



Phone Improvement

SoloPoint's founders eyed an exploding market—people who work in home offices—and reversed the usual Silicon Valley order of business. First they learned what those customers wanted. Then they built it

By David Whitford

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In Silicon Valley, it's technology that excites entrepreneurs, seduces venture capitalists, and lures talent to a start-up. In the Valley, technology is sexy, products are meat, and consumers are dogs, as in the crude but commonly asked question there, "Will the dogs eat it?"

When Martin McKendry and Charlie Bass co-founded the company that would become SoloPoint Communications, on April Fools' Day, 1993, they couldn't talk about their technology, because they didn't have any. That made SoloPoint rare in the Valley, where technology-driven start-ups flare up and burn out like autumn brushfires in the palomino hills. McKendry had already been singed by two such ventures. He had come north from Orange County in 1990, looking for an opportunity after three years at FileNet, at the end as principal engineer of the then \$103-million public company. At Focus Systems, which dissolved, and later at Network Computing Inc., which failed to meet investors' expectations and merged with Seagate Technology, McKendry experienced disappointment firsthand. But it was experience he could use. It suggested to him that nobody he had worked for yet had shown him anything he couldn't do himself. And it taught him some-thing about why so many high-tech start-ups didn't work.

"The fundamental problem in both companies was the fit of the products to the market and the channels," Mc-Kendry says now. "We couldn't say, 'This is what it costs, this is what it will do, here are the people who will value it at this price, here's how they buy products, and here's why this one is a natural fit for those channels.'"

Bass, meanwhile, was thinking along parallel lines, albeit from a loftier vantage point. He had a long and fabled history in the Valley. In 1979 he had co-founded Ungermann-Bass, now a \$200-million subsidiary of Tandem Computers. Currently, he's general partner of Bass Associates, a small venture-capital firm in Palo Alto, Calif., that exists mainly to give others the opportunity to participate in deals he likes. Bass has had a directorial hand in more than a dozen high-tech start-ups, including Focus Systems and

Network Computing, which is how McKendry appeared on his radar. In McKendry, Bass saw an ideal partner with whom he could apply some of his own beliefs about what makes a high-tech enterprise successful. Those beliefs are crystallized in a mantra Bass borrowed from one of the patriarchs of venture capital in the Valley, Don Valentine. "Markets," Bass says. "Markets, markets, markets."

Bass set McKendry up in an office at Bass Associates, designated him "entrepreneur in residence," and gave him \$250,000 of the firm's money—pocket change in Valley terms. In exchange McKendry agreed to spend up to a year scoping out new product possibilities in a hot new market Bass was eyeing: the people who work in the more than 45 million small offices and home offices, known in marketing jargon as SOHO workers. "I was intrigued by this individual-office phenomenon, and I did not see in it the elements of control, management, and sophistication I felt could be applied to it," says Bass. "I simply engaged Martin in that thought, and as I assumed before engaging him, he got it."

Executhve Summary

COMPANY: SoloPoint Communications, in Los Gatos, Calif., founded by engineer Martin McKendry, formerly at FileNet, with initial backing from venture capitalist Charles Bass, cofounder of Ungermann-Bass

CONCEPT: Chose a market first—people who work in small and home offices, known as SOHO workers; then developed a product—a telephone switching device that helps SOHO workers manage incoming communications. Objective: to be the entry point of communications into the home office

PROJECTIONS: \$4 million in revenues in 1996; \$27 million in 1998

COMPETITIVE ADVANTAGE: Enough time (three years) and capital (from Bass and his friends) to develop a market-oriented product and a well-planned launch; a potent distribution partner (Ameritech)

HURDLES: To increase margins and convince SOHOs that improved communication management can come in a \$379 box



Martin McKendry (left) and SoloPoint's newly appointed CEO, Edward Esber Jr.

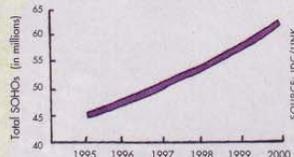
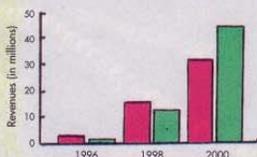
How SoloPoint Proposes to Profit by Keeping SOHOs Connected



As calls arrive the PCM sorts and directs them: faxes go to a fax machine and voice calls to voice mail or wherever the SOHO worker happens to be—at the desk, in the kitchen, on the road, with a client, or at the beach. The PCM also permits SOHO workers to monitor incoming calls undetected from any location.

