as of 2005, the entire US videogame software market was only $7.1 billion.***

SM: What s your business model? JW: We have two business models now: the $20 try-before-you-buy download model and ad-supported free play. However, we will expand the way casual games are monetized later this year.

SM: What does it cost you to produce one title? How many titles do you carry? And what s the royalty structure? JW: It costs us about $250,000 per game that we develop in-house. We have six such games developed internally. We also have 18 others that we ve paid to develop, but they re developed by contractors and game development houses. Our deal with them includes exclusive distribution, and we pay them royalties between 5% 25%.

Then, we have hundreds of non-exclusive titles that we sell on our site. In those cases, we keep 60% 75% of the retail price and pay out 25% 40% to the producers. This, of course, is gross. The net is very different, as we have to foot the entire marketing and operational charges.

Also, we sell our games through Yahoo! and other sites, in which case they keep 60% 75% of the proceeds, and we get 25% 40%.

We ve also announced a deal with Hudson Entertainment whereby they ll publish our games on gaming consoles like PSP and Nintendo. In general, we make games for the PC, downloadable from the Internet, and license them out to others who port them to other platforms such as mobile and shrink-wrapped retail channels.

SM: What are your top target segments? JW: Traditionally the casual games market has been known as the domain of the 35-plus female. This segment is still strong, but it s not the only audience attracted to playing casual games just the one with easy access to credit cards.

When we put games on computers, they became more and more just for kids, especially boys. Teens make up over half of our traffic on PlayFirst.com, but a small minority of our purchasers. This all adds up to an opportunity to me.

SM: How did you penetrate the market and get early traction? JW: While I was at Shockwave, I had the privilege of working with some of the top developers in casual games. We saw the opportunity to help those developers do what they love focus on making games by becoming the first publisher in casual games.

> ***Game making is an art, but if you want to do it for very long, you also need to focus on efficient production practices, business development, marketing, sales, finance, legal, etc., etc.***

Shipping a good game is hard enough, but creating the foundation for a long-term business is even harder. We provide that solution to our developers.

We were also fortunate to attract the right investors, management team, and superstar employees who make unbelievable products at a very quick pace. Having our first launch, Diner Dash, turn into the No. 1 franchise in the industry also didn t hurt.

SM: What stage are you at now in terms of revenue, profitability, and traffic? JW: Our revenue reached almost $5 million in 2006. We ve enjoyed triple-digit annual growth since we started, and we expect that to continue into 2008 and beyond. We receive over 50 million brand impressions per day, across our 24-title game portfolio. PlayFirst.com receives nearly a million unique visitors per month, and high scores are posted from a PlayFirst title once every eleven seconds.

SM: How did you finance the different phases of the company seed, angel, VC?JW: I supplied a very small amount of seed capital that basically covered expenses while we secured our first round of venture funding. The $5 million Series A was led by Trinity Ventures and Mayfield Fund in mid-2004. Rustic Canyon led a $5 million Series B in December 2005.

SM: You re in a hits business. It s like film you have to produce hits to be able to keep growing. Silicon Valley VCs largely dislike that model. How did you get past that in

your initial funding? JW: Well, semiconductors are also a hits business   you spend $20 million and then figure out whether the chip is a success or not!

SM: You got that logic from Gus Tai at Trinity Ventures. JW: Yes, but you know what I m saying, right? Also, we aren t just in the hits business. We re also spreading the risk and diversifying the revenue stream by selling other people s games, as well as taking a portfolio approach with multiple parallel titles.

SM: Yes, in that sense, your risks are lower than the semiconductor industry because these days it takes $20 $30 million to bring one chip to market. You only need $250,000 per title. JW: Yes. But I think VCs are actually starting to even take the $20 $30 million risks on games. The massively multiplayer games cost that much to build, and they re investing in MMP games now.

SM: Describe some of your team-building experiences. Is your management team complete now? JW: The first hire was the toughest. We raised $5 million on a PowerPoint deck and the promise that we knew the industry better than anyone. But then weeks went by and we couldn t seem to find the right people to come on board. I recall our investors getting a little curious. But things started falling into place as my network started to deliver.

As a software startup, PlayFirst s most critical hire was our senior Web software architect. As a game publisher, our most critical hire was the chief creative person to run the portfolio and hire game producers. In both cases, a friend of a friend turned out to be the perfect fit. These two people have now been with the company for three years. The rest of the management team is also composed of former colleagues, or in one case a friend of a former colleague.

PlayFirst s management team has been complete for almost two years, but the business and the company are growing. I wouldn t be surprised if we add another person or two to the executive team at some point.

