

Venture Capital - 'Early Stage – Pivotal Inflection Points'- Managing External Risk



Sudhir Rao
Managing Partner
Indusage Partners

"A ship in harbor is safe, but that is not what ships are built for."

- John A. Shedd

"If Columbus had an advisory committee, he would probably still be at the dock."

- Arthur Goldberg

EXTERNAL-RISK

Noun - (plural external risks)

1. *Risks that are produced by a **non-human** source and are **beyond human control**. They are **unexpected** but happen regularly*

*enough in a general population to be **broadly predictable**.*

Firms get built with an idea to successfully implement an idea and make a relevant impact chosen by their Founders and teams. Detailed spreadsheets outline 'models', 'unit economics', fitting into multiple tabs to become financial and business 'plans.' This could be potentially very detailed or as perfunctory as required to get some structure to a potential implementation into the future. Let's call this the 'Math'.

Dreaming the extraordinary and the 'never before' allow these teams to embark with either a very detailed cartography and the necessary nautical instruments or could be even more souped up with electronic navigation systems to let them know each deviation along the routes chosen to explore and sail on to get to their desired destinations.

Accountants and financial planners most often factor 'internal costs' and put together an 'inside-out' view so as to present their data and thoughts to external stakeholders. The computations often give an ability to 'simulate' what-if scenarios on these models and check for 'tolerance' to any of the plans going awry and mostly for 'known' reasons. What manifests in reality often turns out to veer away from these paths and the benefits of using spreadsheets is to bring these new variables into the 'Actuals' by explaining deviations from the 'plan'. Sensitivity analysis can get to be perfunctory, an artifact. It isn't computed into the core. The focus is to indicate a growth-centric approach, that we forget to account for obstacles - from hiring to competition and then to pandemics like Covid in size.

External risks are mostly given the go by in planning and are at best 'footnotes' or a last page of the document highlighting 'risks and mitigation plan' captured on a Word document or PowerPoint rather

than on the Spreadsheet.

An *Outside.In* view is best brought in and only by making it as a choice by hiring a Chief Risk Advisor if not a CRO who looks at all the areas of potential failure rather than success and creates more of a 'preparedness' assessment for at least a number of known-unknowns. Having 'sparring' partners ahead of going into the 'ring' helps boxers to prep well for a fight. Using a number of techniques to overcome potential hits through Muhammad Ali's well-known technique called Rope-a-Dope which is to use the power of the ring fence to receive blows along the way and then be in a position to make a comeback to fight the 'opponent' which in businesses are described as 'risks' other than just 'competition'.

External Risks can bring unforeseen events right up-front and often at the most vulnerable times in the journey of an early-stage Venture. Enterprises need to be trauma-ready and be set to go in and come out of an Accidents & Emergencies ward. *After all the Math* be ready for the potential *Aftermath*. Being prepared is half the battle won. It is, as Bruce Lee would say, excel in the Art of Fighting without Fighting.

2. Managing Hemorrhage

In the face of an event occurring that is 'beyond conceivable control', the preparedness to combat the post-event fallout is most critical to the organization. Some maintain simple First-Aid kits, a First-Response Trained Team that has run *Drills* to simulate extraordinary events and surprises and has the necessary readiness to respond. Most recently, the experience around Black Swan events and White Swan Pandemics have taught us a lot to respond with alacrity. Pivots are exercised normally when the actual scenarios vary significantly from those forecasted. In as much as access to Emergency Blood banks is considered a first response to excess bleeding, organizations need to have SWAT (Special Weapons and Tactics) teams, multi-disciplinary outside counsel to combat the exigency.

The Plan A is all that is required which contemplates the what-if and there's no room for a Plan B given the time to respond becomes infinitesimally short. Often, we only look for the 'obvious' risks rather than contemplate the potential for the tornado in the well-appreciated Lorenz's *Butterfly Effect* that causes a less 'visible internal bleeding'.

External Risk management requires the setting up of a Dojo where the forces are trained for combat and self-defense as well as to stay still in meditative pose. This assures the insights of circumspection rather than

reaction at first pass of an event forced upon the entity. Bringing back what might be lost in a potential damage is as valuable as having the resilience to withstand the maelstrom. Bringing back the Mojo in parallel and not sequentially where teams drive the managing of a disaster as well as drive the action to forge ahead in a new avatar when essential. Stillness in Imbalance is a fine art and becomes one only when practiced upon. Calling upon varying degrees of hindsight, insight and foresight from a multi-disciplinary access to talent go a long way to benefiting the organization's comeback from a situation unknown.

Talent in the form of the *Outside.In* should be brought in early in the form of a Board that has Independent Directors in majority, an Advisory Board that has a deeper operational experience across key aspects including the Product/Service, Market, Capital, People & Process, Risk Management & Audit. This is betting on Wisdom while Institutional Memory gets built from within.

3. Being Adaptive Micro-animals - Tardigrade – The Little Water Bear & Echinoderms

Early-stage companies are seen to be more vulnerable as little children are. History has many a tale that the very large enterprises too succumb to external risks or at the least lay in a paralytic state. Adaptive organizations can either happen by chance or by choice and have a design-in.

Accepting and living in a VUCA world (Volatile, Uncertain, Complex & Ambiguous) is an important first step before we step forward to design one's thinking to being Adaptive.

Evolutionary biologists have given us enough analogous evidence to adopt biomimetic architecture in designing and building organizational response

systems. Morphing can be both calibrated, incremental and built-in or can also make some 'big' steps with the preparedness to make non-linear and lateral moves. Imbibing not just up-stream and down-stream thinking but absorbing lateral-streams and leveraging eco-systems become imperative.

Echinoderms like the Starfish that exhibit radial symmetry have mechanisms for the edge to play an important role in providing the 'vision' through multiple 'eyespot' rather than just one pair of eyes. This gives them edge-vision. In the event an arm gets cut off, the starfish response systems allow for reproduction using autotomy and multiply through an asexual process. Organizations will certainly have similar events when a VUCA event cuts off an activity. Such scenarios need to be mitigated through an evolutionary method pre-baked into design preferably.

External risk management requires organizations to evaluate themselves constantly just as their products are often classified. Consumer-grade, Industrial-grade, Military-grade, Fire Resistant or Fire retardant. What organizations should rely on is a 'Tardigrade' construct. These micro-animals or Little Water Bears as they are called are 1mm in size unlike their namesakes the Bears that can be 10 feet tall and weigh 1 Ton. They have learnt to live in both Polar zones as also the equatorial climate. From springs to the deep sea. They have also travelled to space! They have been 'survivors' of mass extinction events, gamma-ray bursts and large meteorite impacts. They can sustain radiation, dehydration, environment toxins and ultra-pressure.

In summary, External Risk is always prevalent, and organizations must learn to build themselves to Tolerate, Treat, Terminate & Transfer it adaptively.