THE FINANCIALS

| | 1996 | 1998 | 2000 |
|--|-------------|--------------|--------------|
| Revenues | \$4,000,000 | \$27,000,000 | \$75,000,000 |
| → Step one: sales by Baby Bells, cellular providers | 2,865,000 | 15,000,000 | 31,000,000 |
| → Step two: sales from catalogs, direct marketing, retail | 1,135,000 | 12,000,000 | 44,000,000 |
| Gross profits | 1,900,000 | 15,000,000 | 45,000,000 |
| Expenses | | | |
| Marketing/sales | 2,700,000 | 6,400,000 | 15,000,000 |
| R&D | 1,600,000 | 3,400,000 | 9,000,000 |
| G&A | 1,100,000 | 2,200,000 | 6,000,000 |
| Profit (loss) | (3,500,000) | 3,000,000 | 15,000,000 |



Step One ■ Step Two ■

SoloPoint hopes to establish a revenue flow with help from distribution partners, including Baby Bells and cellular providers. As production costs decline and gross margins widen, sales will shift toward more expensive, higher-volume channels, including catalogs, direct marketing, and retail stores.

The SOHO Market

Includes small offices (10 people or fewer) and income-producing home offices. "You only have to be conscious to realize that something big is going on in this market," says SoloPoint chairman Charlie Bass.



Instead of technology first, product second, and hope the dogs eat it, McKendry and Bass were taking the approach Procter & Gamble would take if P&G made dog food: start with a promising market, create a product you know the dogs are hungry for, and serve it up.

Though McKendry is very much SoloPoint's founder, he's neither the chairman (that's Bass) nor the chief executive (that's Edward Esber Jr., who wasn't hired until last October). McKendry's title is chief technical officer. He has equity (13%) but didn't have to pay for it. His own risk is therefore contained; if SoloPoint flops, he keeps his house.

By last spring, two years after Bass engaged McKendry in his thought, SoloPoint had developed a working product: a computer-telephony device called a PCM, short for personal call manager. Last November, when the product was in beta testing prior to a launch this month, seemed like a good time to check in with the company to see how things were going.

SoloPoint's 19 employees had just moved into a new suite (much like the old suite, only bigger) in a glass-and-concrete office park in Los Gatos, Calif., outside San Jose. McKendry walked into the back room and pulled a prototype PCM off the shelf. It looked like a modem: a gray box with red and green lights on the front and phone jacks in the back. A PCM is not a modem, however, or a telephone or an answering machine. The presumption is, if you're a SOHO worker, you already have all those

things. What you need is a way to consolidate the clutter and get all your telephony devices working together. That's what the PCM purportedly does. It's supposed to work like a switching device, separating faxes from phone calls and enabling certain fancy maneuvers McKendry likes to call "stupid phone tricks."

For example, with a PCM and a second phone line, you can turn the cellular phone in your car into an extension of your home-office phone. That's not the same as simply forwarding all your calls; the phone company can do that for a nominal monthly fee. What's different about the PCM is that it lets you listen in, undetected, on your car

phone while the caller leaves a message, as if you were monitoring calls on an answering machine. If you decide you want to talk, you punch a number and you're connected. If not, you let it go and pick up the message later; the caller is none the wiser. You can also program the PCM to accept calls only from people you want to talk with and to take a message from everybody else, or to give everybody a choice of leaving a message or trying to reach you someplace else. If you need to take something down but don't have a pencil handy, it can even bounce a caller back to your answering machine after you're done talking. You can program it at home on your computer, using Windows-compatible software, or on the fly, using a touch-tone phone.

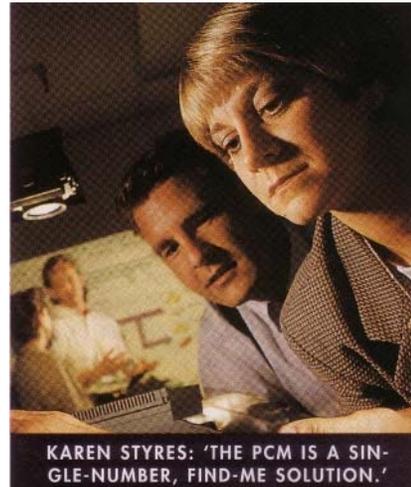
The PCM will sell for \$379, based on market research that reveals certain price thresholds for SOHO workers. At \$200, according to McKendry, they're apt to buy something off the shelf, take it home, and see if it works. At \$300, they want to read a review first and know what they're getting. At \$400, most people feel the need to consult with their spouses before they buy. "That told me that \$400 is too much," says McKendry. The price ceiling helped determine which features would be part of the initial release and which would have to wait. But in defining the product, price was never the only issue.