SM: What is your growth strategy? JW: Deliver more great games that offer deeper and deeper forms of consumer engagement and broader forms of monetization.

SM: This deep customer engagement rings as one of your key learnings from this journey. What else? JW: At my first startup, we cut off our consulting business to focus on raising venture capital that never materialized.

Cash is king. Build the business that makes you money and keeps the doors open; it can finance your riskier investments.

During the early days at Shockwave, I learned the perils of hyper-quick growth. Don t hire faster than you can grow your management capabilities and revenues, and don t spend all of your money unless you re certain that you re investing in things that will give the expected return.

Honest communication is of the utmost importance, in life and in business.

Alissa and I were very different people. None of our friends thought we made a good couple early on, but we communicated very well. The key thing you can do as a manager is let people know

where you re unhappy with their performance. They might improve, they might quit, or you might fire them. Any solution is better than nothing. As an employee, your manager needs to know how he or she is doing. Their job is to inspire you and offer an environment in which you can be successful. If you re not getting these key things, don t be silent. I prepared my résumé four times while at Shockwave twice because I was sure I would be fired, and twice because I was sure I wanted to quit. On one of those occasions, when I thought I would be fired, I was, instead, promoted. I ended up spending nearly five years there, learning many things I needed to learn to start my own company. I wouldn t have stayed, nor learned so much, had I been timid. Speak your mind. Of course, do it politely and in the right setting, and it helps if people know your tenacity springs from a passion for the team and product to succeed.

Then: Invest in people. I met Gus Tai from Trinity Ventures at an MIT club function more than ten years ago. We kept in touch, and he ended up funding PlayFirst. The value goes both ways he wouldn t have had such proprietary access to the deal had he not impressed me as someone with great integrity, who could add tremendous value to my career.

Related to the previous two points, the most important thing Gus ever said to me was ten years ago: I m not going to fund your company, and nobody else will either. Go become an expert in something and come back to me in three years. I waited over five, but I came back. Patience and persistence are good balances to passion.

Final thought, and probably the most important in business: Please the customer. If you do everything else wrong but get this right, it s better than the reverse. That s our guiding principle at PlayFirst. We never optimize for a buck at the customer s expense.

SM: I couldn t have said it better. Thank you a wonderful discussion.

Epilogue

If there is one thing that VCs master, it is a refined ability to poke holes in a business plan. I once took a client with over $20 million in profitable annual revenue to Trinity Ventures for financing. Larry Orr, one of Trinity s general partners, dissected the business a semiconductor yield management software company and by the end of the meeting, he had sharpened his teeth on what he considered to be an inadequate TAM. He segmented and then sub-segmented the business, establishing that in our assumptions we had mistakenly included a set of unreachable segments. We eventually sold the company to a larger player in the category, without raising further financing.

This poking holes, unfortunately, is a skill I ve now mastered as well. Those of you who have attended my strategy roundtables have experienced this firsthand. I may have told you straight to your face that your vision is nowhere near 20/20.

There is, however, something enormously valuable in this exercise of litmus testing: it eliminates bad ideas and saves months, if not years, of your life.

In my consulting, I remind people that my job is to help them ask the right questions. If I have achieved that, I have brought them three-quarters of the way to the solution. In light of this, you will find in the appendix a set of questions to guide you through this process. Put your idea through this rigor before committing precious years of your life. And if you have already leaped into the business with both feet, then this rigor will yield something else: strategy. You will learn, if you are truly open, what to avoid and wherein lie the fastest market penetration opportunities.

But be honest. Be brutally honest as you seek answers to the questions. For while optimism is a requirement for entrepreneurial success, fanaticism is a surefire recipe for failure.

Appendix: Clarify Your Story

For Enterprise- and SME-Facing Businesses: *This set of questions will help you through the process of testing and validating your idea while building an effective go-to-market strategy for a B-to-B venture.*

Product or Service Value Proposition:

- What pain does your product/service address?
- What is the profile of your ideal target customer (company)?
- What is the profile of your ideal target user (within the target company)?
- What is your technology?
- What is the application of this technology?
- What are some compelling use cases?
- What is your differentiated, must-have value proposition to this customer?
- Which market? Which segment? Why?
- How big is the market? Is it big enough? If not, how do you expand? Should you expand, or should you focus within a niche?
- What is the usage model of the product?
- How does the user currently solve the problem in question?
- Who is the buyer?
- How strong is the pain? Does the buyer care to solve the user s pain?
- How do you prove your value? Pilot? Free trial for a month? Three months?
- How long does it take to prove value?

