

Friday  
September 12





# Advanced Innovation Program

Section III:

*Evaluating And Valuing The Deal*  
*Steve Ciesinski*

**Friday, 12th September**

|                                                                                                                                             |                                                                                                                                              |
|---------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>8:30 - 9:15 am</b><br/> <b>Steve Ciesinski: Evaluating Venture Opportunities, Valuing Startups</b></p>                                | <p><b>1:00 - 2:00 pm</b><br/> <b>Guest Speaker: Term Sheet</b><br/> <i>Tim Young, VC attorney</i></p>                                        |
| <p><b>9:15 - 10:15 am</b><br/> <b>Guest Speaker: Prepping your company for Series A</b><br/> <i>Eric Ver Ploeg: Tunitas Ventures VC</i></p> | <p><b>2:00 - 2:45 pm</b><br/> <b>Steve Ciesinski: After First Closing of Pre-Seed, Seed, Series A</b></p>                                    |
| <p><b>10:15 - 10:30 am</b><br/> Break</p>                                                                                                   | <p><b>2:45 - 3:00 pm</b><br/> Break</p>                                                                                                      |
| <p><b>10:30 - 11:00 am</b><br/> <b>Guest Speaker: Corporate VC</b><br/> <i>Shaloo Garg, Microsoft Corporate VC</i></p>                      | <p><b>3:00 - 4:00 pm</b><br/> <b>Guest Speaker: Exiting your Investment</b><br/> <i>Touraj Parang: COO, past VC, author of Exit Path</i></p> |
| <p><b>11:00 am - 12:00 pm</b><br/> <b>Steve Ciesinski: Corporate Governance</b></p>                                                         | <p><b>4:00 – 5:00 pm</b><br/> <b>Steve Ciesinski: Venture Returns; Final Q &amp; A</b></p>                                                   |
| <p><b>12:00 - 1:00 pm</b><br/> Lunch at the Garden Patio</p>                                                                                | <p><b>5:00 pm Reception and certificates</b><br/> At the Upper Terrace</p>                                                                   |



# Assessing Venture Opportunities

# Topics Covered In This Module



1. Learn a structured framework for evaluating venture opportunities.
2. Learn to break down a business' value proposition into its individual components.
3. Learn to assess the attractiveness, risks, and competitive advantages of a new venture.
4. Segue way to learn to perform due diligence on a new venture's business plan.

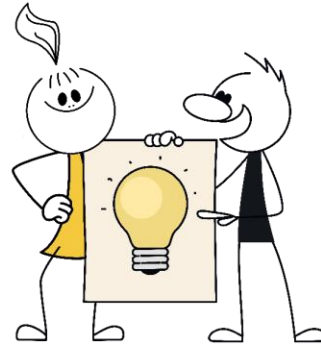


# Evaluating A Business Opportunity

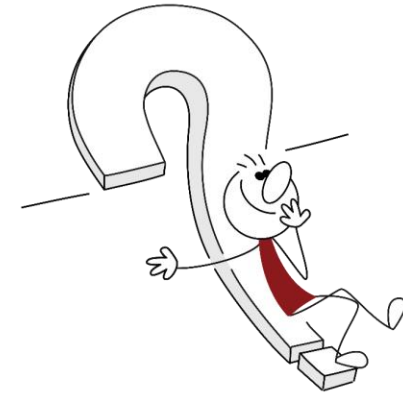
*The starting point for any investment is evaluating the proposed business opportunity:*



***Will the opportunity be able to capture market and be profitable enough (for a given risk)?***



***Is your assessment based on intuition or an objective thorough analysis***



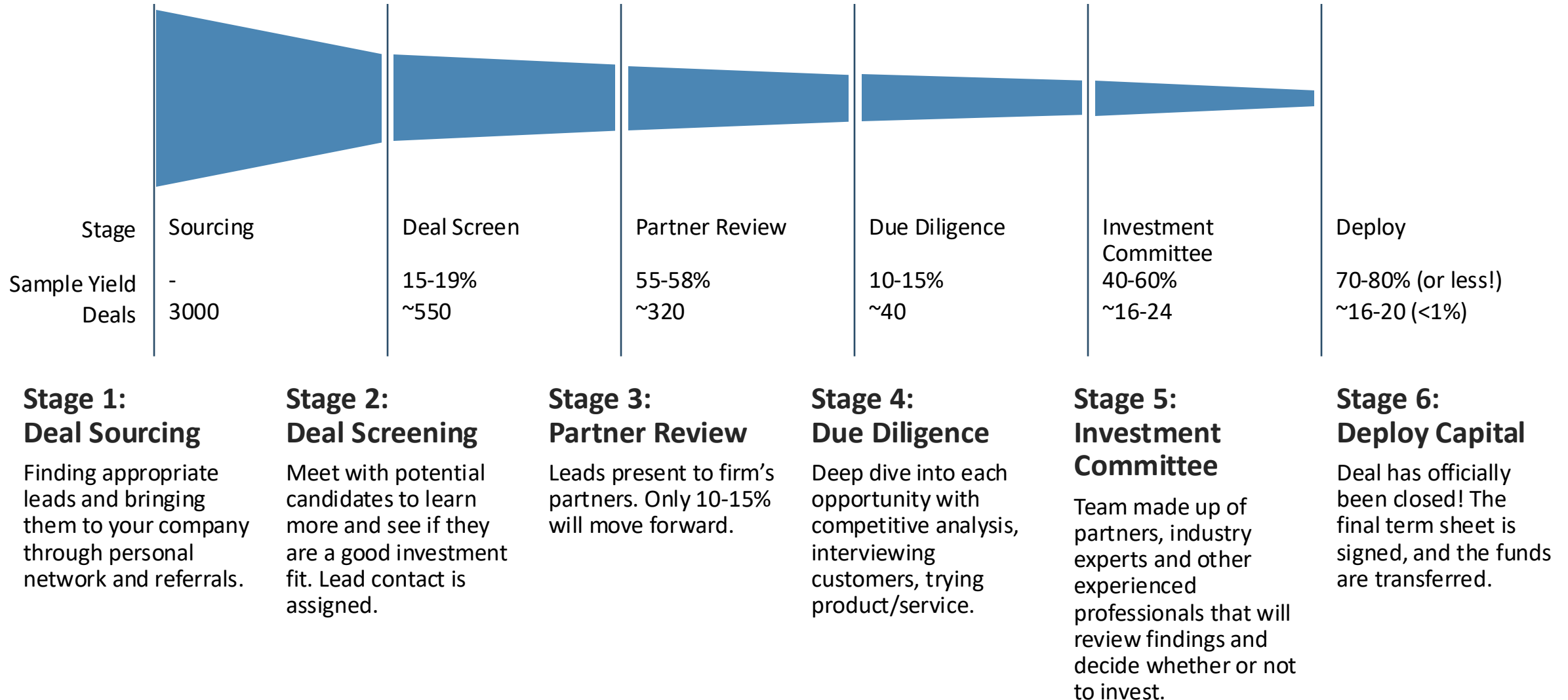
***Is tis an absolute and relative evaluation vs other opportunities***

# 12 Things We Consider Before Deciding to Meet A Founder-Entrepreneur

- Founders: Tech and Business
- Founders: How Many?
- Founders: Past Experiences
- What Industry?
- What Problem to be Solved? How Urgent? How Hard?
- Immediate Market Size and Growth
- MVP or PMF
- Capital Required (Now and Future)
- Timing
- Traction
- Past Funding, Investors, Advisors?
- Referral Source

**You learned about many of these in the Pitch Deck session**

# Venture Selection Process





# The Venture Evaluation Matrix ("VEM") Framework

# What are your assumptions going into this investigation

- Is this your “sweet spot”
- (if not, eliminate quickly and explain)
- Is this your stage?
- If not eliminate
- Does this check or uncheck the boxes on your checklist

# What are your assumptions going into this investigation

**1**

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(if not, eliminate quickly and explain)

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**Is this your stage?**

If not eliminate

**Does this check or uncheck the boxes on your checklist**

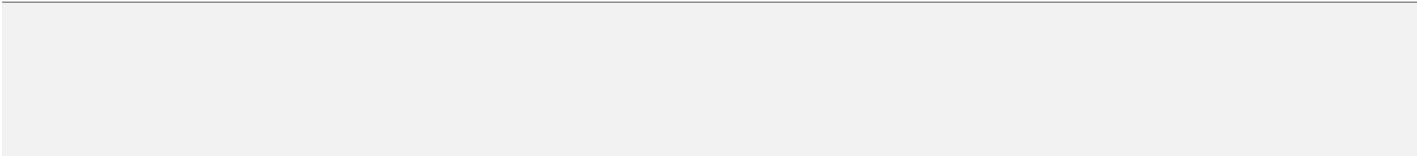
# Start With Key Actors

**Customer**

**Company**

**Entrepreneur**

# Then Introduce Key Perspectives



---

**Value Proposition**  
(micro)

---

**Market/Industry**  
(macro)

---

**Strategy**  
(dynamic)

---

# Key Perspectives

**Value Proposition**  
(micro)

can the company create value (PMF) ?

**Market/Industry**  
(macro)

can the company win market share and then scale up?

**Strategy**  
(dynamic)

can the company capture target value for investors?



# Key Actors With Perspectives: “3 X 3” Matrix

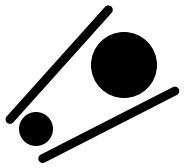
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# Venture Evaluation Matrix (“VEM”) Cells

|                   | Customer | Company | Entrepreneur |
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| Strategy          |          |         |              |

# Venture Evaluation Matrix Logic

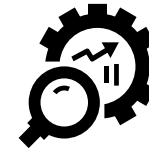
*Evaluate the strength of an entrepreneurial idea by assessing how it proves able to generate value:*



**1. Start with micro perspective**, move to the macro perspective and finally to the ability to be dynamically sustainable



**2. Derive** the opportunity's competitive advantages and attractiveness

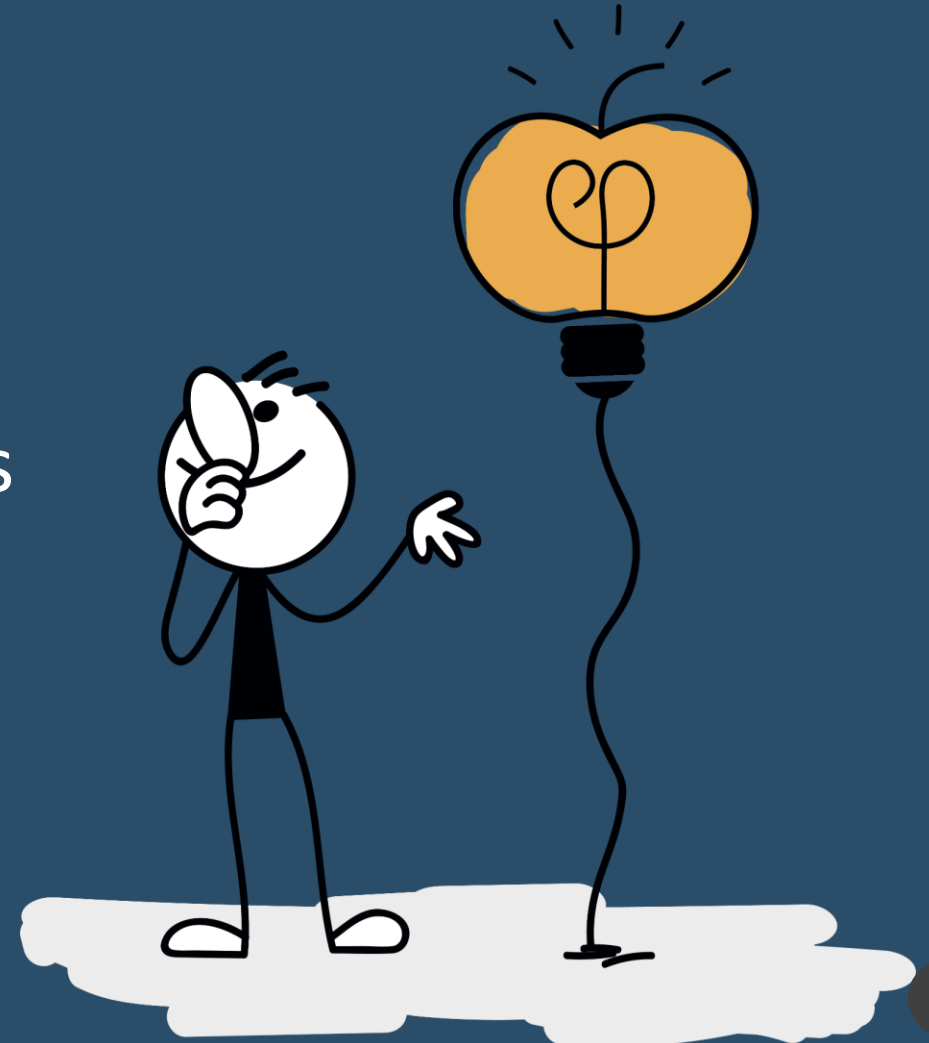


**3. Assess** the long-term economic viability of the opportunity

**The “VEM” takes both entrepreneur and investor perspective**

# Venture Evaluation Matrix Cells

Let's go through the nine matrix cells



# Venture Evaluation Matrix Cells

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# Need

## Know your customer!

- What exactly is the customer need?
- How strong is the need? How urgent is it? How well do customers understand it?
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**Individual vs. corporate customers: very different decision process**

**Learning** from early adopters, iterative exploration



# Fully Understand Customer Priorities (needs)

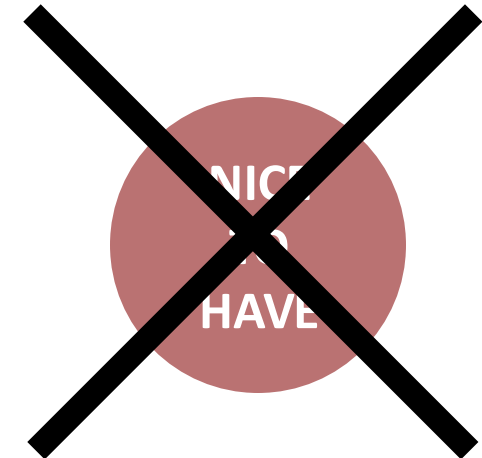


**MUST HAVE**

**SHOULD  
HAVE**

**NICE TO  
HAVE**

# Fully Understand Customer Priorities (needs)



**NOTE:** Too many startups concentrate on – “should haves” and “nice- to-haves”,  
*not on absolute must-haves!*



# What Is An Urgent Customer Problem And Need?

**Customer really cares: Serious Pain**

**Urgent, immediate**

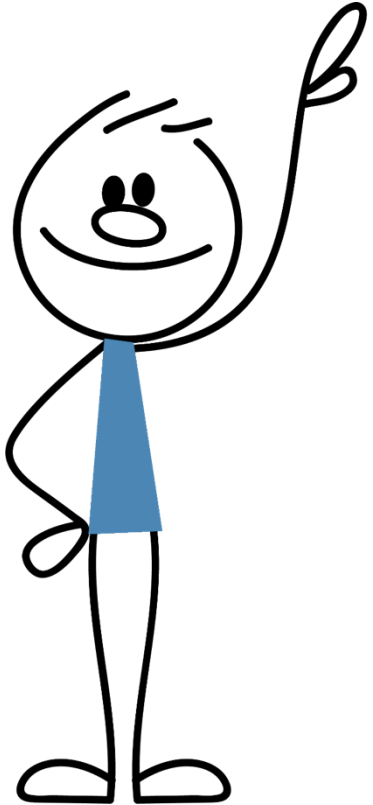
**Large market opportunity**

## **Other Examples**

- Therapy for **lead poisoning**
- Identify sources and fixes of **cyber attacks**
- **Navigation** without a GPS signal



# Solution (innovation)



## **Know your offering (product, service, subscription, etc.)!**

- Does the proposed solution precisely solve the customer's need?
- How does the proposed solution compare to the alternatives? How is it different?
- To what extent can the innovation be protected?

## **Role of product experimentation, customer vs solution**

## **Nature of the innovation, compelling or not?**

- How to come up with the right solution? Design thinking

# Ibuprofen To The Rescue!



# Team

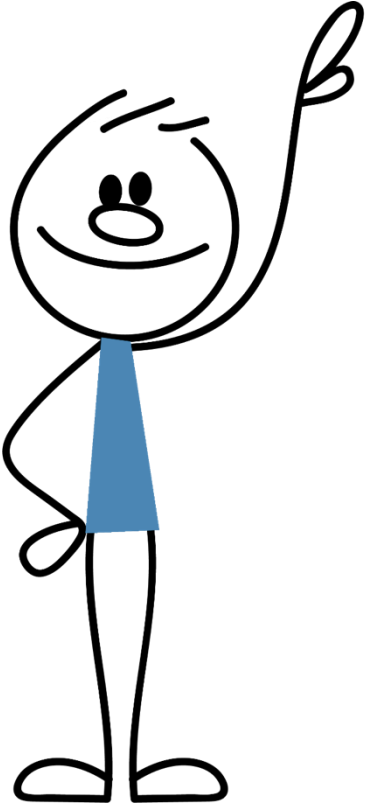
**Talent is the  
scarce resource**



**The team is the  
differentiator**



# Team



## **Talent is the scarce resource:**

- Do the founders have the required skills and experience?
- What are their motivation and commitment?
- Is the founders' team complementary and cohesive?