"There are lots of things you can think up, but by the time you look at the dynamics of who will buy them, it doesn't work," says Karen Styres, SoloPoint's marketing vice-president, who joined the company a year and a half into product development.

Charles Simonyi, chief architect at Microsoft, is underwhelmed by the PCM's current capabilities. "SoloPoint is getting into the marketplace in a very cautious way," he says. "I don't view their first product as something that will change people's lives." But that didn't stop Simonyi from investing personally in the company. "The product is not an answer to the big need," he acknowledges, "but it is an answer to a subset of the big need that is easy to justify and will establish the position, the single point of consolidation, the point between the sockets in the wall and the various communications units. Whoever owns that point will be able to leverage it in the future."

What makes that leverage potentially so significant is the attractiveness of the SOHO market: workers in some 40 million home offices and 5 million small offices. They are people for whom the challenge of presenting a businesslike front to the rest of the world often comes down to what happens when the phone rings.

Again, it was the market that got McKendry and Bass rolling, not any specific product or technology. They certainly weren't thinking about telephones. Most of their collective technical experience related to networking products. They assumed that whatever they came up with, it would in some way help solve the thorny connectivity problems that arise in small offices struggling to integrate computers, faxes, printers, and whatnot. But when they listened to people talk in focus groups, they realized they were off base. What the SOHO: really wanted was something much simpler: a seamless phone system.



SoloPoint could act on that unexpected information because it didn't have to contend with impatient venture capitalists, Bass in this case assuming more of a founder's role. A more traditional model for financing a Valley start-up might look something like this: take \$2 million to \$3 million from the VCs on day one, then \$5 million more 15 months down the road, at which point the product had better be ready to ship. Ideally, revenues should be \$3 million to \$5 million in the first year of shipping the product, \$25 million to \$30 million in year two, and then \$50 million, which would lead into an initial public offering. "And you basically bet the farm on that," says McKendry. "There's not a lot of room in there to make adjustments along the way. If you have to adjust, the founder and management get blown out, viewed as having failed, and new people come in."

That was not the SoloPoint model. Not until March 1995, almost two years into the deal, did SoloPoint get major VC backing. Until then it relied entirely on Bass and other individuals, mainly Bass's friends, who helped out when asked to but otherwise didn't interfere. SoloPoint raised \$1.5 million that way and spent it slowly, burning less than \$20,000 a month during the focus-group days and less than \$100,000 a month for the first 18 months. When it finally approached the VCs, SoloPoint had an exciting product to demonstrate and a compelling story to tell, and the money flowed in. In three rounds of financing since last March, the company has raised \$2.6 million, much of it from prominent venture funds, including Hambrecht & Quist and J. F. Shea Co. SoloPoint hopes to complete its first all-venture-capital funding round, worth \$5 million, by early 1996.

McKendry has a tendency to characterize SoloPoint's capitalization history in idealized terms, as if starting with almost no money and taking three years to get the first product out the door was the preferred model. Clearly, there were costs; having to rely heavily on independent contractors to keep the burn rate low was one. "It saved money and saved stock," says Mike Harrison, cofounder of Gain Technology and one of the initial SoloPoint investors, "but there were times when I wished we had more employees."

The Founder

Martin McKendry, age 41

FAMILY: Married, with three children
PERSONAL FUNDS INVESTED: \$2,200

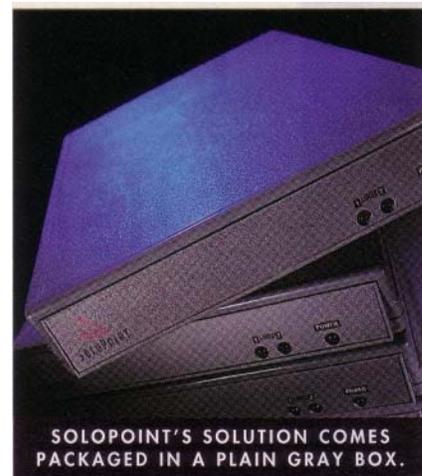
EQUITY: 13%

SALARY: \$130,000

ENTREPRENEURIAL ROOTS: Financially independent at 17, married at 20; ran a business with his wife, preparing high school students for the New Zealand equivalent of the SAT, before emigrating to the United States, in 1978.

WHAT HE TELLS PEOPLE WHO ASK ABOUT HIS ACCENT: "I'm from the South."

ON FINANCIAL PROJECTIONS: "It's a lot healthier to look for customers' reactions and for the number of customers than to focus on things like revenues. Those will be there if people love your product."



Bass describes SoloPoint's "long gestation period" as a combination of "what we thought was the right way to do it, what we knew how to do, and what we could do."