Competitive Positioning & Pricing:

- Who is the competition, and how do you differentiate from them?
- What are the various classes of products in immediate and related categories?
- Which, of those, compete directly with you?
- Which ones are likely to move into your space?
- How do your product features compare with the competition s? Can you compete on the basis of functionality?
- How does your product pricing compare with the competition s? Can you compete on the basis of price?
- How do customers and prospects view your offering, vis-à-vis competition? Do they see you as one-tenth the functionality? One-fifth the functionality? 300% the functionality?
- What value does the customer see?
- What are customers willing to pay for your solution? One-tenth the key competitor s price? Same price? 200% the price?
- What price can you charge based on perceived value?
- What is the ROI for the customer? How long will it take to realize the ROI?
- Can you offer both better performance and lower price?
- Whom do you need to partner with to offer a full solution?

" How do you position win-win deals for partners?
" Can you turn some of the competition to partners/channel/OEM relationships, so as not to go head-to-head?

Sales Cycle & Messaging:

" What are the top target segments (verticals, size, geography)?
" What is a typical repeatable sales cycle for each segment?
" Who is the relevant VITO (very important top officer)/EB (economic buyer)?
" What job title does that correspond to within the target company/segment?
" Who is the technical decision maker (TDM)? What job title?
" Who is the user? What job title?
" Who is a likely champion for your solution? What job title?
" Who can coach you inside an account? How do you gather information required to qualify the lead? Extract the pain? Position the solution?
" What is your value proposition to the VITO/EB? TDM? User? Champion? Coach?
" How do you communicate that value in 20 words or less?
" What pain-extraction questions correspond to that value? In other words, if a sales rep gets a relevant stakeholder on the phone, what should she ask? Or what should she ask in a succinct e-mail to gain permission for further engagement?

Lead Generation & Qualification:

" What are the top target segments (verticals, size, geography)?
" What is the best way to generate a list of the target accounts within the segments?
" What job titles are you after within those accounts?
" What is the organizational map within the account that maps to the sales cycle?
" What are the names of the stakeholders who correspond with the economic buyer, the technical decision maker, etc.?
" What is the pain-extraction question/value-proposition message if someone with the right job title gets on the phone?
" What are the criteria for a qualified lead?
" What lead-generation programs do you plan to pursue? Google PPC advertising? E-mail campaigns? Trade shows? Other forms of online advertising?
" How do you plan to qualify the leads? Telemarketing? Outsourced? In-house?

Sales & Business Development:

" What is the appropriate channel strategy (direct, OEM, resellers, system integrators, telesales)?
" Are there channel conflicts? How do you resolve?
" What is your territory plan and prioritization, based on market segment targets?
" What paid proof-of-concept/pilot engagement/evaluation framework will get you to a deal within a short time?
" What are the appropriate sales cycle steps, next steps, and duration breakdown?

- What is the likelihood of a deal by sales cycle steps? How do you forecast?
- What are the must-have key target accounts? Why? What do you need to accomplish in those engagements to be able to achieve high leverage for reference selling, proof points, and metrics?
- Do you have reference accounts? What is the best strategy to leverage the reference accounts and proof points?
- How do you build new reference accounts? Who is your target? Why? How do you penetrate, sell, and demonstrate ROI?
- Are there must-have channel relationships? What do you need to do to appropriately establish and manage them?
- What kind of channel discount do you need to provide to enlist the channel to perform on your behalf?
- Can you get OEM deals that may help you accelerate adoption?

Corporate:

- What is the product roadmap for the company?
- What is the unifying theme that positions the company and leverages its strengths (technology, product, channel, current customers, references, etc.)?
- Is there a platform strategy? A point-product strategy? A solution strategy? What holds all these pieces together? How do you position to make it into an integrated *big* story?
- What products/pieces need to be repositioned/repackaged to align with the corporate strategy?
- What is the full story? Is it a powerful, differentiated story that can go beyond a point-product/one-trick pony to become a category leader?
- What is the category? Do you define a new category, or do you position within an existing one?
- What technology/product/channel/media elements need to be introduced/influenced to make it into a larger story?
- What broad scale industry trends can you impact based on your offering, and how do you position to align with such trends?
- What is your funding strategy? How do you position, package, and sell?
- What is your exit strategy? How do you position, package, and sell?