**“I invest in people, not ideas” Arthur Rock**

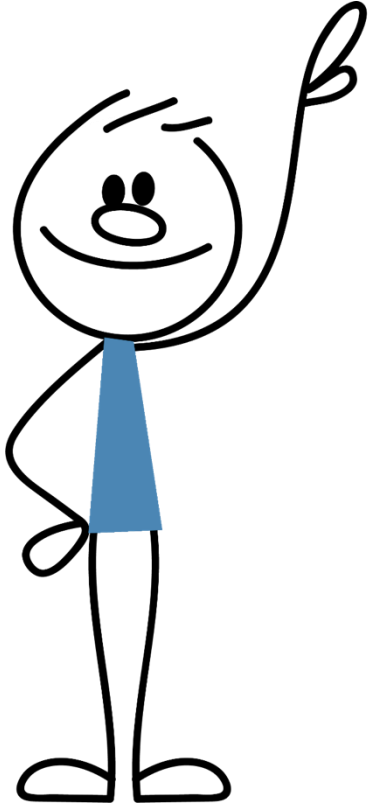
**Importance of integrity and trustworthiness**

**Solo founder vs. founding teams**

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# Market



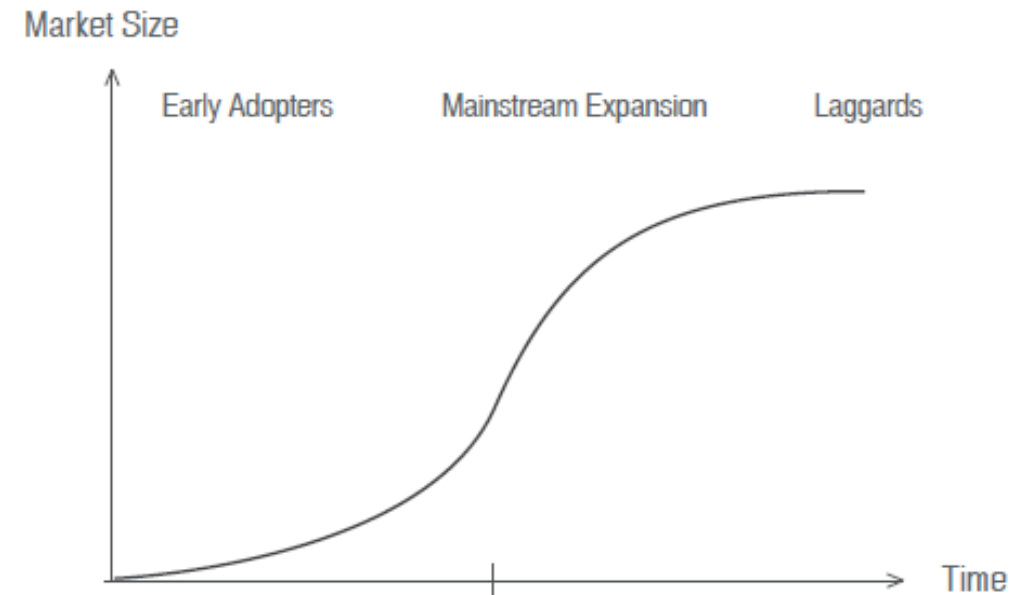
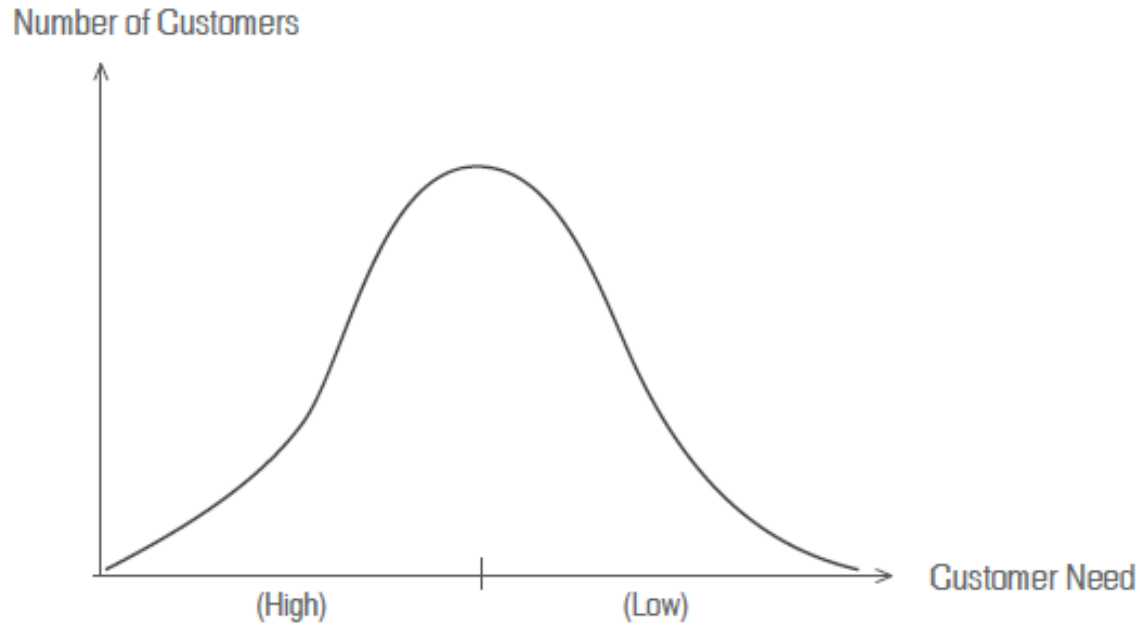
## **How big is the opportunity?**

- How large is the target market?
- How fast will the target market grow?
- How will adoption take place?

## **Adaptation process and marketing timing**

## **Product life-cycle: S-curve (what does the the shape look like?)**

# What Do the Market Curves Tell You?????





# AI To the Rescue?

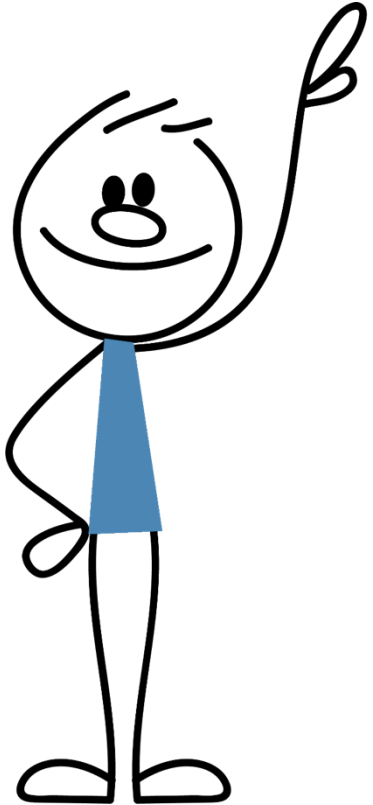
## Average number of individual contributors per people manager at small businesses

Among 8,500 businesses using Gusto with 2 to 500 employees; Monthly, January 2019 to September 2024



Data: Gusto; Chart: Axios Visuals

# Competition



## **Know your competitors!**

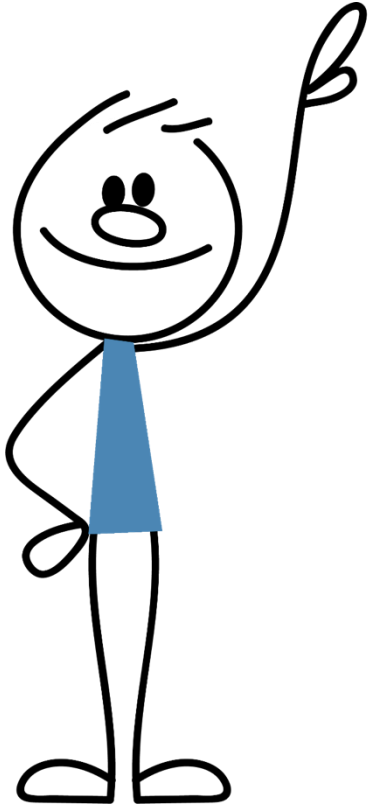
- Who are current and future competitors?
- What is the nature of competition?
- How can the venture differentiate itself?
- Is your most feared competitor same old way (“SOW”)?

**Transformative (breakthrough, disruptive) vs incremental innovation**

**Cooperation vs. competition**

**Nature of barriers to entry and product longevity**

# Network



## **The founders' network allows to access resources**

- What is the founding team's reputation?
- What networks does the team have access to, especially in the selected industry or adjacencies?
- How does the team forge and maintain new relationships?

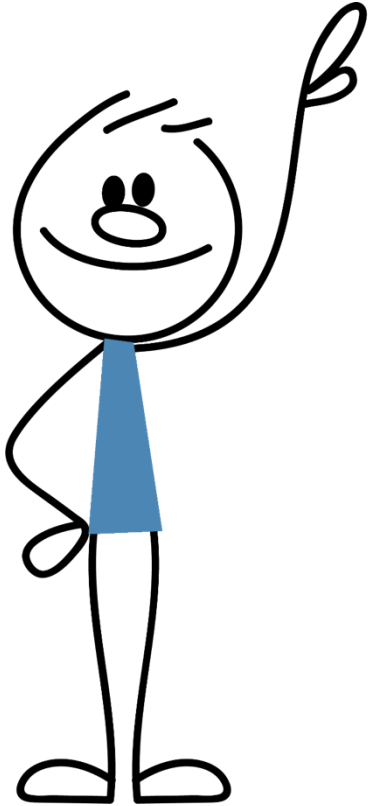
## **Importance of network centrality**

- Quality of network ties: connectedness, diversity, position

# Venture Evaluation Matrix Cells

|                   | Customer                        | Company                   | Entrepreneur |
|-------------------|---------------------------------|---------------------------|--------------|
| Value Proposition | Need                            | Solution                  | Team         |
| Industry          | Market                          | Competition               | Network      |
| Strategy          | Go-to-market<br>Marketing/Sales | Technology/<br>Production | Organization |

# Marketing/Sales



**What are the “long-term” Go-to-market plans?**

**How is the product brought to customers?**

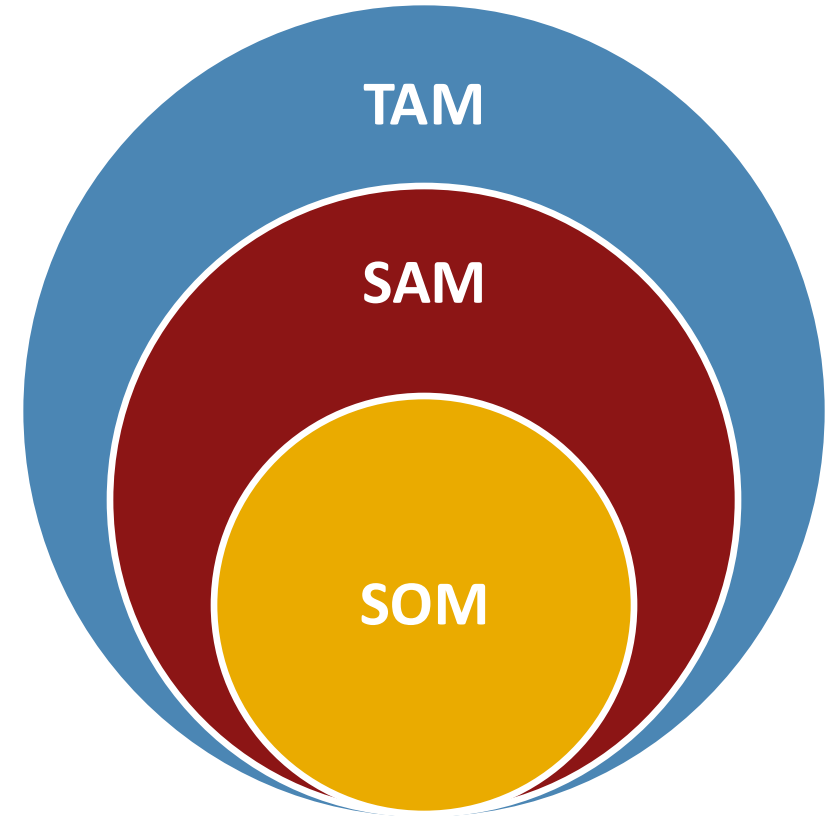
- How does the venture reach its customers?
- What are the marketing and distribution strategies?
- What are the pricing strategy and the revenue model?
- **How will you scale?**

**Transformative vs incremental products**

- Natural resistance to adopt – adoption costs
- How much education is needed, and how long will this take until the market takes off beyond the early adopter stage?

# TAM - SAM - SOM – What It Means And Why It Matters

When doing their market analysis start-ups often refer to TAM, SAM, and SOM but what do these acronyms mean and why are they useful to investors when assessing an investment opportunity?



# Tam Sam Som – What It Means And Why It Matters

**TAM: Total Available Market**, that is, the total possible market for a company's product or service.

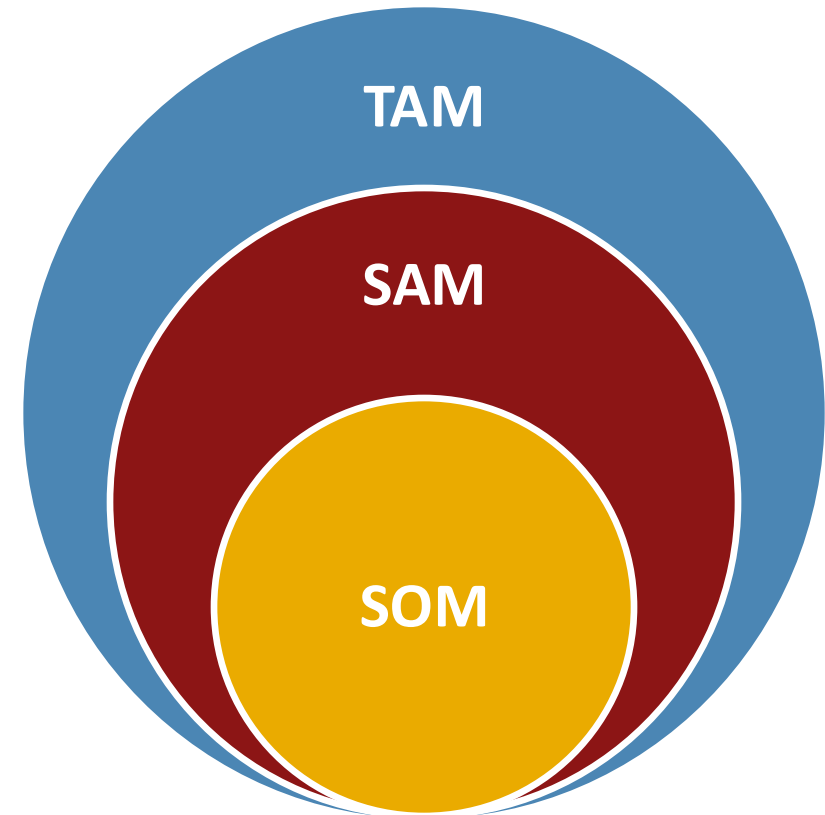
- For example, the total amount of beer sold worldwide

**SAM: Serviceable Addressable Market**, that is, the proportion of available market that best fits a company's product or service.

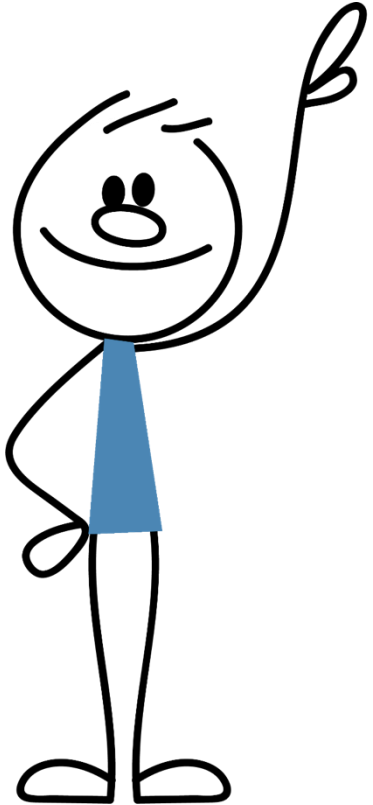
- For example, the total amount of “craft beer” sold worldwide

**SOM: Serviceable Obtainable Market**, that is, the proportion of SAM a company can realistically achieve.

- For example, The total amount of craft beer sold in California



# Development/Engineering/Production



## **How does the company capture value?**

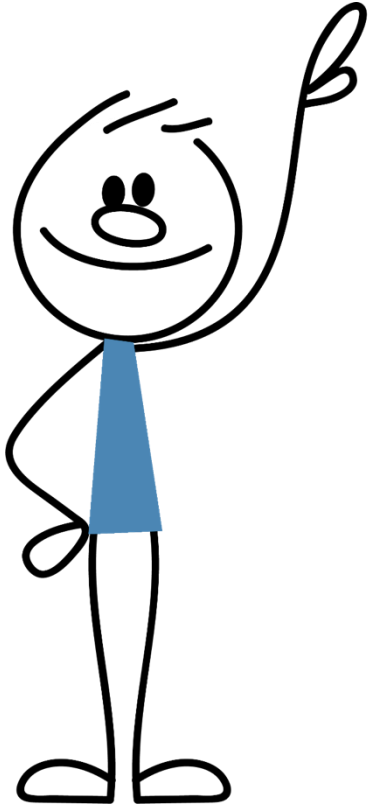
- What is the development and engineering strategy?
- What are the scope of activities and the partnering strategy? What will you build yourself, and what will you out-source?
- How efficient are operations?

## **Importance of technical milestones / key inputs**

- Will the technology and architecture scale?



# Organization



## **How to develop and maintain company leadership?**

- How will the role of the founders evolve?
- What is the (management) governance structure?
- What is the talent strategy?

## **Developing a cultural imprint**

## **Talent recruiting and retention**

## **Founders' succession**

## **What are the potential boundaries of the firm**

Ultimately,  
Market Size and  
Investor Value  
Matter!

