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Dancing Along the "Long Tail"

by: Stuart Davidson, Labrador Ventures – September, 2005

Will the 80/20 rule be challenged by the Long Tail? Only partly. Niche markets don't always make the greatest businesses – or investments.

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The Long Tail. For ten years now e-commerce entrepreneurs, analysts, investors and Internet pundits have waxed on and on about it, the concept that niche markets can now be served by the wonders of technology. The Internet is now in a position to provide this very marketplace for discerning consumers who were never that thrilled with the mass market offerings anyway.

Karate documentaries on DVD? No problem. Portuguese rap music? Done. Nike sneakers built to order? Absolutely.

Lately, T*he Long Tail*, as a thesis and paradigm for online business has gained a further head of steam. Chris Anderson, editor-in-chief of Wired magazine, and author of *The Long Tail,* an article and a future book of the same name, promotes this concept as entirely game changing, offering the argument that specialty businesses are the untapped potential of the business world and that technology, as enabler, will lengthen and monetize the so-called *Tail*.

It's an interesting proposition – that consumer's interests will now be served in ways they never were before, changing the traditional 80/20 rule that 80 percent of profits or revenue come from a mere 20 percent of widely embraced 'hit' products (i.e. mass market products or services loved by most) into something far more subtle, unique and individualized. Yet, does *The Long Tail* really change the 80/20 rule all that much? Moreover, does it further translate into truly untapped opportunities for VC's – particularly early stage ones – looking to profit from even small to medium sized liquidity events in potential Long Tail types of investments?

Possibly. Possibly not.

Personalize this!

As a pure business, *The Long Tail* is largely untenable in and of itself, at least as far as any VC should be concerned. We shouldn't even look at a business solely dedicated to selling out-of-date Jewish cookbooks or hard to find buttons or zippers. But as an add-on to an existing business, *The Long Tail* makes all the sense in the world.

Amazon and Netflix are obvious examples. Offer well-branded mass market standard-fair books, music and DVDs at cheap prices with decent service, and consumers will beat a path to your door. Maintain a further inventory of hundreds of thousands of hard to find titles – the *Tail* – and a company can reap wonderful opportunities for marginal revenue where none existed before.

Now, extend this to startups. Fund a company with at least a baseline of broad consumer interest – say TV over your wireless phone or an online diamond merchant with a huge inventory of rare gems – and you've killed the same two birds with one stone. For example, a company such as Berkeley, CA-based Idetic, a startup offering television over any wireless device, offers both *Head* and *Tail* as part of its business. The *Head* is the proposition that large numbers of consumers will now wish to have rich, robust data applications over their wireless phones; that beyond instant messaging and ring tones, TV on your cell phone is the next logical step for the mobile consumer.

Now add the *Tail*, which Paul Scanlan, Idetic co-founder and head of marketing and business development describes this way: "We are moving TV toward being highly personalized now that it's on your phone. Even though right now most of the content is delivered in a broadcast form where everyone watches the same thing, our model and our technology allow us to tailor each experience to the individual who is watching. This can take form as interactive input and feedback, specific languages for audio or closed captions, targeted advertising with complete interactivity, and even personalized channels that assemble content based on your viewing habits and/or preferences. For example, "I like baseball, the Giants, don't like hockey, like national news and financial news, but not the weather." If Idetic can package such 'personalized content' in a way that specifically monetizes each person's unique television interests, those *Long Tail* dollars offer significant revenue potential far beyond what the company might have generated through basic wireless TV service.

Let's take another company, Blue Nile Inc., the publicly-traded online diamond merchant based in Seattle, Washington, whose inventory of diamonds dwarfs that of even Tiffany's. Though the *Head* in this case is the broad appeal of diamonds as gifts and status symbols, the *Tail* plays a far more interesting role in meeting consumer demand – in a sense helping create its own demand. "For special interests in music, movies and entertainment, the *Long Tail* is

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great, as consumers only have so much capacity for products and marketing and thus need to coagulate around a few certain things … yet now other interests can be served," says Tod Francis, Partner with Shasta Ventures, one of the venture firms that backed Blue Nile as a private company.

"But along comes the Internet where you can store everything and supply customers all from one location. For information and entertainment that works, though I'd worry that too much might be being bundled into that *Long Tail*," says Mr. Francis."

When you look at a business like Blue Nile, the *Long Tail* concept becomes one of a very *big* category overall. That it's not just an inventory of 200 different kinds of diamonds, but 20,000 different diamonds. And even the broadest audience of diamond buyers would still want that."