Execution Roadmap:

- What is your next major milestone? Product launch, funding round, exit?
- What derivative milestones/related projects do you need to accomplish to be able to stay on track and execute on the strategy?
- What is the project-resource-timeline map tracking to the next milestone?
- What is the messaging matrix?
- What is the collateral map, based on the sales process/sales cycle steps?
- What are the reference account milestones?
- What is the PR strategy?
- Do you have the resources to staff all the projects that lead up to the milestones?

- Who will manage lead sourcing/lead generation/lead qualification?
- Who will manage the PR process, pitches, follow-ups, etc.?
- Who will write the collateral (Web site, sales pitches, data sheets)?
- Who will design and produce the Web site?
- Who will manage events/trade shows?
- What are the key additional hires/timeframe?
- Does everything align with your operating plan/budget? What tradeoffs do you need to make? What are the prioritization algorithms?

For Consumer-Facing Businesses: *This set of questions will help you through the process of testing and validating your idea and building an effective go-to-market strategy for a B-to-C venture.*

- Who is your target customer/user?
- What is the user experience you plan to offer?
- Does the customer/user care? Why?
- What is your differentiated value proposition to the customer/user?
- Which market? Which segment? What demographic? What psychographic?
- How big is the market? Is it big enough? If not, how do you expand? Do you need to expand, or is staying within the niche desirable?
- What is the usage model?
- How does the user currently accomplish the objective?
- What is the competition, and how do you position against them?
- What is the business model? On-demand? Subscription? Advertising CPM? CPC? CPA? Transaction fee fixed? Commission? Final value fee?
- How do you build traffic? What FREE incentive can you offer to bring users en masse to your site?
- What premium service can you offer that users would want to pay for? How much would they pay?
- What is your context strategy?
- What is your content strategy?
- What is your commerce strategy?
- What is your community strategy?
- What is your search strategy?
- What is your personalization strategy?
- How do you plan to sell ads? Internal ad sales force? Ad networks? Which ones? What kind of ad rates can you command?
- What ad management system will you use if you do it internally?
- Are you going to advertise online to recruit customers? Google/Yahoo! PPC? On blogs and other sites? Which sites? Using which ad networks?
- What are your search engine marketing/search engine optimization strategies? What keywords are you trying to own/position around? How expensive are they?
- For your category, what are the most influential blogs? How will you get them to talk about you?

"	What are the top mainstream media properties that you need to get written up in?
"	Whom do you need to partner with to offer a full solution/whole product?
"	Whom do you partner with to generate traffic? Under what terms?
"	Do you have a widget strategy for Facebook, iPhone, Hi5, MySpace, etc., to generate traffic and visibility?

Other *Entrepreneur Journeys* books by Sramana Mitra
Now available from Amazon.com

Entrepreneur Journeys, Volume One:

Entrepreneur Journeys begins with a simple idea: technology start-up success, and the knowledge required to achieve it, is out there to be leveraged by anyone who is willing to listen. Using her own intimate knowledge of the entrepreneurial world, in this book renowned strategist and *Forbes* columnist Sramana Mitra captures the stories of entrepreneurs that have come before to help those who are looking to learn. Offering readers an inside view of how to navigate an entrepreneurial path, Mitra synthesizes candid conversations with her own incisive analysis, to create a unique set of case studies.

Truly a book that distinguishes itself from the crowded business-book marketplace, Mitra has written a text that is accessible through its story-telling narrative, and at the same time academic in its depth of insight.

Some praise:

Inspiration awaits readers in this volume of interviews with entrepreneurs. Entrepreneur Journeys will provide great insight into the questions and answers behind a start-up business. It succeeds in sharing the enthusiasm and sense of adventure of these technological pioneers.

-Kirkus Discoveries

Entrepreneurship is not a career. It is a way of life. And what better way to learn about it than to listen to people who have done it, successfully, and to learn about their lives in that fast lane? In a carefully structured set of interviews, Sramana Mitra gives the readers an opportunity to discover their paths, their successes, their setbacks sometimes, and the joys of meeting the immense challenges that have been theirs in a dizzying world where technical competence and management skills have allowed them to leave a deep and lasting mark.

-Professor Elisabeth Paté-Cornel
Chair, Department of Management Science and Engineering, Stanford University

More praise for *Entrepreneur Journeys*:

Enjoyed *Entrepreneur Journeys* and found it worthwhile. The stories are inspiring and could have a significant influence on a student of entrepreneurship or an aspiring entrepreneur. To paraphrase a trite phrase; Yes, you can! The stories are more than inspiration though. The insightful questions and the thoughtful answers give much guidance, and general wisdom. The book occupies a nearly empty niche between lightweight collections of anecdotes and ponderous but often irrelevant academic research. A great opportunity to come close to sitting with masters and learning directly.