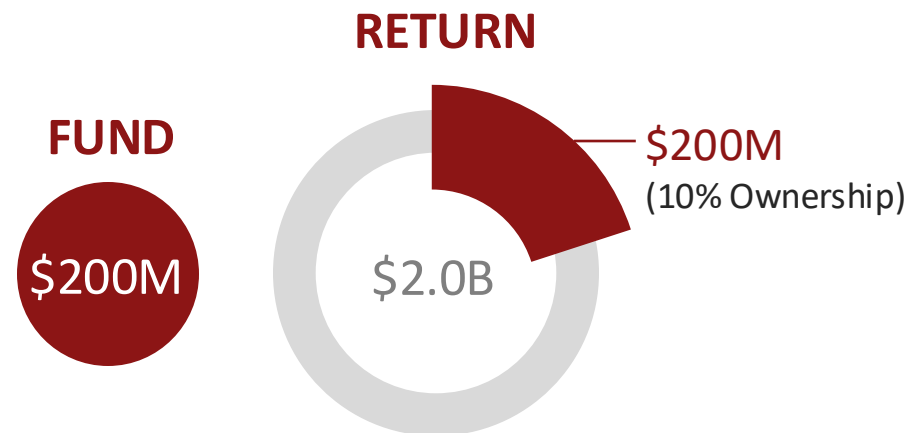


## Serviceable Obtainable Market => Return

### Rule of thumb

Investors will often want to see a scenario where any given company could **theoretically return “the fund” 1x**

### Example



Assuming software company  
↓  
**8x exit**  
revenue multiple  
↓  
Company needs  
**\$250M ARR**

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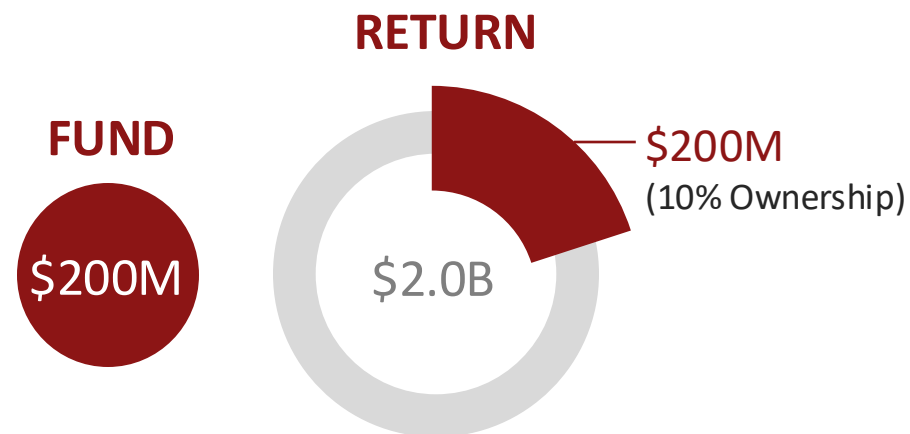


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# Venture Evaluation Matrix: Taking Stock

| <b>Venture Evaluation Matrix</b> | <b>Customer</b> | <b>Company</b>            | <b>Entrepreneur</b> | <b>Attractiveness</b> |
|----------------------------------|-----------------|---------------------------|---------------------|-----------------------|
| <b>Value Proposition</b>         | Need            | Solution                  | Team                | <b>Customer Value</b> |
| <b>Industry</b>                  | Market          | Competition               | Network             | <b>Venture Scale</b>  |
| <b>Strategy</b>                  | Sales           | Technology/<br>Production | Organization        | <b>Growth/Profit</b>  |
| <b>Competitive Advantage</b>     | Access          | Entry Barriers            | Competencies        |                       |

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# Venture Evaluation Matrix

## *Taking Stock*

The VEM also allows assessing venture's main risks, also across the three vertical dimensions:



**market risk**



**Technology/delivery risk**



**people risk**

# VEM: Taking Stock, Make Investment Decisions

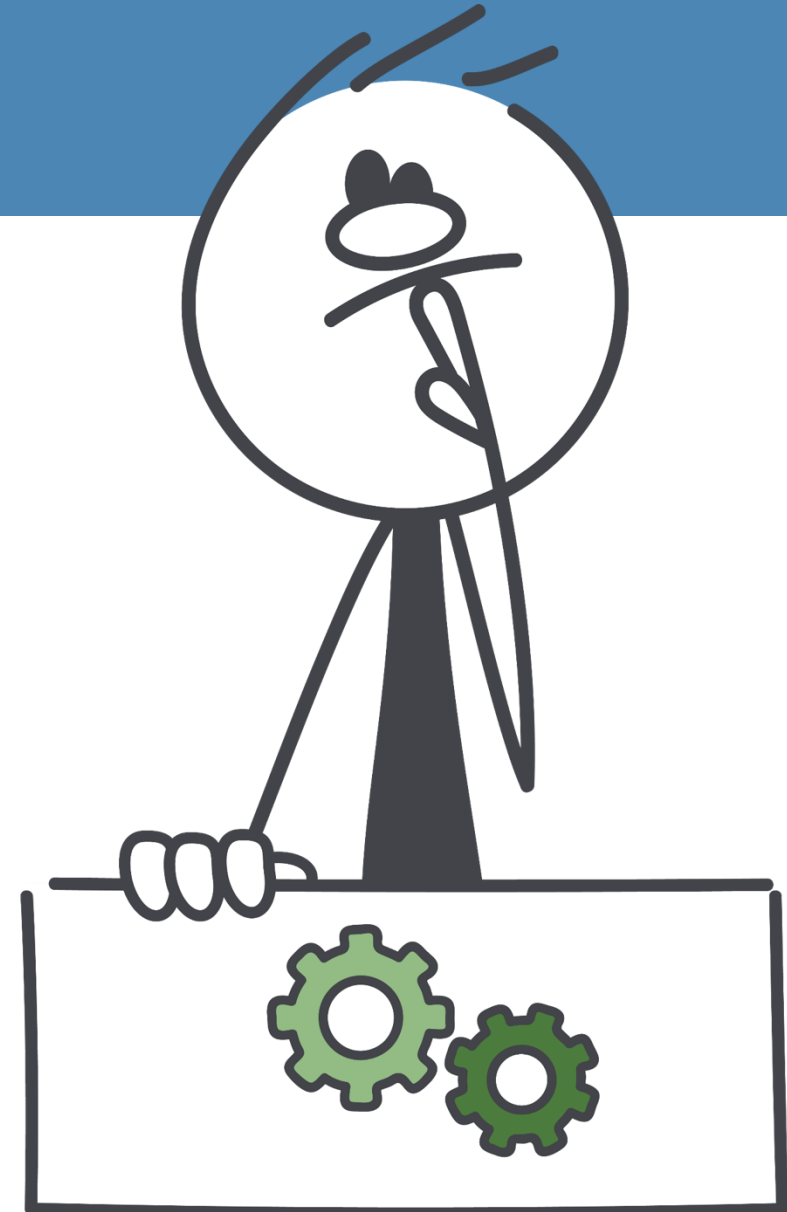


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| Strategy                  | Sales    | Technology/<br>Production | Organization | Growth         |
| Competitive Advantage     | Access   | Entry Barriers            | Competencies | DECISIONS!     |

# The VEM In Practice

**We have built a 3x3 matrix** that encompasses the key questions both entrepreneur and investor should ask.

- You will need to apply your own “tough questions” to each of these cells (the book has lots of detail!)
- Both the entrepreneur and the investor can use the VEM to guide their actions and decisions



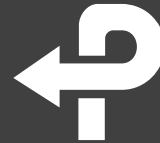


# How Entrepreneurs Can Use The VEM

*The entrepreneur can use the VEM to look at the strengths and weaknesses of her venture, and honestly and objectively assess whether:*



**It is fully  
convincing  
(rarely!)**



**It requires some  
dose of pivoting  
(always!)**



**It should be  
dropped  
(frequently!)**

# How Investors Can Use The VEM



*The investors can use the VEM as a time-saver at two levels:*

## 01

For a first screening, using the spreadsheet tool (probably eliminating >> 50% of deals)



# How Investors Can Use The VEM



*The investors can use the VEM as a time-saver at two levels:*

## 02

For guiding more detailed due diligence, providing a structured approach to a decision



# Topics Covered In This Module



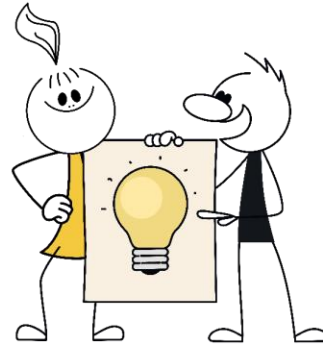
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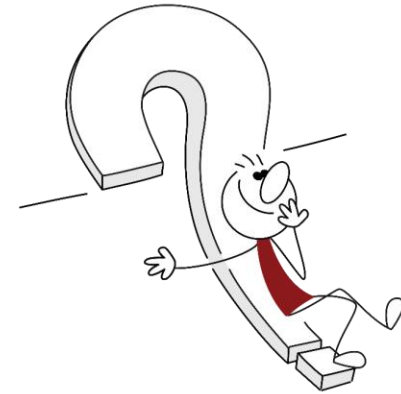
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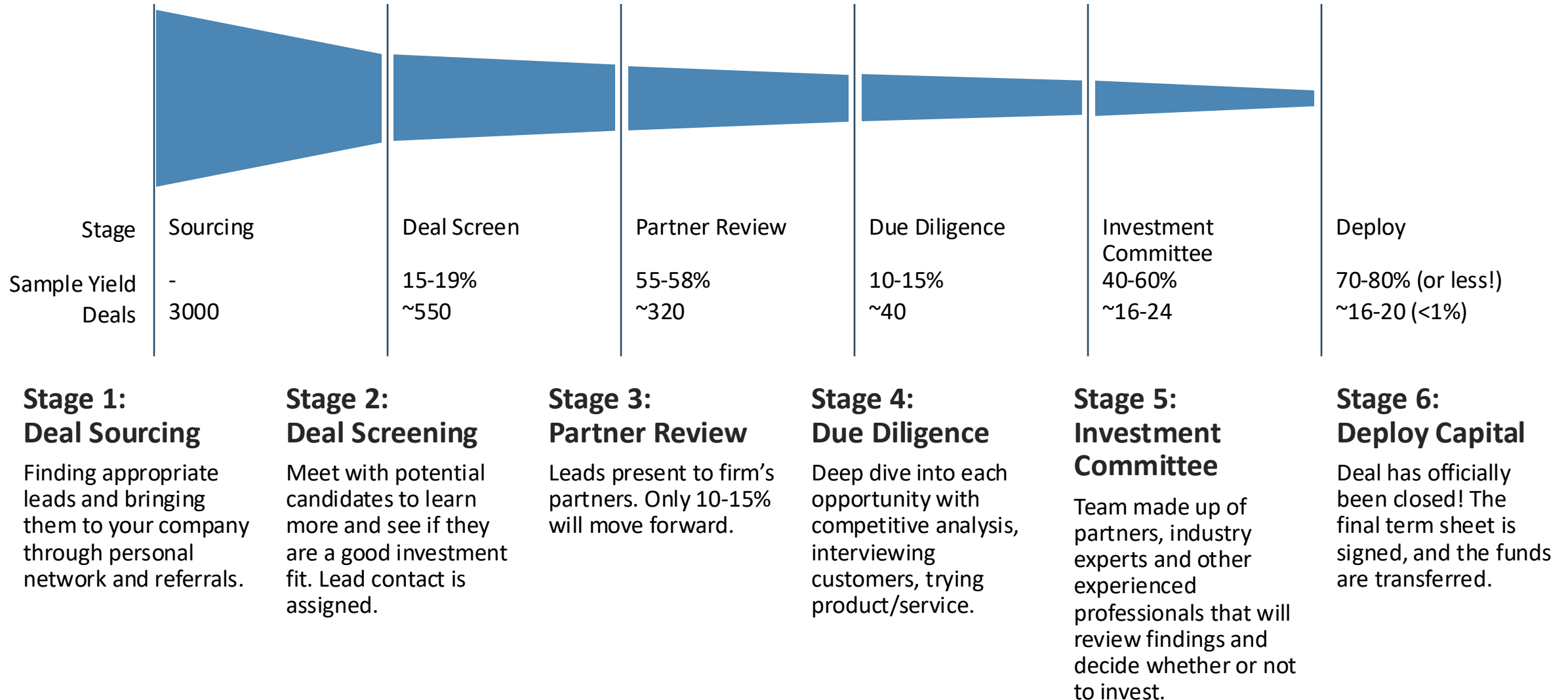
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# The Venture Evaluation Matrix ("VEM") Framework



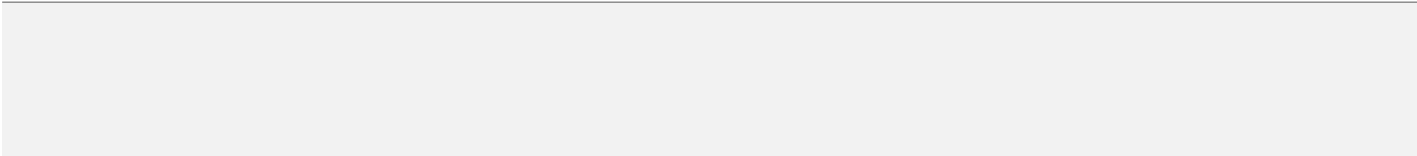
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# Key Actors With Perspectives: “3 X 3” Matrix

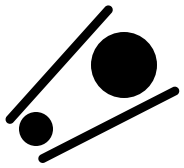
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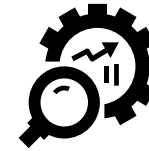
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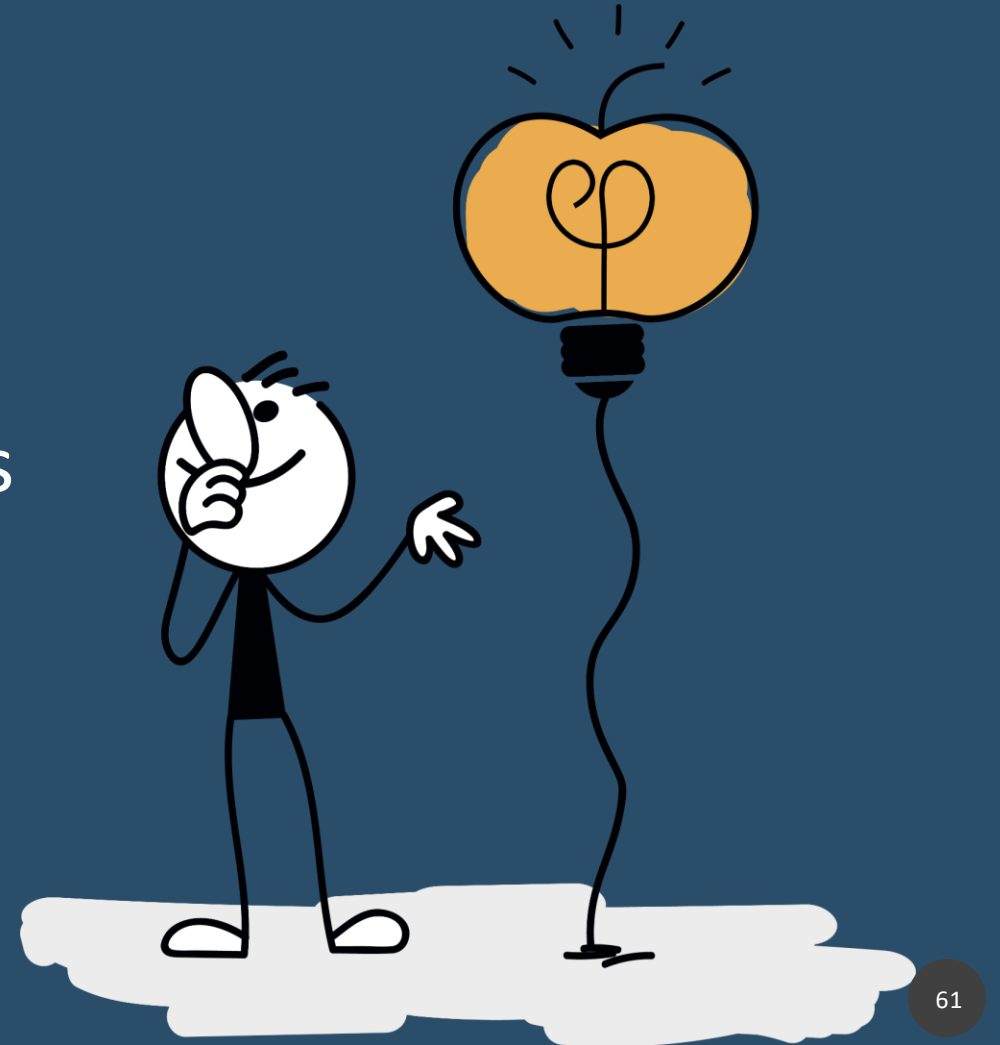


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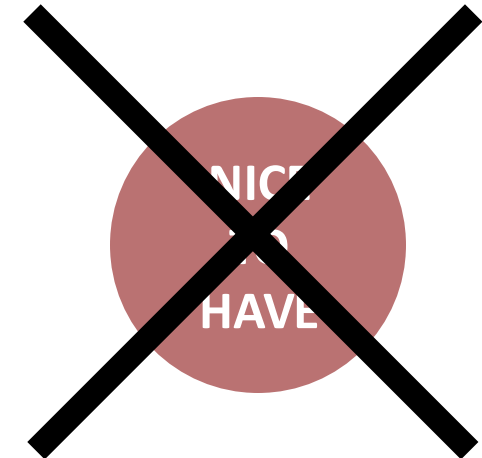


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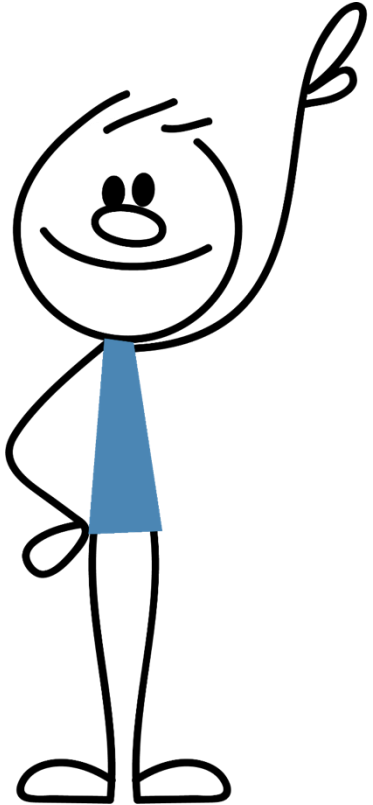
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## **Role of product experimentation, customer vs solution**

## **Nature of the innovation, compelling or not?**

- How to come up with the right solution? Design thinking

# Ibuprofen To The Rescue!





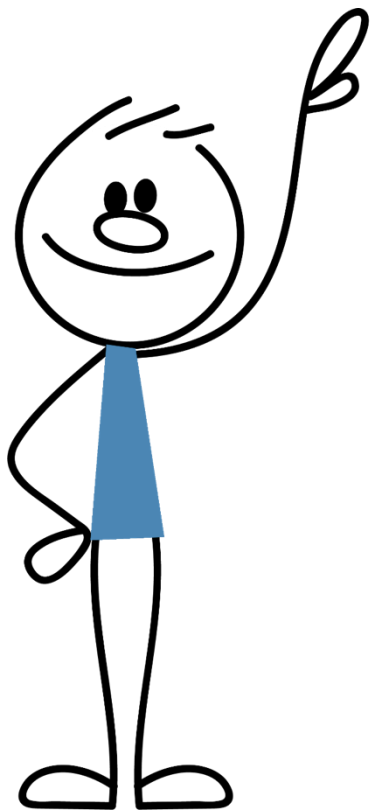
# Team

**Talent is the  
scarce resource**



**The team is the  
differentiator**

# Team



## **Talent is the scarce resource:**

- Do the founders have the required skills and experience?
- What are their motivation and commitment?
- Is the founders' team complementary and cohesive?

