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VCs throw weight behind onshore outsourcing

By Paul Gasparro

After a venture capital firm invests in a startup or expansion company, their commitment to that company doesn't end; in fact, it's just begun.

Eager to see their investments increase in value, venture capital firms often introduce various resources — advertising agencies, technology consultants, recruiters, even channel partners — to their investment companies in the hope that these vendors can provide services that will help grow the company, both short- and long-term. After all, once a VC has poured substantial dollars into a new or early-stage outfit, it's understandable that they would want to strengthen their investment.

Chris Albinson, founder and managing director of Panorama Capital, is familiar with this practice. His company, founded in 2005, invests in "passionate entrepreneurs building leading companies in life sciences and technology." To Albinson, investing involves far more than plunking money on the table; it means helping a company realize its full potential.

"Obviously, I'm looking for the best possible return on my investment in a company," said Albinson, whose clients are scattered across the United States. "So if I'm familiar with a vendor who can provide a service that will help a company improve some aspect of its operation, I am going to recommend that vendor. Simply writing a check, then sitting back and assuming that the investment will do well is not the smartest approach; a more proactive approach goes a long way towards increasing the company's - and my - chances for success."

Increasingly, Albinson finds himself recommending software development outsourcing firms. In fact, outsourcing this function makes sense in a variety of scenarios. Certainly, it is a sound strategy when the project does not necessarily revolve around the investment company's core competency. It also helps the company manage expenses by not introducing new capabilities for what may amount to just two or three discrete projects; in other words, it's a good alternative to building an internal team.

Albinson perhaps put it best when he said, "I would say the best candidate for an outsourced project is probably a company that has developed its core offerings and is now thinking about upgrading certain aspects of those offerings, or adding new features and functionality."

Regardless of why the outsourcer is being used, it's the VC's responsibility to bring the good ones to their client's attention.

"If VC's are doing their jobs right, they are helping companies grow faster using less money," Albinson said. "Over time, the good VC's have recommended a large number of vendors to their clients. In doing so, they've learned which ones can provide value and help guide a young company through the critical early stages of development. They've also learned which ones to stay away from and focus only on the 'cream of the crop.' That's not value-added service, that's just a part of the job."

When it comes to software development, many companies have been lured by the siren song of offshore resources, particularly places like China or India where the labor rate can be as low as 20 percent of the going rate in the United States. Since cost and cash management are critical drivers for pretty much every business and every sector, but especially for startups or expansion-stage businesses, it's a song that is hard to resist. However, low labor costs can be deceiving, as they can be more than offset by various hidden costs, many of which might not even be considered until after the engagement has begun.

Consequently, savvy VC professionals are often recommending "onshore" options to their North American clients. While some of reasons are financial in nature, others go far beyond pure dollars and cents. To begin with, there is the issue of proximity. In this area, looking eastward towards India is not the most prudent decision.

"India is as many as 12 time zones away from the westernmost parts of North America," Albinson noted. "This means that setting up a conference call or video meeting is going to be painfully inconvenient for one of the parties. Plus, it's difficult to have any 'real time' communication if someone has a creative idea on the spur of the moment. The opportunity to capitalize on a spontaneous suggestion or thought is almost impossible.

"Conversely, when the investment company and the outsourcer are both in North America, there will never be more than a four-hour time difference between them. Meeting times are relatively easy to set up, and spontaneous communication is greatly facilitated."

Travel is a major consideration, especially when you're talking about the furthest reaches of the globe.

"When you start up an outsourced project, you either take a bunch of people over to the outsourcer or they come to you," Albinson explained. "This is necessary to get everyone up to speed. The airline flights, the accommodations, and everything else become a significant investment. On the other hand, flights within North America are a fraction of the cost. In fact, if you're staying in North America, you can conceivably do it in one day and save the cost of accommodations."

Language issues can often present a nearly insurmountable challenge, according to William J. Wilcoxson, general partner at Axiom Venture Partners.

"Even if you find an offshore outsourcer that has English-speaking capability, you still may find yourselves with a communication problem," said Wilcoxson, whose company invests in the "extension stage" of information technology enterprises, primarily in the United States and Canada.

"Certain phrases and idioms in English don't always translate to another language the way the speaker means them. So you may not be conveying the right message, even if you're both speaking the same language. That can lead to losses of time and, if mistakes are made on a project, money."

Intellectual property issues can also present a real predicament to a young company with a solid blueprint for the proverbial "better mousetrap."

"Not all foreign countries are responsible when it comes to observing IP or copyright laws," observed Wilcoxson. "A company with a great new idea or proprietary information may have its IP jeopardized by an unscrupulous offshore outsourcer. That's not to say it can't happen with a North American outfit, but, generally speaking, IP laws are taken far more seriously on this continent."

Turnover in offshore outsourcing firms always has to be considered as well, according to Wilcoxson.

"There has been a lot of turnover in the overseas development partners, which has led to difficulties in getting projects delivered on time, within the specified cost parameters, and with the required level of quality," he said. "For example, if I gave a project to a 10-person team in India, given the normal churn rate there, by the time the project is finished, as many as half of the people that had been working on that project would likely have left and new people would have been brought in. Even if I'm paying labor costs that are 80 percent less than what I'd pay in North America, the time and effort to bring new people up to speed on the project, the increased management costs, the delay in bringing the product to market, and the potential impact on quality all take a financial toll."

So, Albinson and Wilcoxson both make a strong case for the use of onshore outsourcers, particularly in the area of software development for new products or product enhancements.

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