However, there is a principle at work. For the first two years we were cautious about taking money. With money come expectations, and with big money come big expectations. We're at a point where we're now ready to take the big money and meet the big expectations."

An attractive market, a supposedly winning product. Now, to bring the two together.

As of this past fall, Ameritech, the regional Bell operating company for the upper Midwest, had invested a total of \$385,000 in SoloPoint. By inviting Ameritech's participation, SoloPoint at once discouraged a potential competitor and gained a powerful ally. The PCM's technology may be ingenious, but it's hardly irreplicable. McKendry has tried to build a line of defense with patents, but he knows that once the PCM starts selling, somebody will take it apart and figure out how it works. Ameritech makes SoloPoint a more intimidating presence.

Moreover, Ameritech gives SoloPoint an established pipeline to a broad segment of SOHO workers. By definition, they don't think of themselves as members of any group. In the upper Midwest, though, almost all of them buy their local phone service from Ameritech, and many subscribe to cellular service provided by an Ameritech subsidiary, Ameritech Cellular. Now they'll be able to buy a PCM—or, more likely, subscribe to an enhanced small-business service that includes leasing a PCM—from Ameritech, too.

The size of Ameritech's position is significant enough to discourage equity participation by other Baby Bells, which face regulatory limits on how much they as a group can invest in manufacturing companies. So it was a strategic investment that was also a blocking maneuver. Ameritech gained a lock, for now, on SoloPoint's attention, even if SoloPoint is ultimately successful, as it hopes to be, in signing distribution agreements with other Baby Bells and cellular providers.

Eileen Peco, Ameritech's director of business development, views SoloPoint's PCM as a complement to existing net-work services, not as a competitor. "We don't have the sophisticated call-routing capability that is inherent in the box," she says. "The other reality is that there's a market that wants a desktop solution. We feel we can provide small-business customers with both." That's just one of many potential benefits to Ameritech. By putting its own name on SoloPoint's PCM, Ameritech hopes to build customer loyalty. Also, to take full advantage of the PCM's capabilities, besides two lines, users will want voice mail and three-way calling, both high-margin services Ameritech can sell. Finally, because the PCM allows cellular users to accept incoming calls even if they're uncomfortable publicizing their cellular number, it may increase cellular traffic—a bonus for cellular-service providers, like Ameritech.

SoloPoint plans to supplement its deal with Ameritech by selling a version of the PCM directly to consumers through a computer-telephony catalog called Hello Direct, which targets SOHO workers. And it will go after at least one well-defined subset of SOHO workers—real estate agents—with a limited direct-mail campaign. But only Ameritech and distribution partners like it have the marketing clout SoloPoint needs right now to establish a revenue stream early and—just as important—to generate feedback from users.

"No product hits the market perfectly aligned," McKendry says. "Ninety percent of the people will use two or three features constantly. Once you learn what those

features are, you have to allow enough time to make them a bigger presence in the product and diminish the ones that only 10% of the people are using but that end up generating 40% of your technical-support load because they're hard to get at."

There's also a margin issue. The Baby Bells can't take SoloPoint as far as it wants to go—together all seven by themselves probably represent only about \$15 million to \$20 million in potential sales, according to Styres—but they can play a critical role early in the game, while SoloPoint's gross margins are still too thin for the start-up to market extensively on its own. McKendry says his cost of goods sold is nearly 50% higher today than what he would like it to be. As that cost comes down—through design simplification, offshore manufacturing, and higher volume production—then SoloPoint can begin to move product through more expensive distribution channels, meaning general retail. If all goes according to plan, four years from now the line representing PCM sales in high-volume retail outlets such as Staples and OfficeMax will soar and lift earnings with it. Meanwhile, McKendry hopes, the PCM will become a whole lot smarter: maybe with electronic-mail, fax-sorting, and video functions built in, maybe with its essential technology compressed into a single chip that comes preinstalled on the motherboard of your computer or inside your telephone. "The goal of the company in the early business plans was to be the entry point of communications into the home office," says McKendry. "Nobody else has taken that position."

Before SoloPoint can become the Intel of computer telephony, it must prove it can succeed at selling stupid phone tricks in a box. Last fall, with about 100 beta units in the field, the feedback was encouraging but as ephemeral as the results of pre-election polling. Soon, however, McKendry and his colleagues should be poring over actual early returns. The PCM was scheduled to debut this month, appearing in Hello Direct at the same time Ameritech would begin inserting sales literature in its SOHO customers' phone bills.