**“I invest in people, not ideas” Arthur Rock**

**Importance of integrity and trustworthiness**

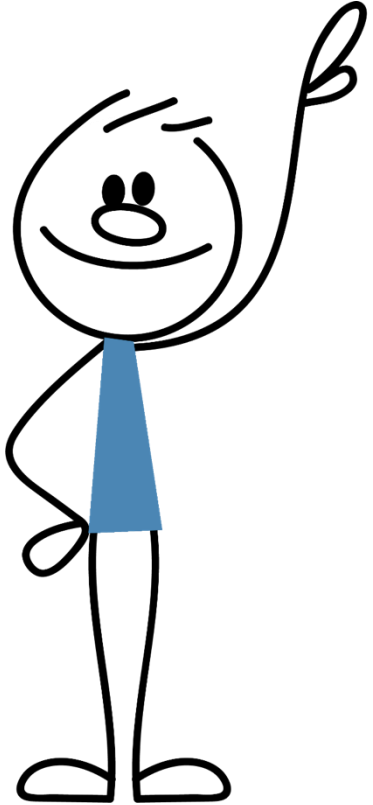
**Solo founder vs. founding teams**



# Venture Evaluation Matrix Cells

|                   | Customer        | Company                   | Entrepreneur |
|-------------------|-----------------|---------------------------|--------------|
| Value Proposition | Need            | Solution                  | Team         |
| Industry          | Market          | Competition               | Network      |
| Strategy          | Marketing Sales | Development<br>Production | Organization |

# Market



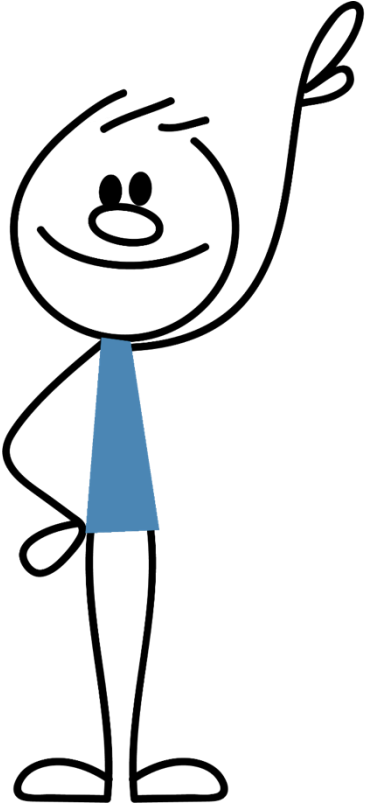
## **How big is the opportunity?**

- How large is the target market?
- How fast will the target market grow?
- How will adoption take place?

## **Adaptation process and marketing timing**

**Product life-cycle: S-curve (what does the the shape look like?)**

# Competition



## **Know your competitors!**

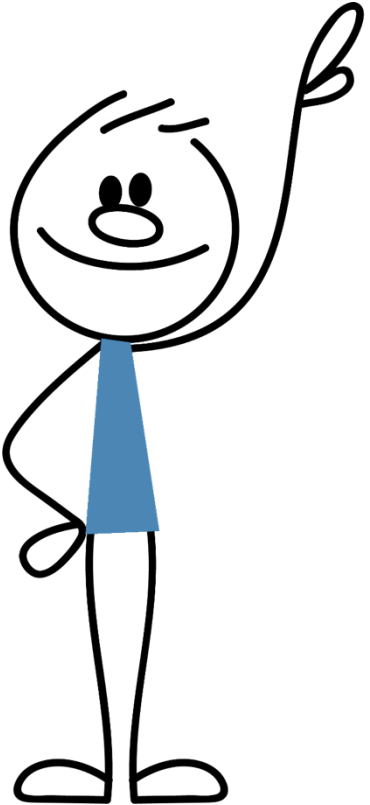
- Who are current and future competitors?
- What is the nature of competition?
- How can the venture differentiate itself?
- Is your most feared competitor same old way (“SOW”)?

**Transformative (breakthrough, disruptive) vs incremental innovation**

**Cooperation vs. competition**

**Nature of barriers to entry and product longevity**

# Network



## **The founders' network allows to access resources**

- What is the founding team's reputation?
- What networks does the team have access to, especially in the selected industry or adjacencies?
- How does the team forge and maintain new relationships?

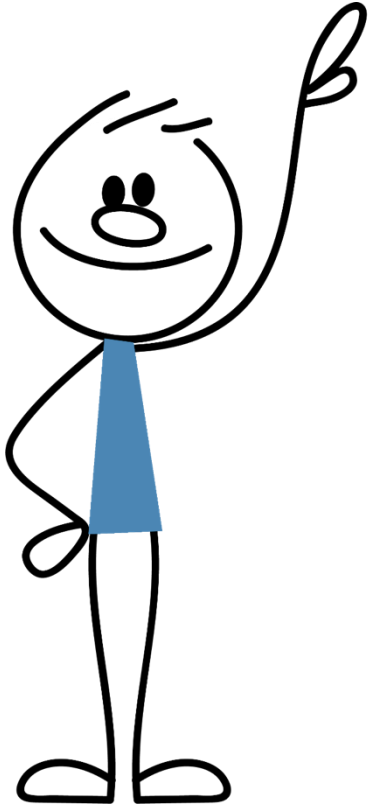
## **Importance of network centrality**

- Quality of network ties: connectedness, diversity, position

# Venture Evaluation Matrix Cells

|                   | Customer                        | Company                   | Entrepreneur |
|-------------------|---------------------------------|---------------------------|--------------|
| Value Proposition | Need                            | Solution                  | Team         |
| Industry          | Market                          | Competition               | Network      |
| Strategy          | Go-to-market<br>Marketing/Sales | Technology/<br>Production | Organization |

# Marketing/Sales



**What are the “long-term” Go-to-market plans?**

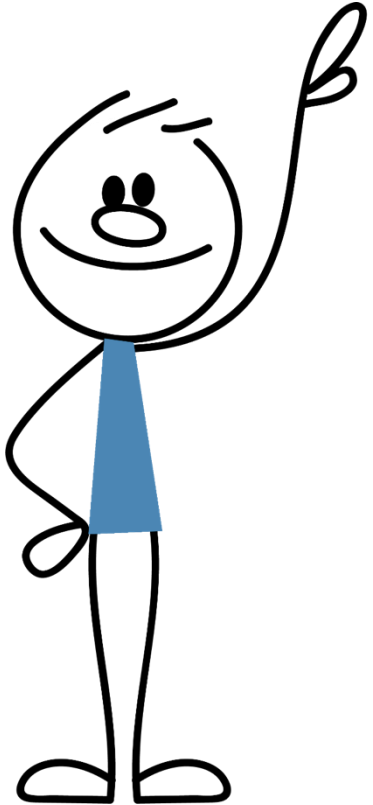
**How is the product brought to customers?**

- How does the venture reach its customers?
- What are the marketing and distribution strategies?
- What are the pricing strategy and the revenue model?
- **How will you scale?**

**Transformative vs incremental products**

- Natural resistance to adopt – adoption costs
- How much education is needed, and how long will this take until the market takes off beyond the early adopter stage?

# Development/Engineering/Production



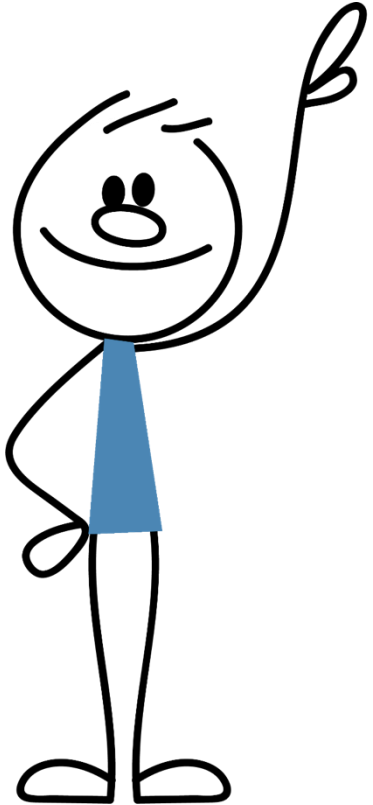
## **How does the company capture value?**

- What is the development and engineering strategy?
- What are the scope of activities and the partnering strategy? What will you build yourself, and what will you out-source?
- How efficient are operations?

## **Importance of technical milestones / key inputs**

- Will the technology and architecture scale?

# Organization



## **How to develop and maintain company leadership?**

- How will the role of the founders evolve?
- What is the (management) governance structure?
- What is the talent strategy?

## **Developing a cultural imprint**

## **Talent recruiting and retention**

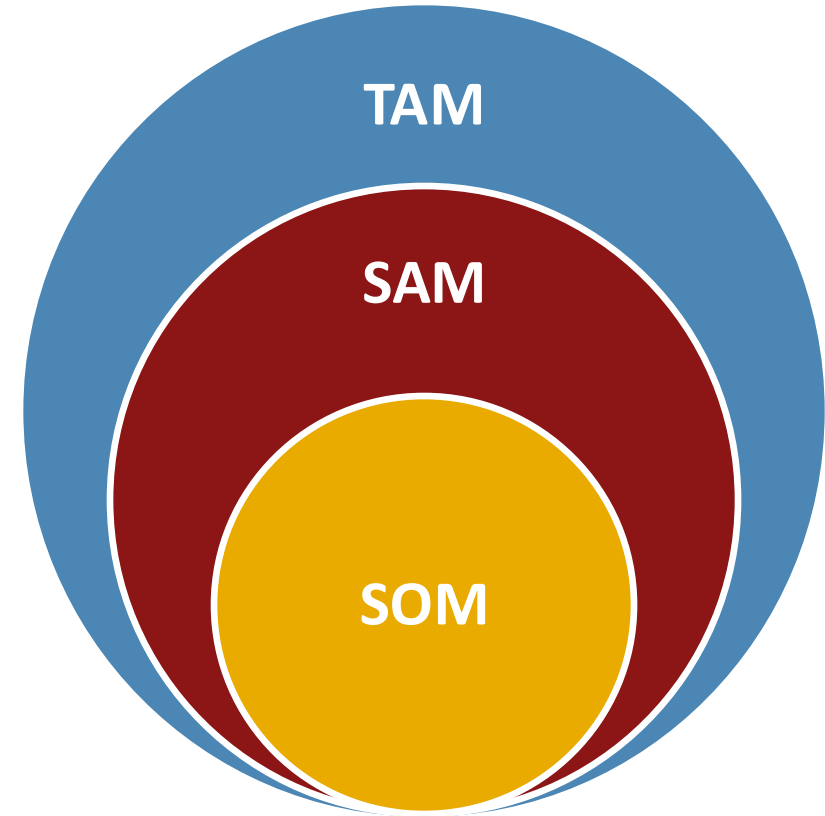
## **Founders' succession**

## **What are the potential boundaries of the firm**



# TAM - SAM - SOM – What It Means And Why It Matters

When doing their market analysis start-ups often refer to TAM, SAM, and SOM but what do these acronyms mean and why are they useful to investors when assessing an investment opportunity?



# Tam Sam Som – What It Means And Why It Matters

**TAM: Total Available Market**, that is, the total possible market for a company's product or service.

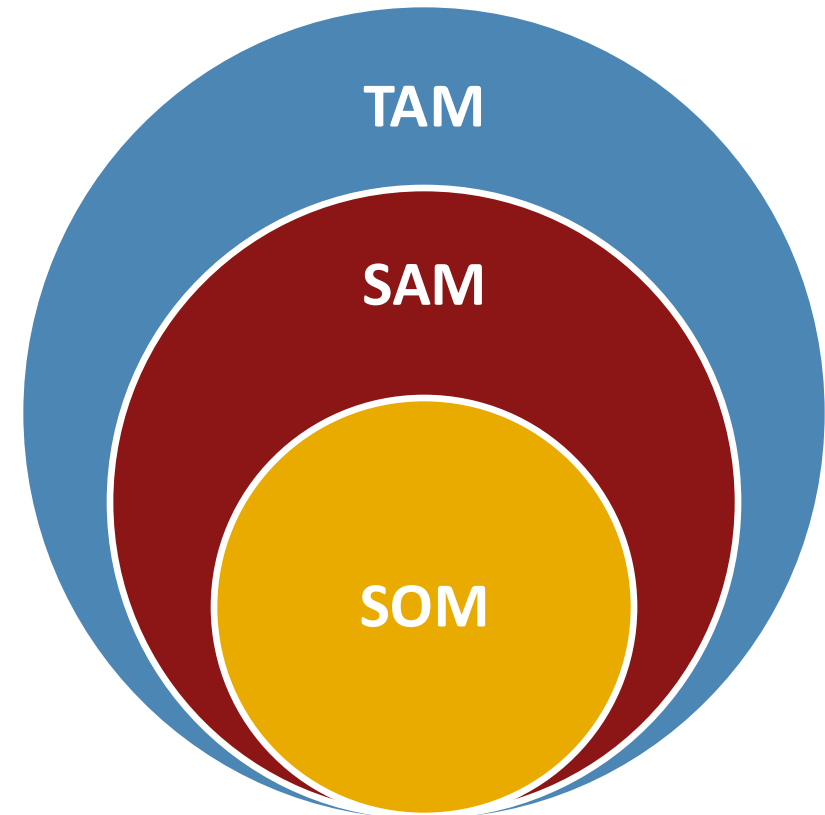
- For example, the total amount of beer sold worldwide

**SAM: Serviceable Addressable Market**, that is, the proportion of available market that best fits a company's product or service.

- For example, the total amount of “craft beer” sold worldwide

**SOM: Serviceable Obtainable Market**, that is, the proportion of SAM a company can realistically achieve.

- For example, The total amount of craft beer sold in California



Ultimately,  
Market Size and  
Investor Value  
Matter!

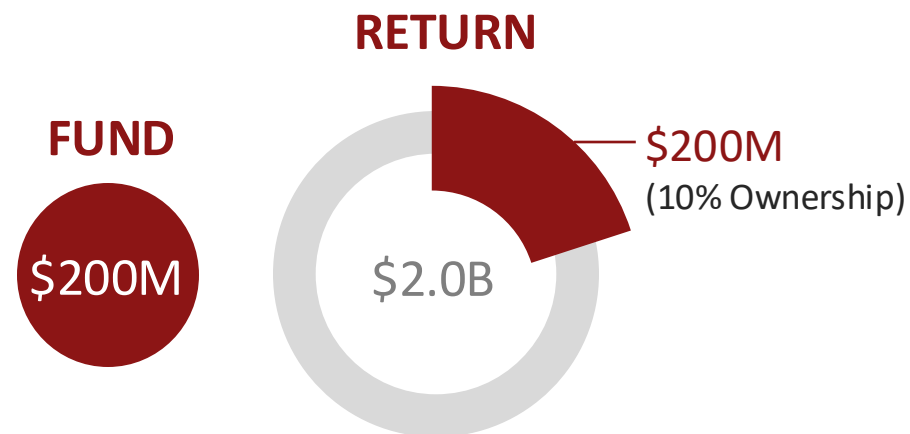


## Serviceable Obtainable Market => Return

### Rule of thumb

Investors will often want to see a scenario where any given company could **theoretically return “the fund” 1x**

### Example



Assuming software company  
↓  
**8x exit**  
revenue multiple  
↓  
Company needs  
**\$250M ARR**

Ultimately,  
Market Size and  
Investor Value  
Matter!

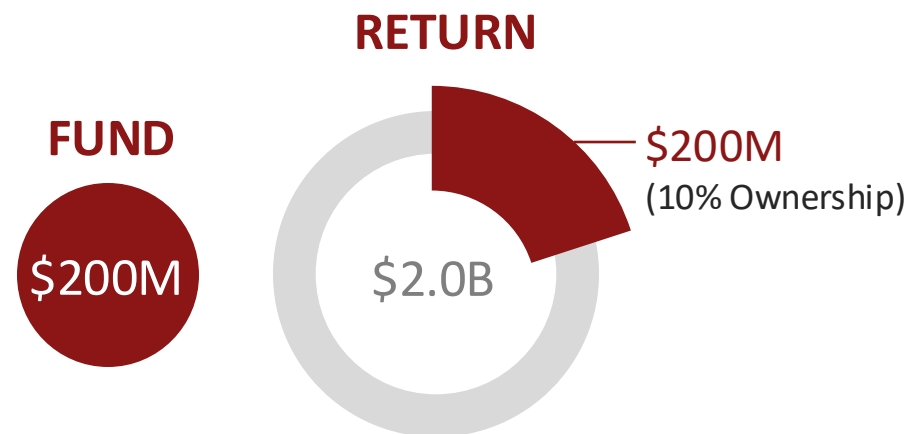


## Serviceable Obtainable Market => Return

### Rule of thumb

Investors will often want to see a scenario where any given company could **theoretically return “the fund” 1x**

### Example



Assuming software  
company



**8x exit**  
revenue multiple



Company needs  
**\$250M ARR**

# Venture Evaluation Matrix: Taking Stock

| <b>Venture Evaluation Matrix</b> | <b>Customer</b> | <b>Company</b>            | <b>Entrepreneur</b> | <b>Attractiveness</b> |
|----------------------------------|-----------------|---------------------------|---------------------|-----------------------|
| <b>Value Proposition</b>         | Need            | Solution                  | Team                | <b>Customer Value</b> |
| <b>Industry</b>                  | Market          | Competition               | Network             | <b>Venture Scale</b>  |
| <b>Strategy</b>                  | Sales           | Technology/<br>Production | Organization        | <b>Growth/Profit</b>  |
| <b>Competitive Advantage</b>     | Access          | Entry Barriers            | Competencies        |                       |

# Venture Evaluation Matrix: Taking Stock

| <b>Venture Evaluation Matrix</b> | <b>Customer</b> | <b>Company</b>            | <b>Entrepreneur</b> | <b>Attractiveness</b> |
|----------------------------------|-----------------|---------------------------|---------------------|-----------------------|
| <b>Value Proposition</b>         | Need            | Solution                  | Team                | Value                 |
| <b>Industry</b>                  | Market          | Competition               | Network             | Scale                 |
| <b>Strategy</b>                  | Sales           | Technology/<br>Production | Organization        | Growth/Profit         |
| <b>Competitive Advantage</b>     | <b>Access</b>   | <b>Entry Barriers</b>     | <b>Competencies</b> |                       |

# Venture Evaluation Matrix

## *Taking Stock*

The VEM also allows assessing venture's main risks, also across the three vertical dimensions:



**market risk**



**Technology/delivery risk**



**people risk**

# VEM: Taking Stock, Make Investment Decisions



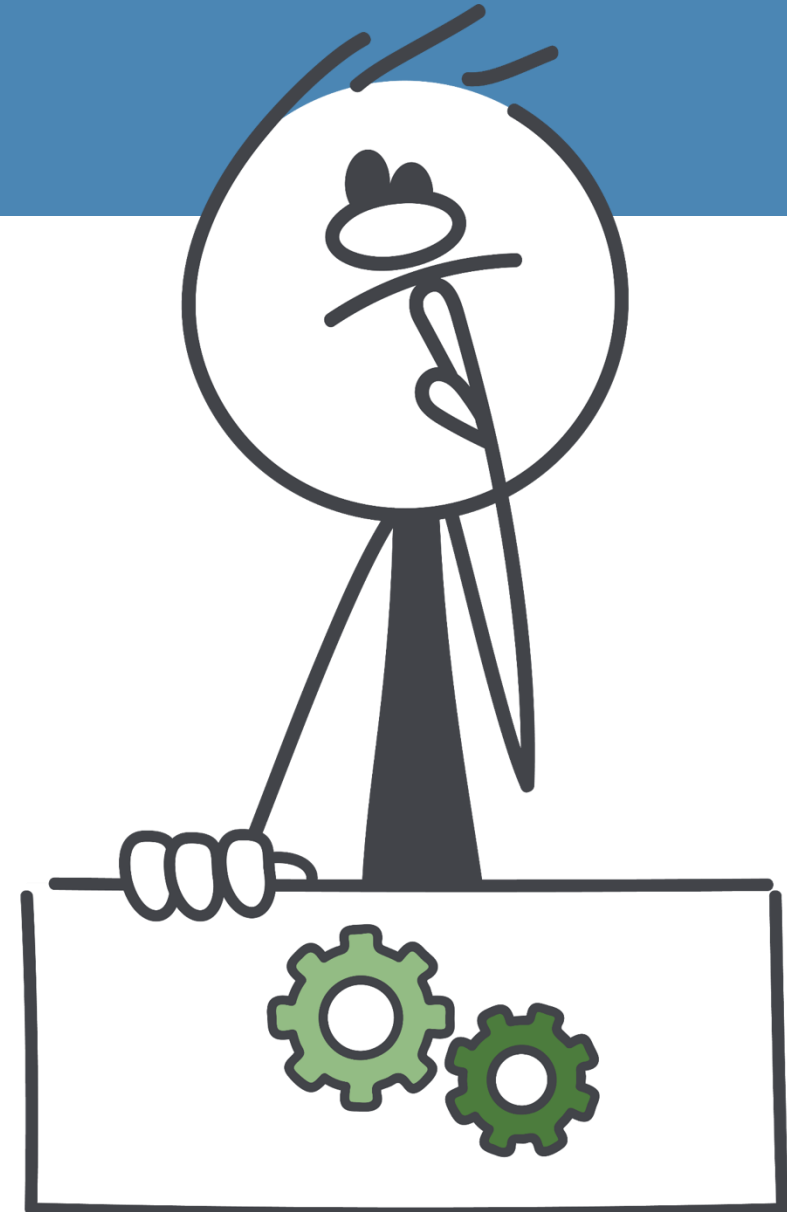
| Venture Evaluation Matrix | Customer | Company                   | Entrepreneur | Attractiveness |
|---------------------------|----------|---------------------------|--------------|----------------|
| Value Proposition         | Need     | Solution                  | Team         | Value          |
| Industry                  | Market   | Competition               | Network      | Scale          |
| Strategy                  | Sales    | Technology/<br>Production | Organization | Growth         |
| Competitive Advantage     | Access   | Entry Barriers            | Competencies | DECISIONS!     |



# The VEM In Practice

**We have built a 3x3 matrix** that encompasses the key questions both entrepreneur and investor should ask.

- You will need to apply your own “tough questions” to each of these cells (the book has lots of detail!)
- Both the entrepreneur and the investor can use the VEM to guide their actions and decisions

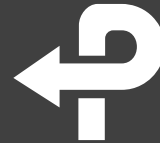


# How Entrepreneurs Can Use The Vem

*The entrepreneur can use the VEM to look at the strengths and weaknesses of her venture, and honestly and objectively assess whether:*



**It is fully  
convincing  
(rarely!)**



**It requires some  
dose of pivoting  
(always!)**



**It should be  
dropped  
(frequently!)**

# How Investors Can Use The VEM



*The investors can use the VEM as a time-saver at two levels:*

## 01

For a first screening, using the spreadsheet tool (probably eliminating >> 50% of deals)



# How Investors Can Use The VEM



*The investors can use the VEM as a time-saver at two levels:*

## 02

For guiding more detailed due diligence, providing a structured approach to a decision



# So, Let's Go Through The Arithmetic

*Assume a \$30 million Seed Stage Fund, lasting 10 years, no salary to manager*

\$1.5M invested in each of 20 startups

2X return = Need to achieve \$60 million overall return, **7% IRR** (\$50m = 5% IRR)

## REALISTIC SCENARIO OVER 10 YEARS

**10 outright losers**  
0\$ return from  
50% of companies

**4 exit at \$5.1M**  
return of \$1.275M  
per company

**2 exit at \$25M**  
return of \$12.5M  
per company

**One is a superstar,  
exiting at \$30M**  
with only \$1.5M  
invested = 20x return,  
or 1.0x fund of \$30M

Total return over 10 years = **\$60M**

# Let's Go Through The Arithmetic

*Assume a \$2 million Seed Stage Angel Fund, no salary to manager*

\$100K invested in each of 20 startups

2X return = Need to achieve \$4 million overall return, **7% IRR** (\$3.5m = 5% IRR)

| REALISTIC SCENARIO OVER 10-12 YEARS                             |                                                            |                                                            |                                                            |                                                                                                                      |
|-----------------------------------------------------------------|------------------------------------------------------------|------------------------------------------------------------|------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------|
| <b>8 outright losers</b><br>0\$ return from<br>40% of companies | <b>4 exit at \$400K</b><br>return of \$100K<br>per company | <b>4 exit at \$800K</b><br>return of \$200K<br>per company | <b>3 exit at \$900K</b><br>return of \$300K<br>per company | <b>One is a superstar,<br/>exiting at \$2m</b><br>with only \$100K<br>invested = 20x return,<br>or 1.0x fund of \$2M |

Total return over 10 years = **\$4.1m**

# Let's Go Through The Arithmetic

*Assume a \$2 million Seed Stage Angel Fund, no salary to manager*

\$100K invested in each of 20 startups

3X return = Need to achieve \$6.2 million overall return, **12% IRR** (\$3.5M = 5% IRR)

| REALISTIC SCENARIO OVER 10-12 YEARS                             |                                                            |                                                             |                                                             |                                                                                                                    |
|-----------------------------------------------------------------|------------------------------------------------------------|-------------------------------------------------------------|-------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| <b>8 outright losers</b><br>0\$ return from<br>40% of companies | <b>4 exit at \$500K</b><br>return of \$125K<br>per company | <b>4 exit at \$1000K</b><br>return of \$250K<br>per company | <b>3 exit at \$1500K</b><br>return of \$500K<br>per company | <b>One is a superstar,<br/>exiting at \$3M</b><br>with only \$100K<br>invested = 30x return,<br>or 3x fund of \$2M |

Total return over 10 years = **\$6m**

# How Investors Can Use The VEM

*Consider the customer dimension:*



**Need is verified  
by asking directly  
customers**



**Market:  
secondary market  
research**



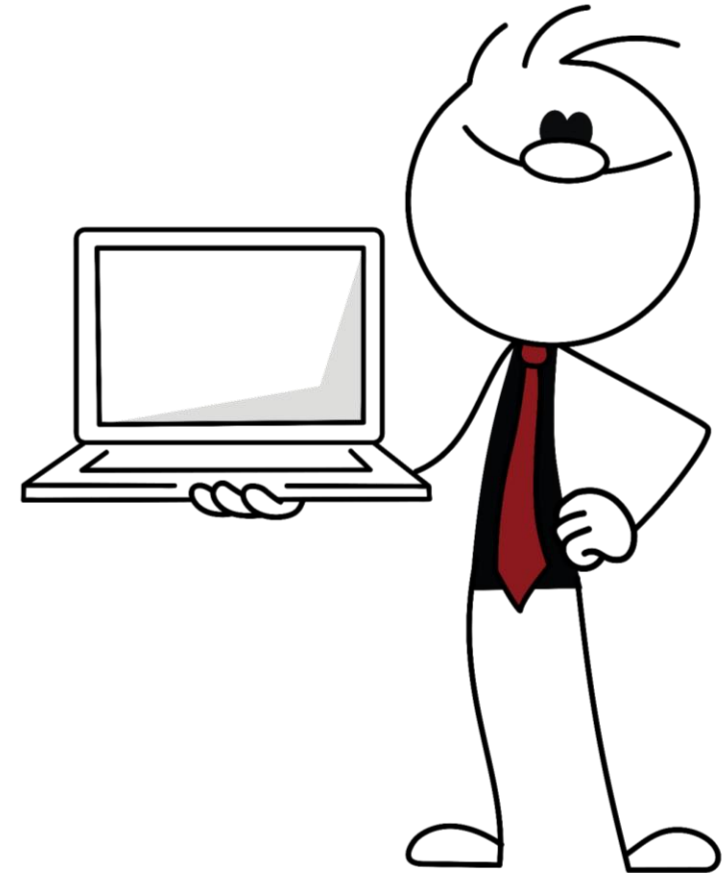
**Sales: verifying  
the quality of  
customer access  
and sales cycles**



# How Investors Can Use The VEM

## About the science and technology dimension:

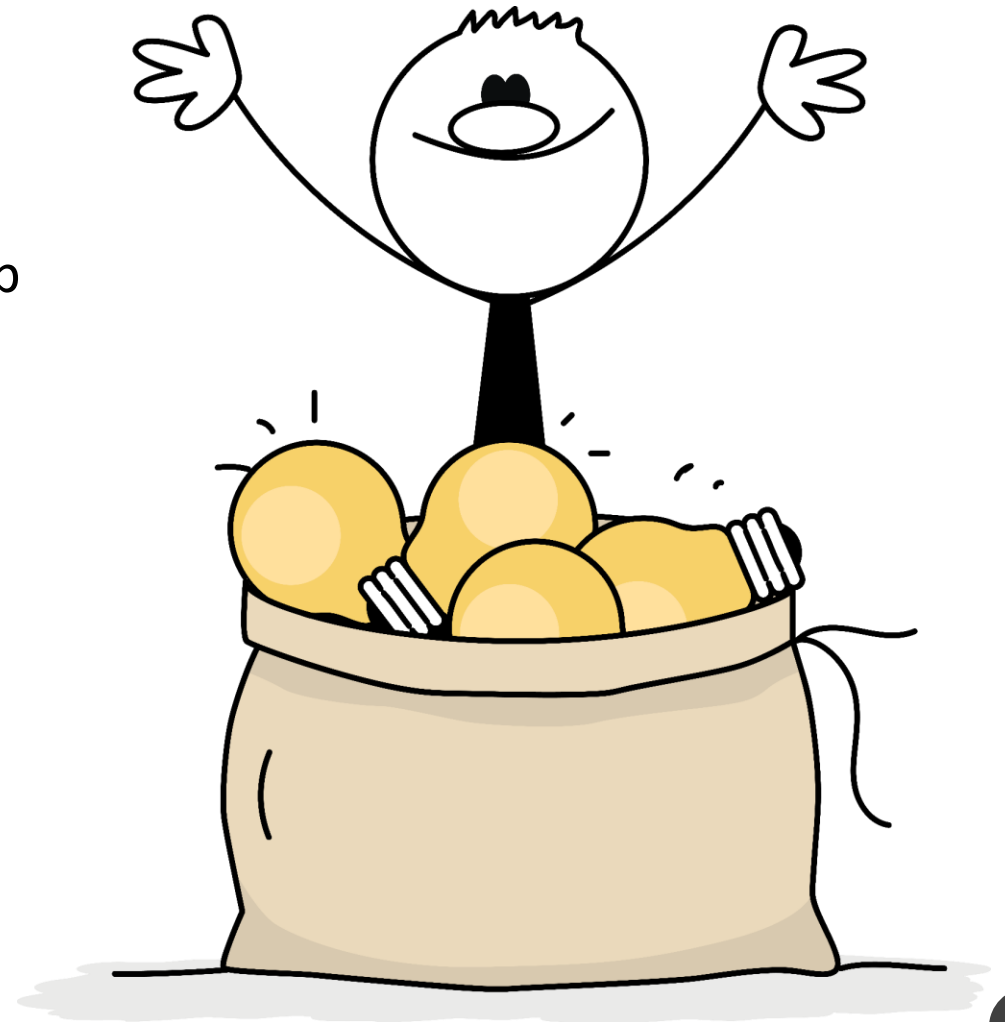
- Solution is verified by expert due diligence and testing of the architecture and technology
- Competition is assessed with primary and secondary market research
- Operational efficiency needs verifying that milestones are appropriate and can be benchmarked to the operations of competitors



# How Investors Can Use The VEM

## About the talent/people dimension:

- Evaluating the team requires fact checking but also evaluating entrepreneurial vision and group work
- Networking is evaluated by looking at the professional standing of the founders
- Organization is about being able to guide a large organization and transiting leadership to new hands



# How Investors Can Use The VEM

| Venture Evaluation Matrix | Customer                            | Company                                    | Entrepreneur          |
|---------------------------|-------------------------------------|--------------------------------------------|-----------------------|
| Value Proposition         | Primary Market Research (Customers) | Assess Technology and Innovation           | Meet the Team         |
| Industry                  | Secondary Market Research           | Characterize Competition                   | Listen to the Network |
| Strategy                  | Verify Customer Access              | Productization, Engineering and Production | Discuss Aspirations   |



# Valuation Methodology

“Fundamentals Of Entrepreneurial Finance” © 2020 Marco Da Rin And Thomas Hellmann

# Topics Covered In This Module



1. Purpose of performing a valuation
2. Who does this?
3. What methods can you use (VC Model, DCF Model, Comparables)
4. Ultimately, how do you select methodology and number?

## You now have a venture that has

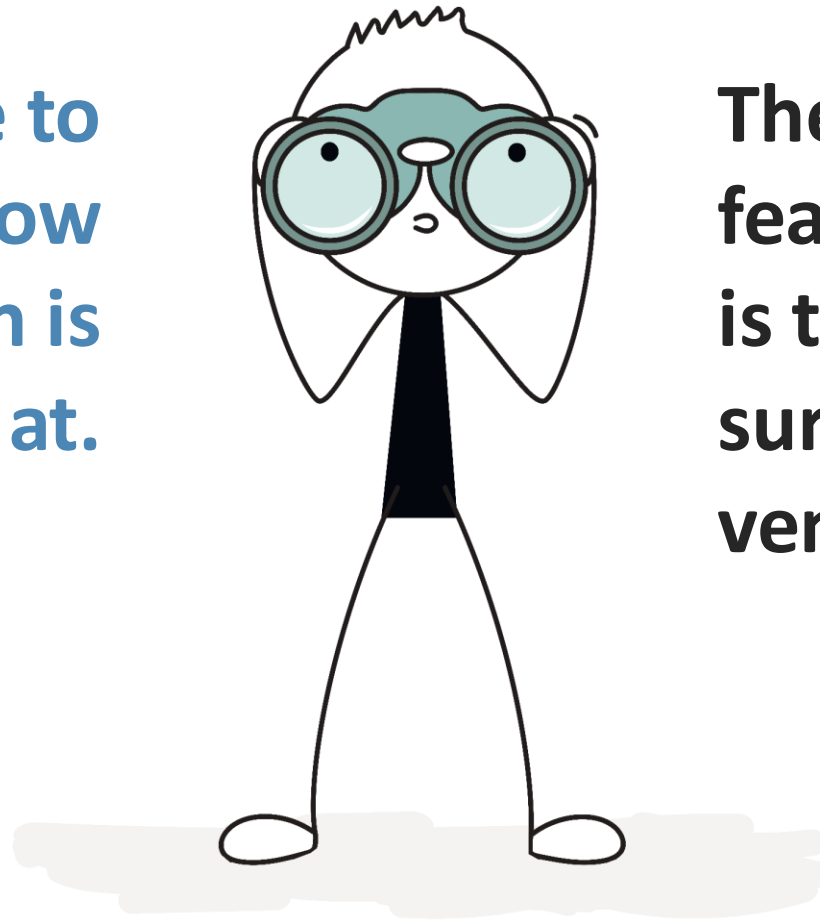
1. a market defined,
2. an innovation,
3. what value the innovation brings to the market,
4. a value proposition
5. an investor pitch deck
6. financial plan.

It's time to figure out the pre-money valuation of the venture at this stage



# Valuing Entrepreneurial Companies

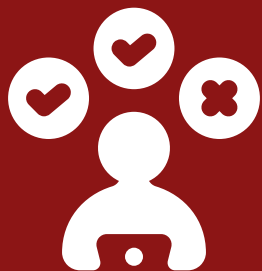
**We now move to  
understand how  
valuation is  
arrived at.**



**The fundamental  
feature in our context  
is the uncertainty  
surrounding the  
venture's future.**

# Valuation Challenges (Pre-Seed, Seed, Series A)- Numerous

*Series B and above are easier to “value”*



**high degree of  
uncertainty**



**asymmetric  
information**



**lack of value-  
relevant objective  
information**

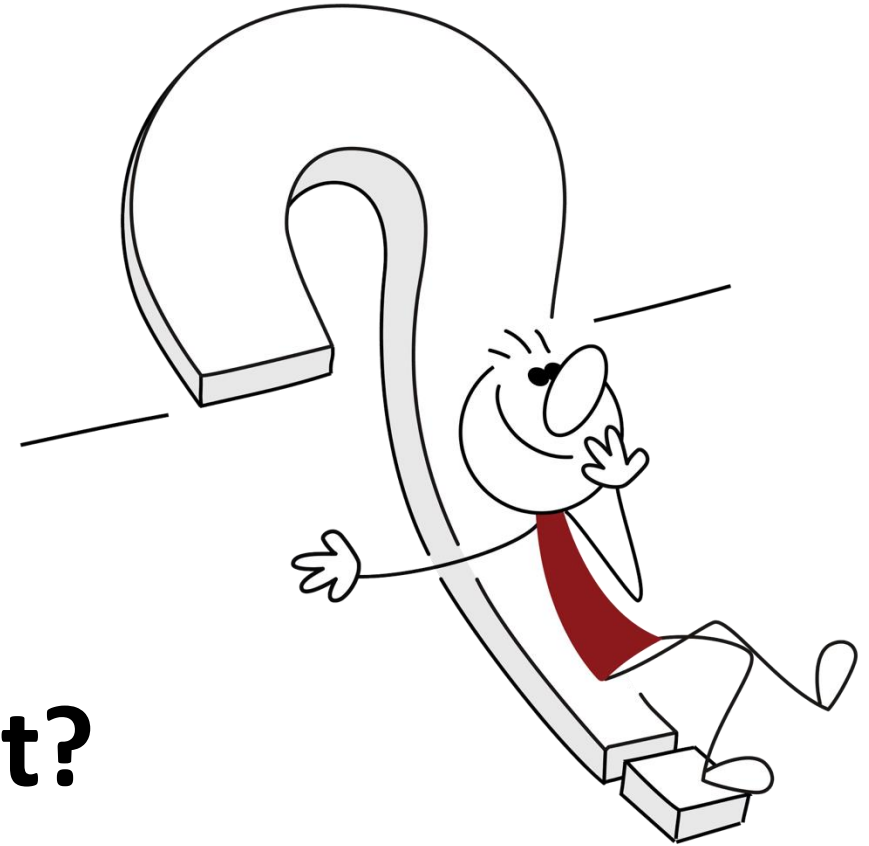


**inadequate  
accounting for  
intangible assets –  
incl. human capital**

Standard valuation models cannot be simply applied.