-Barrett Hazeltine, Professor of Engineering Emeritus,
Brown University

Sramana Mitra is herself a symbol of everything that is great about America: a geek, an entrepreneur, an immigrant, a leader. In *Entrepreneur Journeys* she has taken on the task of modeling how entrepreneurs transform economies into resilient, growing systems that provide a future for our children.

-Stewart Alsop, General Partner, Alsop Louie Partners

Sramana Mitra has gifted us with the first hand stories of industry legends who have succeeded with a combination of fierce resolve, self-reliance, and a willingness to buck conventional wisdom. The next generation of entrepreneurs has an invaluable reference guide on how their predecessors have succeeded.

-Rick Rommel, Senior Vice President Emerging Business, Best Buy

Entrepreneur Journeys, Volume Two:
Bootstrapping: Weapon of Mass Reconstruction

In a world battered by economic crisis, Sramana Mitra believes entrepreneurship is the only sustainable path forward to a healthy economic world order. And core to the success of entrepreneurial ventures today is the invigorating art of bootstrapping. She takes aim at this essential route along the roadmap to startup success in the second volume of *Entrepreneur Journeys*. Along with her incisive analysis and commentary, she showcases a dozen successful entrepreneurs and their lessons from the bootstrapping trenches. Overflowing with lively entrepreneurial tangents, theories, and behind-closed-doors-experience, the book rises to the level of economic policy discussion while simultaneously offering practical advice from experienced bootstrappers. Important issues like doing more with less, getting started with little or no capital, and validating the market on the cheap are discussed with the likes of Om Malik of GigaOm and Greg Gianforte of RightNow.

Some praise:

Sramana Mitra s *Bootstrapping: Weapon of Mass Reconstruction* is a book for our time because it s something real out of Silicon Valley. No more stories about legendary VC fundings of startup-to-IPO in six months. In this, the second volume of *Entrepreneur Journeys*, her focus is on doing more with less, in tune with the times. This book has some fascinating histories of the different paths people take to entrepreneurship, and the difficulties they face. I would only have wished each of the interviews to be longer and deeper, because every story is worth telling.

-Fast Company

Mitra clearly has a passion for small businesses. This useful volume is largely comprised of interviews with the founders of such companies. Her skilled questioning prompts a discussion of the many issues involved in starting and growing a business. The entrepreneurs share wisdom and insight useful to any budding or existing business owner. The reader will be struck by the vision, inventiveness and sheer determination of these entrepreneurial heroes, who operate businesses that are successful but far below the radar. A highly relevant and timely work on entrepreneurship s role in economic reconstruction.

-Kirkus Discoveries

More praise for *Bootstrapping: Weapon of Mass Reconstruction*:

I recommend *Bootstrapping: Weapon of Mass Reconstruction* to my MBA students and to anybody planning on, or even just thinking about, starting a business. And also to policymakers. Maybe especially to policymakers. The importance of entrepreneurs to our economy cannot be overemphasized.

-Craig Newmark, Newmark s Door blog
Associate Professor of Economics, North Carolina State University

Sramana s work on bootstrapped entrepreneurs is an inspiration in these tough economic times. The solutions to our economic problems ultimately lie with the entrepreneur who brings imagination, resourcefulness and good old-fashioned elbow grease to tackle old problems in new ways, create new solutions and new industries. It is all too easy to forget this, particularly when we feed on the depressing daily diet of endless bailouts and hear trillions of dollars being thrown around. A great entrepreneur can do a lot with ten thousand dollars. This book is a good antidote to the depressing mood of these times.

-Sridhar Vembu, CEO of AdventNet and Zoho,
Bootstrapped to over $50 million in annual revenue

In the end, a true entrepreneur will not be denied. What Sramana captures with simple grace are the riveting personal stories of modern day business alchemists, who mix vision, pragmatism and relentless effort to forge creative new and successful ventures. Her collection of interviews will make for an engaging, educational read, for those in the entrepreneurial space, those considering joining the game and those just plain curious about the formative innovators whose efforts provide outsize social returns of the most concrete and enduring nature.

-Don Hutchison, Silicon Valley Angel Investor

Coming Soon:

Entrepreneur Journeys, Volume Four
Innovation: Need Of The Hour
(Winter 2010)

Entrepreneur Journeys, Volume Five
Vision India 2020
(Spring 2010)

You can learn more about Sramana Mitra at
www.sramanamitra.com