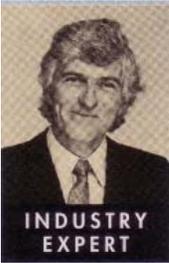
SoloPoint's financial projections are wildly ambitious for a company that's lived nearly three years with no revenues. The charts call for \$4 million in sales of the PCM this year, mostly from the Baby Bells and cellular partners: \$27 million and a small profit in 1998 as retail sales begin to kick in: \$75 million and a large profit in 2000, when retail sales are projected to explode.

McKendry's spoken goals are more your computer or inside your telephone. modest. "I feel pretty good knowing there are 100 units in production and people are saying good things about them. But you can get to 100 just talking to people you know. When we can get 1,000 units in service—early in the first quarter—that will mean we've got distribution moving. When we get to 10,000—by the middle to third quarter of 1996—that will mean we're really poised to go for it, that we've sorted out our business and our manufacturing processes and we're able to shoot these things out like popcorn."

Will the dogs eat popcorn? ■

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What the Experts Say



Harry Newton, Editor-in-chief, Computer Telephony Magazine in New York City

With 75% of business calls reaching voice mail, today's phone is not only stupid but a gigantic time waster. The paradigm of tomorrow's "intelligent phone" is still evolving, but any product that lets customers contact SOHO workers faster, more easily, and more reliably will do well.

I don't believe the \$400 threshold. Heck, people are paying \$2,500 for PCs, and they spend more time on the phone. As for Ameritech's involvement, I'm skeptical. The phone companies have not been successful at complex-product marketing.



Helen Friel, Real estate agent, DeWolfe NewEngland, in Arlington, Mass.

The concept of being able to connect the home phone with the cellular phone is terrific. I also love the fact that you can program it to accept calls only from those you want to talk to. In my business I get people who are calling me about any little thing, and they can some-times abuse the cell number. But when I'm waiting for that very important phone call, this

device would be great. I want people to find me. If they don't find me, they'll find somebody else. In my business what you're selling is service and information. If you're going to give premier service, you have to make yourself available. I think the price is fine. I wouldn't even question it. One sale is more than enough to pay for it.



Geoff Moore, Founder of the Chasm Group, marketing consultants, in PaloAlto, Calif.

In their very early marketing stages, some products require a Field of Dreams approach, which is implicitly criticized here. Valley start-ups often produce a technology in search of a market, but that's how it is with paradigm shifts. Nobody asked for the World Wide Web or the

Macintosh.

By contrast, if the new product fits easily into an existing paradigm, as the PCM seems to, then the kind of Procter & Gamble thinking described here is the winning strategy. The risk of rejection is much lower, but the chance of winning a major market all to yourself is lower, too. The reason that introducing a paradigm-shifting product is worth the risk is that if the market adopts it, the company that dominates the market—Netscape, for instance, in Internet access software—gains astronomical valuation.

SoloPoint is an interesting compromise. PCMs do not seem likely to shift any paradigms, so the company has given away the super-upside potential. But PCMs could generate better returns than the average new product, and thus the product warrants the level of risk taken by Solo-Point's investors.

The company's start-up model does not invalidate the traditional Silicon Valley play, but it introduces an interesting variation. While SoloPoint does not appear to be a

suitable investment for the classic venture fund, it seems to warrant the managed-private-investment approach Charlie Bass is championing. If it works, that approach could find a place on the start-up-funding spectrum.



Nick d Arbellof, Director of marketing at Wildfire, a maker of voice-activated electronic assistants in Lexington, Mass.

An easy-to-integrate, easy-to-use device that forwards calls and helps manage the flow of daily communications could be a big hit in the SOHO market. However, that is a tall order.

Increasingly, consumers want their technology to be "hassle-free." That's why more and more people are opting for a \$6-to-\$8-a-month voice-mail box from the phone company over an \$89 digital answering machine from Circuit City. If the SoloPoint device is truly plug and play, that's a huge plus.

Likewise with ease of use. If the device is simple, highly intuitive, and requires very little programming, then people will use it and make it a part of their routine. If not, they won't. Period.

The bottom line is that early adopters and gadget freaks will snap it up, but achieving market acceptance within the broader SOHO market will be tough. As with many consumer products, it's all about word of mouth: if no one's using it, no one will recommend it; if lots of people are using it heavily, they'll tell everyone they know, and it will spread like...well, Wildfire.

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READER POLL



What do you think of Solo-Point's chances? Send your answers to the following questions by E-mail to anatomy@incmag.com or by fax to 800-335-3348.

We'll report the results when we do an update on SoloPoint's progress.

- 1.** Do you believe, as McKendry does, that SoloPoint is better off today for not having gotten involved with venture capitalists at the start?
- 2.** If you work at home or have a home office, does SoloPoint's PCM sound like a product you would consider buying?
- 3.** Will the dogs eat it?