**Valuation of entrepreneurial companies is quite difficult and time consuming, so why make it?**



# Valuing Entrepreneurial Companies

*Both parties need an informed opinion to enter into the negotiation and know how flexible they can be price-wise- “seeking common reality”*



## Investors

valuation helps becoming investor-ready, sets the basis above which positive returns occur

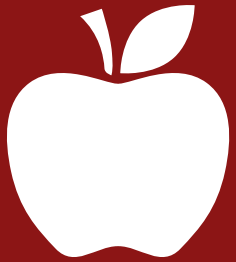


## Entrepreneurs

valuation is part of the decision-making process, it's a measure of where you “stand”

# Economic Determinants (Factors) Of Valuation

*Four main determinants:*



## The Opportunity Itself

the better the more  
courted



## The Market Context

hot vs. cold market  
number and quality of  
competitors



## Deal Competition

more competition,  
higher valuation

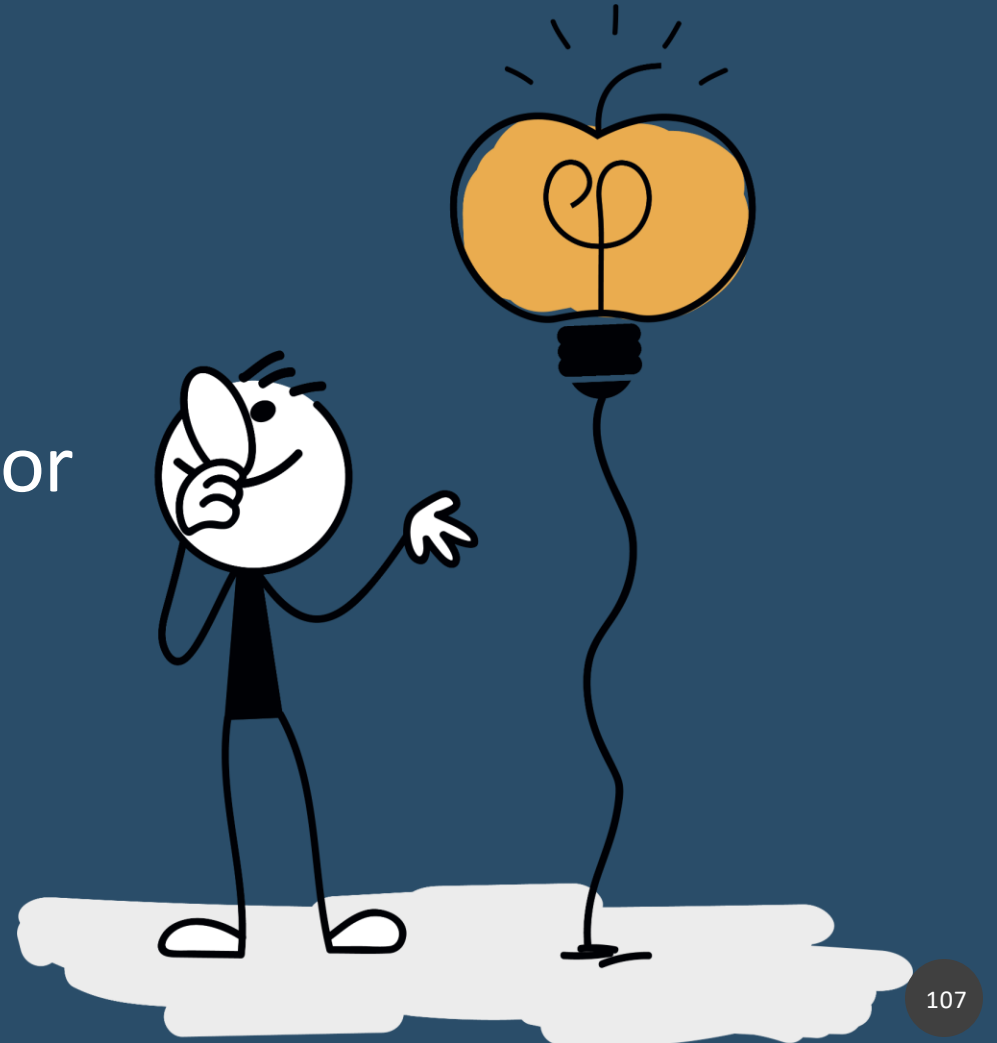


## Investor Quality

good investors achieve  
higher valuations

# Valuation Methods

We examine three main approaches or methods to valuing entrepreneurial companies.



# Valuation Methods

1

## Venture Capital Model

*from practice*

simple, consistent

2

## Scorecard Method

*from judgement &  
practice*

Combination of real  
market data and  
judgement– all relative  
to baseline company

3

## Comparables Method

*from practice*

uses market  
information to  
generate ‘extrinsic,’  
‘relative’ valuation

# 1

## The “Venture Capital Method” (VCM)

**VERY POPULAR AMONG  
PRACTITIONERS.**



---

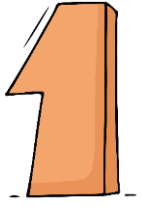
**Models investor cash flows**, which are relatively simple:

- Contribute money at the start and
- then wait for an exit event.

---

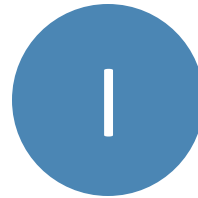
**Simple logic:**

- estimate a likely exit value,
- discount it back in time,
- use it as post-money valuation to derive ownership fractions.



# The Venture Capital Method (VCM)

The VCM requires estimating four inputs:



Investment amount ( $s$ )



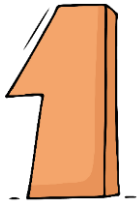
Time-to-exit



Exit value



Hurdle rate, or required rate of return



# The Venture Capital Method (VCM)

I Investment Amount

T

$X^e$

$\rho$

---

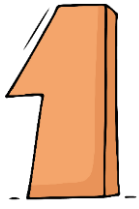
Requires knowledge of the venture's business model and financial plan, and of the economics of its sector of operations. It is recovered from the financial plan.

---

Results in two pieces of information:

1. how much money the venture will need over time
2. when this money will be needed (we covered this in the Financial Plan)





# The Venture Capital Method (VCM)



**Time To Exit**

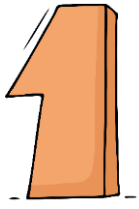


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Requires knowledge of exit markets (acquisitions and IPOs), but cannot be planned in advance.

---

Different investors (and entrepreneurs) have different time horizons and expectations that should be discussed at the time of the deal.



# The Venture Capital Method (VCM)



**Exit Value**

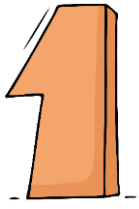


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The value in case of a successful company outcome.

---

Mainly results from an acquisition or an IPO.



# The Venture Capital Method (VCM)



Exit Value



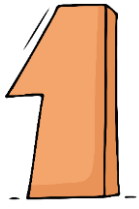
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An exit valuation estimate, not an expected value in statistical sense. The VCM assumes that the venture either succeeds or fails, so the only value to consider is  $X^e$ .

---

Main approaches to estimating  $X^e$ :

1. a discounted cash flow estimate
2. an estimate based on exits of comparable companies



# The Venture Capital Method (VCM)



**Required Rate  
of Return**

---

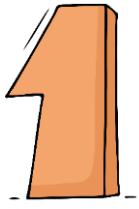
Consists of five elements:

## **Financial**

1. riskless rate of return
2. financial risk premium
3. illiquidity premium

## **Non-financial**

4. failure rate premium
5. 'service' premium



# The Venture Capital Method (VCM)

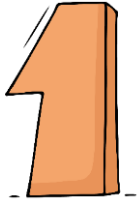


**Required Rate  
of Return**

---

## The financial elements are standard:

- the riskless rate of return (time value of money)
- the financial risk premium (systematic risk - CAPM)
- the illiquidity premium (long-term investments with almost no secondary market)



# The Venture Capital Method (VCM)



**Required Rate  
of Return**

---

**The non-financial elements are less obvious:**

- the failure rate premium, which reflects the high mortality of new ventures.
- the 'service' premium, which reflects services provided by the investor (monitoring, advice, mentoring, networking, etc.)

# 2

## Four Steps For The Scorecard Valuation Method

- First step is to determine the average pre-money valuation for deals in the sector
- Takes current market conditions into consideration
- And stage of company (pre-seed, seed, Series A...)
- And type of company tech (AI, Quantum, etc.)



# 2

## Example Of Comparison Metrics

| Comparison Factor                         | Range (R)   | Target Company (T) | Factor              |
|-------------------------------------------|-------------|--------------------|---------------------|
| Strength of Entrepreneur and Team         | 30%         | Score              | = R x T             |
| Size of the Opportunity                   | 15%         | Score              | = R x T             |
| Product or Service                        | 15%         | Score              | = R x T             |
| Sales Channels                            | 10%         | Score              | = R x T             |
| Stage of Business                         | 10%         | Score              | = R x T             |
| Size of Investment round                  | 5%          | Score              | = R x T             |
| Need for Subsequent funding               | 5%          | Score              | = R x T             |
| Quality of Business Plan and Presentation | 5%          | Score              | = R x T             |
| Location of Business                      | 2.5%        | Score              | = R x T             |
| Type of Business                          | 2.5%        | Score              | = R x T             |
|                                           | <b>100%</b> |                    | <b>Sum of above</b> |



# 2

## Relative Measure Of One Category (of Many)

Next is to **compare and score** against normal/standard companies for various categories: e.g., “size of opportunity”

### Size of Opportunity

#### 1. Size of the specific market for the company's product or service

- o > £500m (+2)
- o > £100m (+1)
- o > £50m (-1)
- o < £50m (-2)

#### 2. Potential for revenues in five years?

- o > £100m (+2)
- o > £50m (+1)
- o < £25m (-1)

#### 3. Strength of competition in this marketplace

- o Weak (+1)
- o Modest (or none) (-1)
- o Strong (-1)

# 2

## Multiple Comparison Metrics Times Target Company Scores

| Comparison Factor                         | Range (R)   | Target Company (T) | Factor              |
|-------------------------------------------|-------------|--------------------|---------------------|
| Strength of Entrepreneur and Team         | 30%         | Score              | = R x T             |
| Size of the Opportunity                   | 15%         | Score              | = R x T             |
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| Type of Business                          | 2.5%        | Score              | = R x T             |
|                                           | <b>100%</b> |                    | <b>Sum of above</b> |

# 2

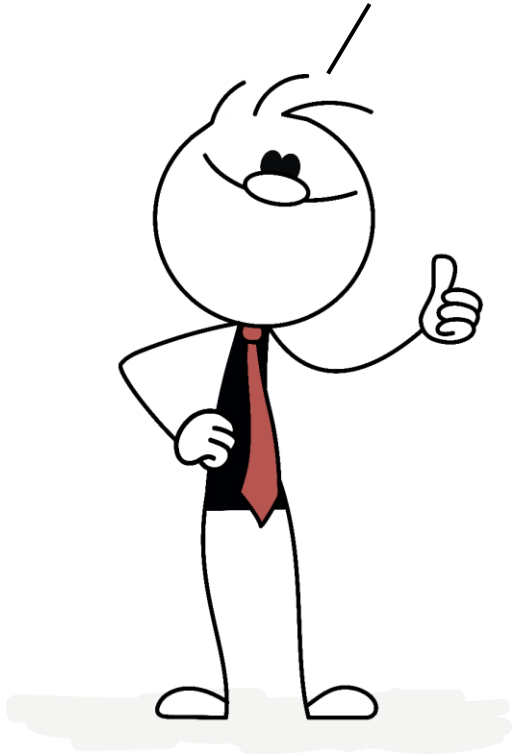
## The Scorecard Valuation Method

- Multiplying the total score against the average valuation for the “standard” provides a baseline valuation for NEWCO
- Not an exact science, but perhaps an important indicator to investors
- It “parallels” the logic used in the VEM modeling discussed earlier

# 3

## Methods Of Comparables

**VERY POPULAR AMONG  
PRACTITIONERS.**



---

It is **short on modelling**, and long on using market valuation comparisons as an indication of potential valuation.

---

**Simple logic:** estimate valuations by comparing it to what the market values 'comparable' companies.

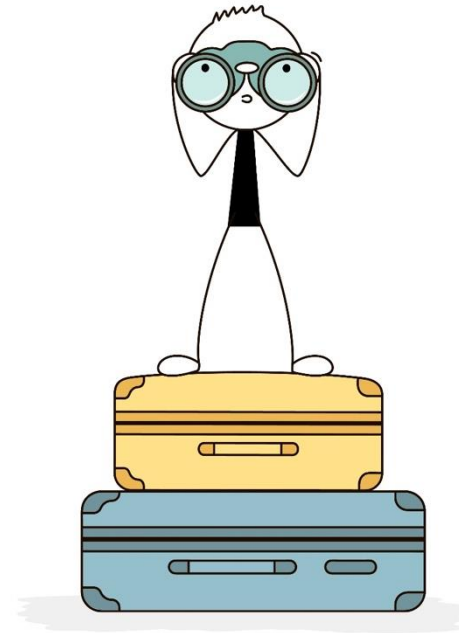
# 3

## Methods Of Comparables

*Two approaches:*



Investment



Exit Comparables

# 3

## Methods Of Comparables



INVESTMENT

### Simple approach

compare directly the venture's valuation with that of similar deals done by investors.

### Conceptually simple

it is about the same type of companies.

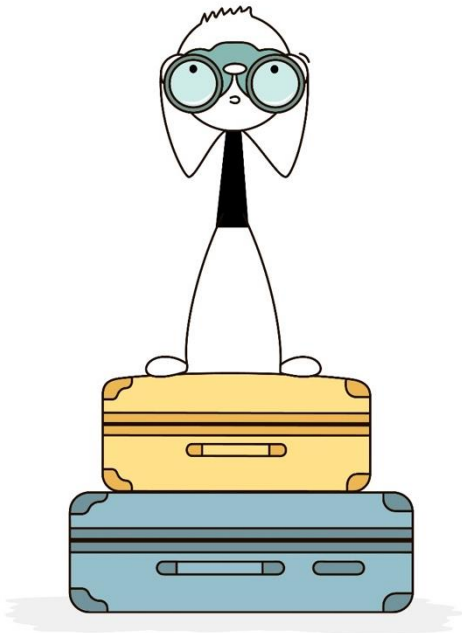
### But, practically difficult

similar: in business model, stage, sector, amount, ...

lack of information, available in part to investors

# 3

## Methods Of Comparables



EXIT COMPARABLES

### Different logic

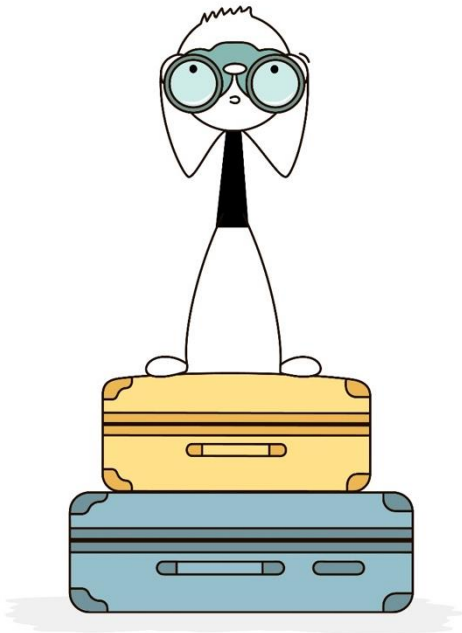
look at how  
markets value  
comparable  
mature companies.

### Two crucial choices

- the set of comparable companies
- the comparison metric

# 3

## Methods Of Comparables



EXIT COMPARABLES

### Choosing the set of comparable companies

**Challenge 1:** identify companies with similar cash flow structure, business risk, broad industry and dependency on the market

**Challenge 2:** find what should be comparable companies:

- (i) innovative companies are 'different,'
- (ii) not all innovative companies are comparable



# 3

## Methods Of Comparables

*Common performance metric multiples are based on:*



**earnings**

but may be negative or  
volatile



**cash flow**

clear economic  
interpretation



**revenues**

possible also with  
negative cash flow



**operating  
measures (KPIs)**

Selected comparables

# 3

## Methods Of Comparables

*Three caveats on using multiples*

Need to measure the multiple consistently **across comparable companies** (and the focal one)

Need to look at the **whole distribution**, not only its average

Need to consider that multiples **reflect market valuations**, and are thus prone to “herding”

# 3

## Methods Of Comparables

*Compare the logic of Investment and Exit Comparables:*



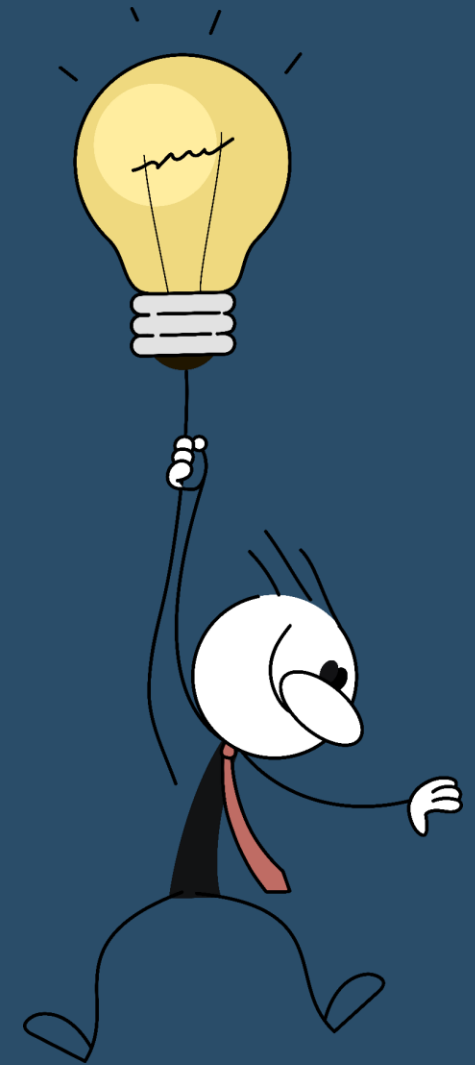
INVESTMENT



EXIT COMPARABLES

|                        | PUBLIC MARKETS       |  | PRIVATE DEALS            |  |
|------------------------|----------------------|--|--------------------------|--|
| Reference              |                      |  |                          |  |
| Valuation Criteria     | EXPECTED PERFORMANCE |  | ACTUAL PRESENT VALUATION |  |
| Treatment of Valuation | DERIVATIVE           |  | DIRECT                   |  |

# Comparing Valuation Methods



# Comparing Valuation Methods

1

## VCM

- The most common
- Takes the perspective of investor cash flows
- Relies on estimating a correct exit with ICM

2

## Scorecard

- Takes the perspective comparison to a “standard”
- Uses Market data for some categories, combined with
- Judgement on other categories

3

## Comparables

- Also common as they rely on market information. (external to the company)
- **Exit Comparables** rely on ‘relative’ valuation of listed companies – are these comparable to ventures?
- **Investment** comparison go closer to peers in terms of comparability – at least they try

# Comparing Valuation Methods- including Market Size and Share

1

## VCM

- The most common
- Takes the perspective of investor cash flows
- Relies on estimating a correct exit with ICM

2

## DCF

- Takes the perspective of company cash flows
- Focuses on 'intrinsic' valuation, it requires strong assumptions
- Not suitable for modelling fundamental uncertainty, nor multiple round valuations

3

## Comparables

- Also common as they rely on market information. (external to the company)
- **Exit Comparables** rely on 'relative' valuation of listed companies – are these comparable to ventures?
- **Investment** comparison go closer to peers in terms of comparability – at least they try

4

## TAM/SAM/SOM

- If you really like a company, look closely at the market dynamics
- Figure out what market share and revenues the venture would have
- This could help you understand how lucrative a "good outcome" could be for you

# Eric Ver Ploeg

*Experienced VC Partner, Post-Seed Fund Founder Tunitas Ventures*



- Tunitas Ventures, Founding Partner
- Independent Venture Investor
- Deutsche Telekom Capital Partners, Managing Director
- VantagePoint Venture Partners, Managing Director
- Stanford University, PhD, Electrical Engineering. Semiconductor Device Physics
- Stanford University, MBA



# Corporate Governance Structures

## *Board of Directors (BoD)*

Board members have a fiduciary duty to all shareholders: they should **put the general interest of the company shareholders first.**

- **Role of observer status:** no voting rights but active involvement
- **Sometimes the law requires a dual board structure\*** : a supervisory board and a management board (small companies may be exempted)

\*you see this more in Europe than in the US





# Corporate Governance Structures

## *Board of Directors (BoD)*



**Typically odd number**

3 or 5, growing over time to 9 (or more)



**Frequent meetings**

(monthly in many cases + ad hoc)



**Directors spend time advising the company**



**Committees**  
(audit, compensation, etc.) **only at a later stage**



# Corporate Governance Structures

## *Board of Directors (BoD)*

### Composition

BoDs include 3 categories:

- entrepreneurs / management
- investors
- independent directors: bring industry expertise and networks

### Membership

BoD members change over time, also reflecting investor additions/turnover.