The 'Wide' Tail?

"The danger with funding *Long Tail* types of investments," says Mr. Francis and others, is that from a VC standpoint you have to step back and say – are their VC types of returns here in specialty businesses. "You have to be very careful not to overcapitalize these businesses, because at the end of the day you still have to reach these customers and serve them in traditional fashion," says Francis.

In this sense, a company such as Pictopia, a 16-person Emeryville, California-based startup offering media companies turn-key opportunities for selling their archives of photographs to a broad consumer audience, is attempting to go both *Long* and *Wide* through the *Tail*. (Think of being able to buy any photo that ever appeared in the *New York Times*, and at the same time having technology allow the *Times* the ability to sell any photo at the touch of a button.) It's the Amazon model for photos, but perhaps a bit better. Or as Pictopia CEO Mark Liebman describes it, "It's not just about creating a marketplace for photography as a consumer good with an infinitude of images back into history and well into the future, but it's about doing that in the context of an inventory-less retail business."

This is where *The Long Tail* gets really interesting. Unlike Amazon which must stock nearly every conceivable photography book along its miles and miles of shelves, Pictopia need not stock anything at all. Searching for a photo of Babe Ruth at the plate? Place your order and it gets printed on demand. A treasured historical print of the first cars crossing the Golden Gate Bridge? The only inventory becomes the digital file to be turned into the print hanging on your wall. Granted, photos – unlike books and movies – might not have their own bestseller list, thus implying the *Head* of *The Long Tail* is not nearly as defined here. Yet as Liebman puts it, "The Long Tail for us becomes more Wide Tail all the way through the business."

In this sense, the 80/20 rule hasn't necessarily changed when it comes to Pictopia's revenue stream; it's that the number of hits blend far more evenly with all of the individual tastes served throughout Pictopia's 'supply chain'. Or as Mr. Anderson has defined it, "Products don't have to become hits to be a success and fill a need. Now that online retail economics allow us to offer and sell modest-selling niche products efficiently, we don't have to settle for one-size-fits-all products of broad appeal. Narrow appeal is often better when it's narrowly focused on *your* interests, and today the economics of digital distribution allow such micro-markets to exist profitably alongside the mainstream."

Tail providers vs *Tail* enablers

If VC's have to be careful as to just what type of *Long Tail* businesses they might invest in, perhaps a better way to look at this is that all online and/or technology related businesses in the future should have some *Long Tail* aspects to them.

In much the way Idetic can offer personalized TV over a cell phone, Blue Nile can offer a broad inventory of gems to match a range of highly personalized tastes, or Pictopia might offer a limitless selection of on-demand printed photographs, all startups should be capable of serving individual tastes as well as offering deep reservoirs of products and/or services. This should also apply to pure technology enablers such as Mediabolic, a San Mateo, California-based technology startup that provides software for connected entertainment products.

It's not so much that Mediabolic itself is a *Long Tail* provider of content; rather that it's a *Long Tail* enabler of it – one of the so-called future 'arms merchants' of the *Long Tail* concept. By allowing televisions or cell phones to share and play back content from other consumer devices, PCs, and the Internet – and vice-versa – Mediabolic allows media content to extend even farther along the farthest reaches of the *Tail*. "People have accumulated tremendous amounts of content and it's all trapped in a PC," says Bob Selzler, Mediabolic's vice-president of marketing. "With our technology it makes it easier for MovieLink to compete with NetFlix, it allows the 20 billion photos taken last year – 63 percent of which weren't even printed – to be shared with family and friends through the living room TV, and it allows personalized media and personalized content to play out to those users furthest out on the *Tail*."

Yet, even Long Tail enablers may still find it a tough sell among VCs. "We're always looking at companies that have the capacity to cut out the distribution people and that's what we might invest in," says Scott Potter, managing partner with San Francisco Equity Partners. "Yet, the *Long Tail* won't suddenly make an underground band into a big seller like Britney Spears. You still want to look at the existing market when it comes to investing, particularly when it comes to disintermediating anything, and see just what's so valuable about making something available to the masses."

In that sense, is the *Long Tail* as a concept, business model and/or investment opportunity really all that special after all. "At the end of the day, I think the *Long Tail* might change the 80/20 rule into more of a 70/30 rule, if that, but realistically it's just one aspect of a company that we might view as upside, that's about it." It appears that most other early stage VCs should feel exactly the same way.

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

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