### Size & Formality

The BoD becomes larger and more formal over time.

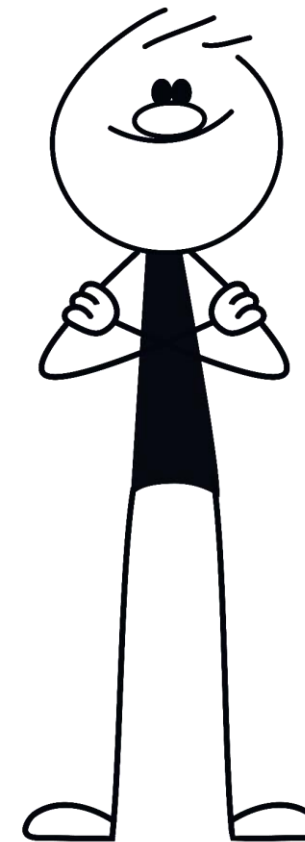


# Corporate Governance Structures

## *Board of Directors (BoD)*

Outside directors have different roles than in public companies:

- **Balance:** pivotal role if investors/management at the odds
- **Promoter:** experience and industry knowledge





# Corporate Governance Structures

## *Informal Control*

Decisions are often made outside of framework of formal control rights:



### **Power of the purse:**

staged financing gives substantial power



### **Power of expertise/personality:**

comes from credibility and respect



### **Power of persuasion:**

comes from experience and strength of arguments



# Corporate Governance Structures

## *Informal Control*

Decisions are often made outside of framework of formal control rights:



### **Power of the purse** (*belongs to the investors*)

- ‘the golden rule is that who has the gold makes the rules’
- entrepreneurs depend on investors for future funding
- current investors wield great power also through their ability to signal to outsiders



# Corporate Governance Structures

## *Informal Control*

Decisions are often made outside of framework of formal control rights:



### **Power of personality** (*belongs mainly to management*)

- Stems from having the trust and respect of employees and directors.
- e.g.: a founder can persuade employees to leave the company if it is sold:
  - makes the company unattractive without key people ...
  - ... it may overturn investors' decision



# Corporate Governance Structures

## *Informal Control*

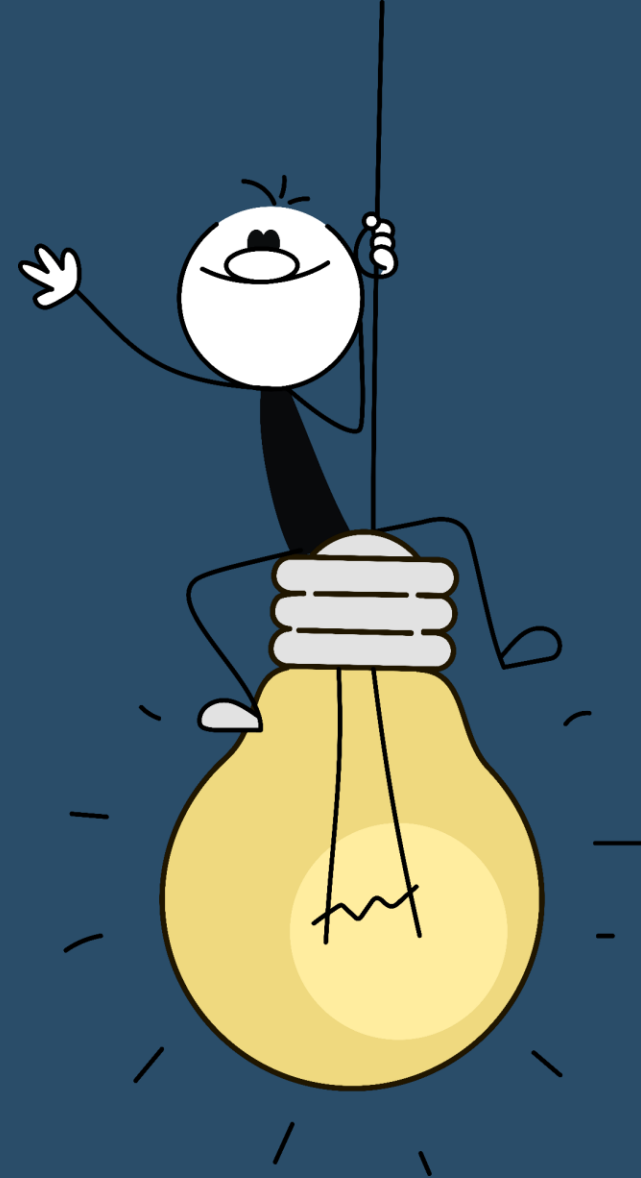
Decisions are often made outside of framework of formal control rights:



### **Power of persuasion** (*belongs to both investors and entrepreneurs*)

- Some decisions are ambiguous and hard.
- BoD votes, especially swing votes kept by outside directors, can be gained by the persuasion of good arguments.
- Knowledge and expertise are therefore important for influencing decision process.

# Investor Value-Adding





**Do investors mainly ‘pick’ winners  
or ‘make’ them?**

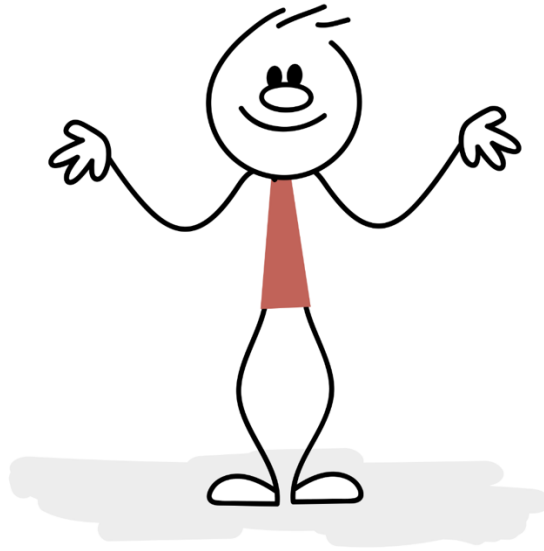


# Investor Value-Adding

*Difficult question.  
We need to differentiate:*

## **Selection**

ability to choose the  
right companies



## **Treatment**

the ability to help it  
succeed

A large empirical literature has found that both dimensions matter.



# Investor Value-Adding

*How do investors add value?*

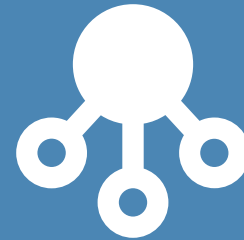
We identify four types of activities:



**Mentoring and  
Coaching**



**Advising**



**Networking**



**Pressuring**

# Investor Value-Adding

*How do investors add value?*



**Mentoring and  
Coaching**

Take place at the **personal level**.

- Founders need to learn how to cope with entrepreneurial and personal challenges
- Investors have seen these various times over

# Investor Value-Adding

*How do investors add value?*



Advising

Takes place at the **company level**.

- Companies **need guidance** in areas where founders are not prepared enough
- Investors can **support decision-making** in strategic, marketing, and human resources, also based on their experience and skills
- Some VC investors **maintain a permanent staff** for this, and use information also to benchmark their companies

# Investor Value-Adding

*How do investors add value?*



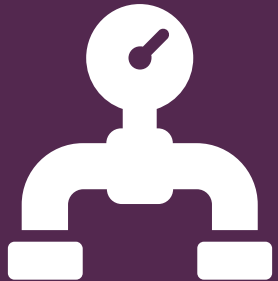
Networking

Takes place at the **industry level**.

- *“Entrepreneurship is the pursuit of opportunities regardless of the resources one currently controls.”* -Howard Stevenson, HBS
- Networking allows **getting in touch** with potential employees, industry leaders, governments, potential funders
- VCs also help companies **forge strategic alliances**

# Investor Value-Adding

*How do investors add value?*



**Pressure**

**Takes place at the company level.**

- IP protection strategy
- Monitoring to suggest when strategic change is needed
- Push managers to rethink their strategies under changed circumstances (e.g., Cut costs in recession)
  - Example: sequoia 2008 slide deck

# Investor Value-Adding



*Where do investors add value?*

**We go back to the VEM to identify relevant challenges:**

|                   | Customer | Company     | Entrepreneur |
|-------------------|----------|-------------|--------------|
| Value Proposition | Need     | Solution    | Team         |
| Industry          | Market   | Competition | Network      |
| Strategy          | Sales    | Production  | Organization |



# Investor Value-Adding

**Sales**

Production

Organization

Investors provide:

**Strategic  
advice** building  
on their  
experience

**Expertise** on  
market  
penetration,  
customer  
engagement,  
geographical  
expansion

**Contacts and  
validation** for  
hiring key  
commercial  
figures

**Support** in  
establishing  
relationships  
with key  
customers

(large companies,  
government-owned,  
etc.)

# Investor Value-Adding

Sales

**Production**

Organization

Investors provide:

**Support** for  
identifying  
suppliers and  
strategic  
partners

**Credibility** and  
certification  
towards third  
parties

**Connections**  
to professional  
service  
providers

**Connections**  
to regulators  
and local  
government  
officials

# Investor Value-Adding

Sales

Production

**Organization**

Investors provide:

**Support** for  
professionalizing  
start-ups

**Pressure** to  
craft a  
functional  
corporate  
culture

**Credibility**  
towards  
potential  
employees

**Network** of  
contacts for  
managerial  
hiring

**Performance**  
**benchmarking**

# Investor Value-Adding

An additional important dimension of value adding is **helping with the exit challenge**:

- **Pressure on companies to build profile** that acquirers / stock market expect (e.g.: focus on a limited set of products, or more developed corporate structure)
- **Instill a corporate culture** of transparent communication, consistent financial reporting

# Replacing Managers

Investors obtain and retain rights to allow replacing under-performing managers. They use that often.

## Why do problems arise?

- Founders prove inadequate as managers, but why?
- Entrepreneurial and managerial skills may be uncorrelated
  - Some founders welcome a change of role, some resist it
  - The case of Uber

# Break!

Walk back to the Faculty Club and  
Stretch for 15 min!





## **CASE STUDY #9: CORPORATE GOVERNANCE**

Theranos

# Lunch!







# Deciding To Invest: The Term Sheet (TS)

# Tim Young

*Venture Attorney “Term Sheet Nuances” and “Trip4Real”*



- Akamai Corporate Counsel, P.C., Attorney
- Fortis General Counsel, Partner
- Wilmer, Cutler, Pickering Hale and Dorr, LLP, Counsel
- Burrill and Company, General Counsel
- Heller Ehrman White & MacAuliffe, Associate
- University of California, College of Law, JD, Law
- Cornell University, MA English

# Topics Covered In This Module



1. What is a Term Sheet (“TS”)?
2. What is the purpose of a TS? Who authors a TS? Is a TS binding?
3. What are the key elements of a Term sheet?
4. When and how is a Term Sheet used? Can angel investors use a Term Sheet or only venture capitalists?
5. What vehicle will you use to fund the deal?
6. Explain the differences between a SAFE, a convertible note and a priced equity round
7. What are “milestones”? How are milestones used in a term sheet?
8. What other important language or terms are used in a term sheet?
9. Let’s use the NVCA standard term sheet template to go through a term sheet

# Tim Young

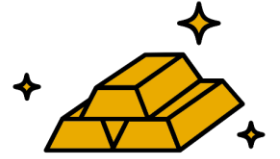
*Venture Attorney “Term Sheet Nuances” and “Trip4Real”*



- Akamai Corporate Counsel, P.C., Attorney
- Fortis General Counsel, Partner
- Wilmer, Cutler, Pickering Hale and Dorr, LLP, Counsel
- Burrill and Company, General Counsel
- Heller Ehrman White & MacAuliffe, Associate
- University of California, College of Law, JD, Law
- Cornell University, MA English

# Term Sheets

## *Principles*



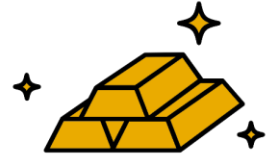
**Term Sheets (TS)** are a set of contractual clauses that govern the rights and obligations of both entrepreneur and investor.

**TS are the negotiation bases** for the final legal documents:

1. Corporate charter
2. Investor rights agreement & purchase agreement
3. Founder employment agreements

# Term Sheets

## *Principles*

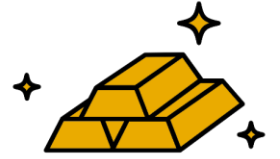


### **TS play several different roles:**

- Govern the rights, obligations, rewards of the parties
- Shape the incentives for all parties (incl. Employees)
- Force the parties to clarify their expectations
- Allocate risk across the two parties
- Specify the rights and duties of the parties towards external parties (employees, future investors)

# Term Sheets

## *Principles*



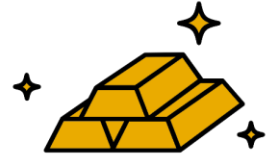
**TS governs several areas, we focus on:**

- cash flow rights
- control rights
- compensation and employment for founders and key employees
- other rights (anti-dilution, future fundraising, liquidity)

**Investors *and* entrepreneurs should rely on experienced lawyers for help on interpreting a proposed TS.**

# Term Sheets

## *Milestones*



### **Milestones measure performance in different dimensions:**

1. Financial (e.g., Sales, EBITDA, operating CF, financial ratio, others)
2. Operational (e.g., Regulatory approval, supply contract)
3. Managerial (e.g., Hiring of CxO, independent director)
4. Technical (e.g., working prototype, license acquisition)



# Term Sheets

## *Cash Flow Rights*

**TS allocate cash flow (CF) rights** to entrepreneur and investors to maximize expected venture value. This is done in two ways:

- Give investors 'downside' protection
- Provide both parties with strong incentives to work for high performance



# Term Sheets

## *Cash Flow Rights*

**Equity (or a Priced Round)** if precise valuation is known

**Pre-seed/Seed investors** use a simple “SAFE”

**Later stage investors can** obtain ‘convertible’ stock instead of (priced round) stock, if valuation unclear.

Convertible gives its holder the right to choose between:

- A debt-like payoff in case of failure (‘downside protection’)
- Conversion into common equity if the company succeeds (profit-sharing in the upside)



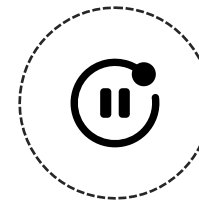
# Convertible Notes And SAFEs

*The appeal of CN and especially SAFEs:*



**Simple, standardized, structure ('templates')**

- Allows to save on legal costs
- Virtually no control and other protective rights



**Delegates/postpones valuation and negotiation**

- Used frequently when there are many “unknowns” about the deal

# “SAFEs”

A simple agreement for future equity (SAFE) is a financing contract that may be used by a startup company to raise capital in its seed financing rounds. The instrument is viewed by some as a more founder-friendly alternative to convertible notes.

A SAFE is an agreement by which an investor provides cash today in exchange for an equity stake in the future at an undetermined valuation. The valuation and conversion are triggered by subsequent funding rounds, typically a Series Seed, Series A, institutional financing, or a sale of the company.

# Convertible Notes

*Convertible Notes (CN) are debt-like claims that address these issues:*



**Automatically converted into stock** at first 'qualified' fundraising (series A)



**Converted into the same security** then issued (conv. Preferred)



**Conversion rate pre-determined** by a price discount (10-20%)



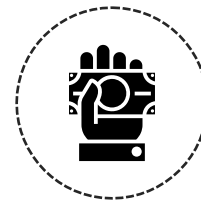
**Maturity:** 12-24 months

# Convertible Notes

*Term sheets are different for seed ('pre-venture') stage, which is characterized by:*



**Low funding amounts**  
(**< \$500K**)



**Unsophisticated investors**



**Most likely outcome:** the  
company fades away (sadly!)

# Convertible Preferred And SAFEs



*Lien holders will first convert to preferred (at a new round) and then into common stock (at exit) when their cash flow being treated as common exceeds the preferred terms*

# Why Preferred Securities?

**There are two main rationales for using preferred stock:**

1. Provide incentives to founders (need for balance)
2. Align investor and entrepreneurs' expectations



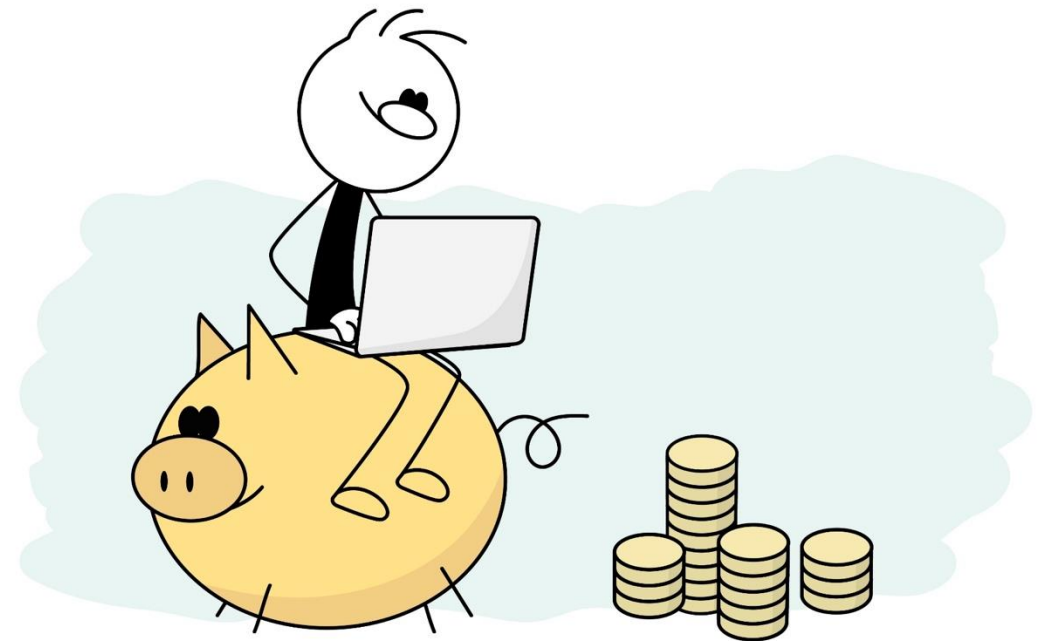


# Participating Preferred

Participating preferred terms combines debt and equity features by adding a (multiple) liquidation preference to the preferred dividend ('double dip').

The investor then gets the PT and at exit also shares into common equity.

Participating preferred is not very normal in early stage deals



# Compensation And Employment

Upon funding, **founders become employees.**

**Main implications** of founder employment agreements:

- They can be fired (Steve Jobs & Travis Kalanick)
- They are possibly subject to non-compete laws in some states and countries
- They confer to the company their IP



# Compensation And Employment

**Founders receive compensation that may include:**

- Salary (below market)
- Performance bonus
- Stock options (at later stages, to restore incentives)

**Two guiding principles:**

- Defer pay as much as possible to save cash
- Provide incentives for long-term value creation



# Compensation And Employment

**Most of the compensation derives from future sale of common stock.**

**Founders' stock is vested ('earned back') with two criteria:**

- Time vesting (linear, with/out cliff, acceleration)
- Performance vesting (accelerated upon IPO/acquisition)

**Vesting is lost in case of dismissal with cause.**



# Compensation And Employment

**Stock options come from an ‘option pool’** that is typically set up at the first funding (Series Seed A) and replenished when needed.

- The pool is 10%-20% of the fully diluted stock base and many companies ‘consume’ 2%-5% per year, depending on the type of talent they need to recruit



# Compensation And Employment

**Stock options are also subject to vesting**, unless they come from a hiring or yearly bonus.

- They have a strike price, often very small or linked to the last round's price
- Exercise may require a (short-term) loan from the company
- Importance of granting liquidity to employees

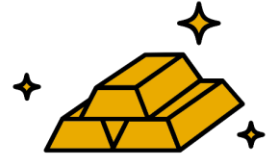


# Term Sheets: Control Rights

**The company charter and by-laws** provide four main types of control rights:

- Shareholders' voting rights
- Board of directors
- Contractual rights
- Informal control

We examine them in a later module.



# Term Sheets: Investor Liquidity

**Investors need to sell their shares at some point.**

- **Redemption Rights:** allows investors to “redeem” his shares after a reasonably long period, at preferred terms.
- **Tag-along rights:** investors can sell their shares along with founders. **Drag-along rights:** investors can force other shareholders to sell their stock.
- **Registration rights and piggy-back:** force listing.





# Term Sheets: Additional Clauses

**Information Rights:** allows investors obtain hard data, useful at early stages.

**Key Man insurance:** the company is the founder(s).

**Legal resolutions:** applicable law and disputes.

**Representations and warranties:** key to close the deal.

**Registration rights:** force listing.

**Negotiation:** no shop clause, exploding offer, due diligence conditionality, co-investors, milestones.



# Valuation vs. Terms

**You cannot ‘have your cake and eat it,’** i.e., you cannot negotiate all terms. What should you focus on?

**Valuation is the most visible term,** and also the easier to grasp for entrepreneurs.

- But at the the early stages, valuation is a very sensitive topic with founders
- However, we have seen that cash flow rights can undo a generous valuation.



Many Other Factors of Term  
Sheets- Make sure you have a  
good VC-Lawyer!





## Case Study #8: Founder Splits

Splunk and Venture Capital Investing in Enterprise Technology



## Case Study: Questions

*Review of 8<sup>th</sup>  
reading*

1. What is the history of Trip4Real? What are the key milestones?
2. How much financing has been raised so far? What is the current need for capital?
3. You are the founder of Trip4Real and have just received a term sheet from Kibo Ventures. You are preparing for a meeting with the VC next week.
  - a. *What are your key concerns? Why?*
  - b. *What clauses are mandatory to negotiate?*
  - c. *What is your counter-proposal to Kibo Ventures?*



# After First Closing- What Should Companies Be Working On?

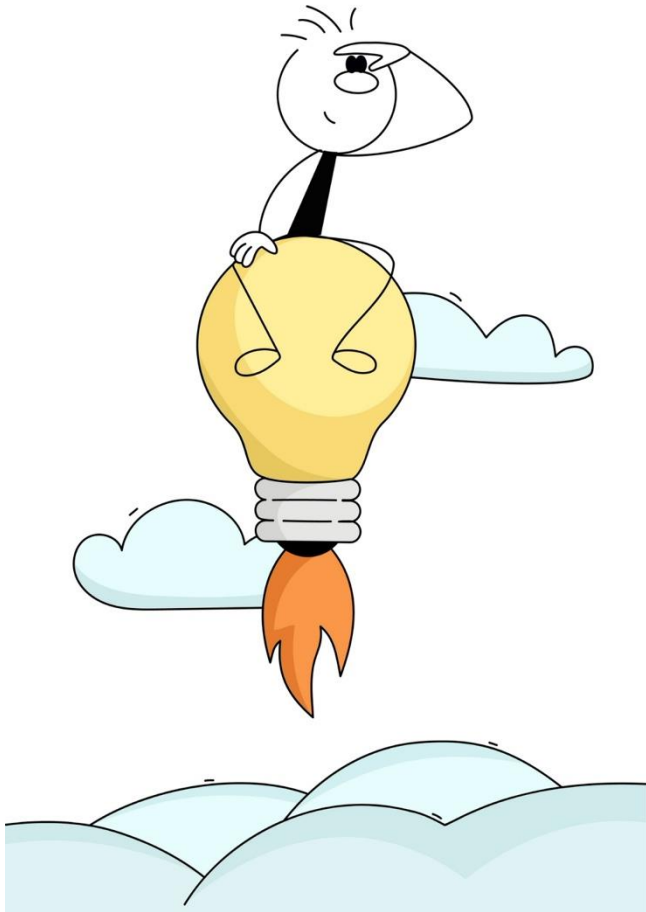
# Topics Covered In This Module



1. After a pre-seed round
2. After a seed round
3. After a Series A

# Progression Of A VC-fundable Startup “our Guideline!”

---



- Idea (research market and use of technology)
- Innovation (either deep tech (IP) or novel business approach)
- Prototype (\$ Pre-seed capital raise)
- Determine First Target Customers and Market
- Create Minimum Viable Product (MVP) ( \$ Seed capital raise)
- Achieve Product-Market Fit (achieve category metrics)
- Evolve Business Model (tested with real customers)
- Scale (\$ Series A capital raise)



# Pre-seed Stage Funding

*Typically the first large injection of cash a startup receives and is the first opportunity for VCs to support your business.*

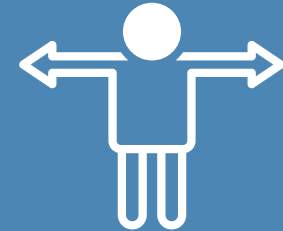
# Pre-seed Financing



**Average pre-seed startup valuation can fall between \$2.5m-10m+ (wide range!)**



**Average pre-seed round can fall between \$100k-2m+**



**Total raised can vary hugely depending on how developed your proof of concept is, who exactly the investors are and what sector you're in.**

# Where To Spend Your Pre-seed Raise



## Testing

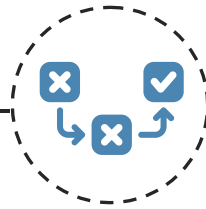
Hypothesis testing;



## MVP

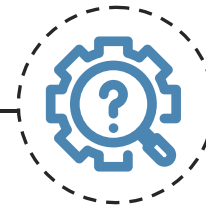
Ensuring you and your team can demonstrate that there is a solid business case for what you're building.

This often takes the form of a [minimum viable product \(MVP\)](#), which for software-based startups could be made using low/no-code tools such as Retool, Airtable or Bubble



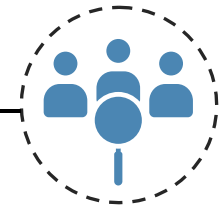
## Pivot

Pivoting or restarting if founders fail to reach **product-market fit** (PMF) at the first attempt;



## R&D

Further research and development;

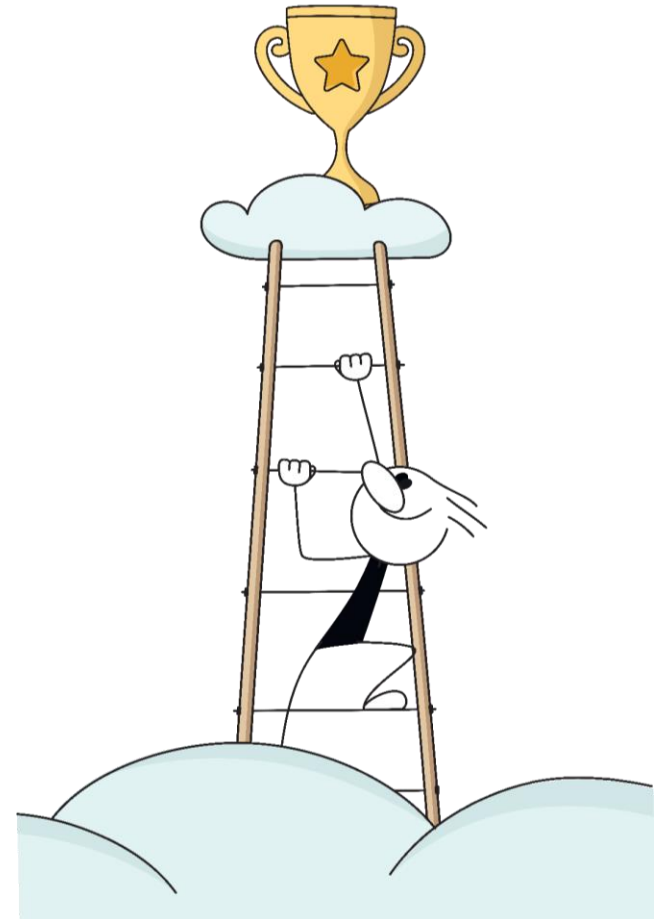


## Team

Hiring the right people who will be able to accelerate building an MVP.

# Pre-seed Stage Goals For The Founder

- Target ... 18-24 month runway following your raise. This should give you plenty of buffer and tide you through to hopefully more favorable market conditions when seeking to raise your seed round.
- Ideally, you should be looking to raise your **seed round** once you have achieved some level of validation from your early users or customers
- In a perfect world, customer validation would be at or close to Product-Market Fit (PMF)
- And you have accomplished several other milestones (key hire, licensing agreement, etc.)
- If you can achieve these at a comfortable stage through your runway so that you aren't starving for cash, seed investors would NOT have additional leverage on valuation for the next round.

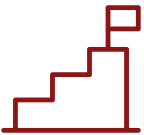


# Seed Stage Funding

*It can represent the first “official” money that a business venture or enterprise raises. Some companies (not many) never extend beyond seed funding into Series A rounds or beyond.*

*This can be the first institutional round of financing.*

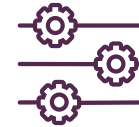
# Seed Financing



- Seed funding helps a company to finance its first steps beyond MVP
- Ensure PMF with KPIs
- Determine what the final products will be and who its target demographic is.
- Seed funding is used to employ a founding team to complete these tasks.



- Average seed rounds tend to fall between \$2m and \$5m
- But (as regularly seen in Sifted's monthly **seed round** summaries) they can both dip below those figures and rise well above them.



- **Excellent Goals:**  
**Need to refine both the “product direction beyond MVP and define go-to-market (GTM) strategy”**  
**Determine competitive advantage (MOAT) over other similar companies’ products**

# Commentary On Seed Stage Actions And Goals



**Piotr Łupiński**

“The tech market has clearly shifted from valuing scale and hypergrowth above all else, to one that **prioritises businesses with a clear path to profitability,**” which makes “the search for product-market fit a more immediate necessity than before”. As such, anything that “proves the viability” of your concept is worth investing into.



**Alberto Rizzoli**

CEO at V7 Labs, says that for SaaS companies, a large chunk of seed-stage funding is likely to go towards **“engineering talent and product-related expenses”**. And getting users!



**Thomas Bigagli**

Conducting research among your prospective customers to set the parameters for what a Minimum Viable Product (MVP) — the basic product that would get early customers on board — would look like. Thomas Bigagli, director and investor at Plug and Play, highlights that **founders should identify a customer base with “real, proven and meaningful pain points” — and, crucially, actually listen to their responses.** And possibly hire a “community manager.”

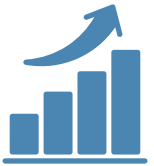
# Series A funding

*The next significant stage of funding you'll raise after a seed round. "Generally speaking, Series A is the phase where you professionalize all aspects of the company, whereas the seed stage is still more about exploration and experimentation," says Andreas Goeldi, partner at b2venture (formerly btov Partners).*



# What To Do With Your Cash

Your *Series A spend should focus on “KPIs and their development over time”*, says Mathias Ockenfels, general partner at VC Speedinvest. This involves:



Scalable Growth

Finding and developing scalable growth channels — for example, **scaling your marketing spend** while delivering and further **optimizing healthy unit economics**. That could involve keeping a **low churn rate** and a **high level of customer retention** as the user base grows, and increasing the lifetime value of each customer by ensuring the time between subscribing and churning doesn't narrow.

# What To Do With Your Cash

*Your Series A spend should focus on “KPIs and their development over time”, says Mathias Ockenfels, general partner at VC Speedinvest. This involves:*



## Build Team

**Building out the leadership and management team** to fill any gaps in experience or skills, and prove you can attract top talent. The most important roles will differ across companies and sectors: a chief financial officer would be a more urgent hire at a fintech than at a deeptech company, and a chief marketing officer would be more valuable than finance-focused roles at a consumer tech startup

# What To Do With Your Cash

*Your Series A spend should focus on “KPIs and their development over time”, says Mathias Ockenfels, general partner at VC Speedinvest. This involves:*



## Identify Metrics

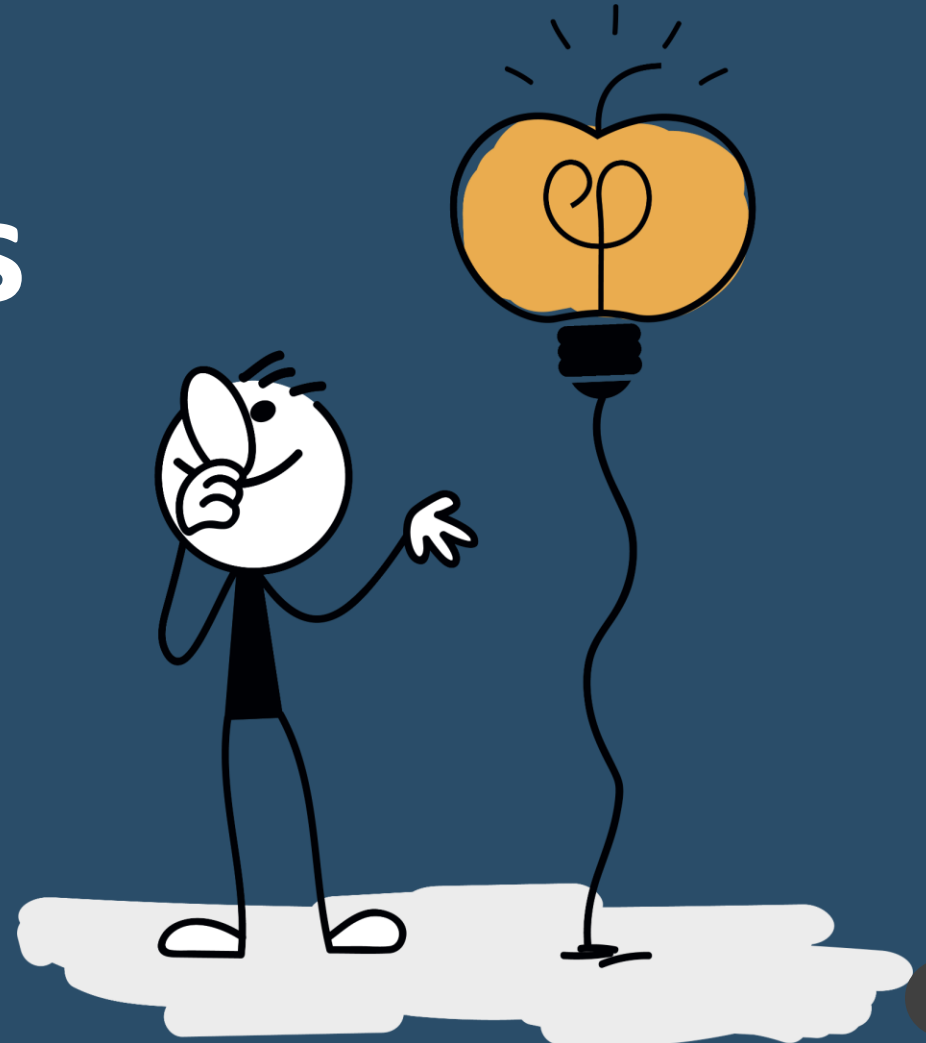
Proof that your go-to-market approach is working and delivering results: **identify metrics in the company's go-to-market strategy** that can be tracked- like customer conversion rate and revenue growth.

# Break!

Stretch for 15 min!



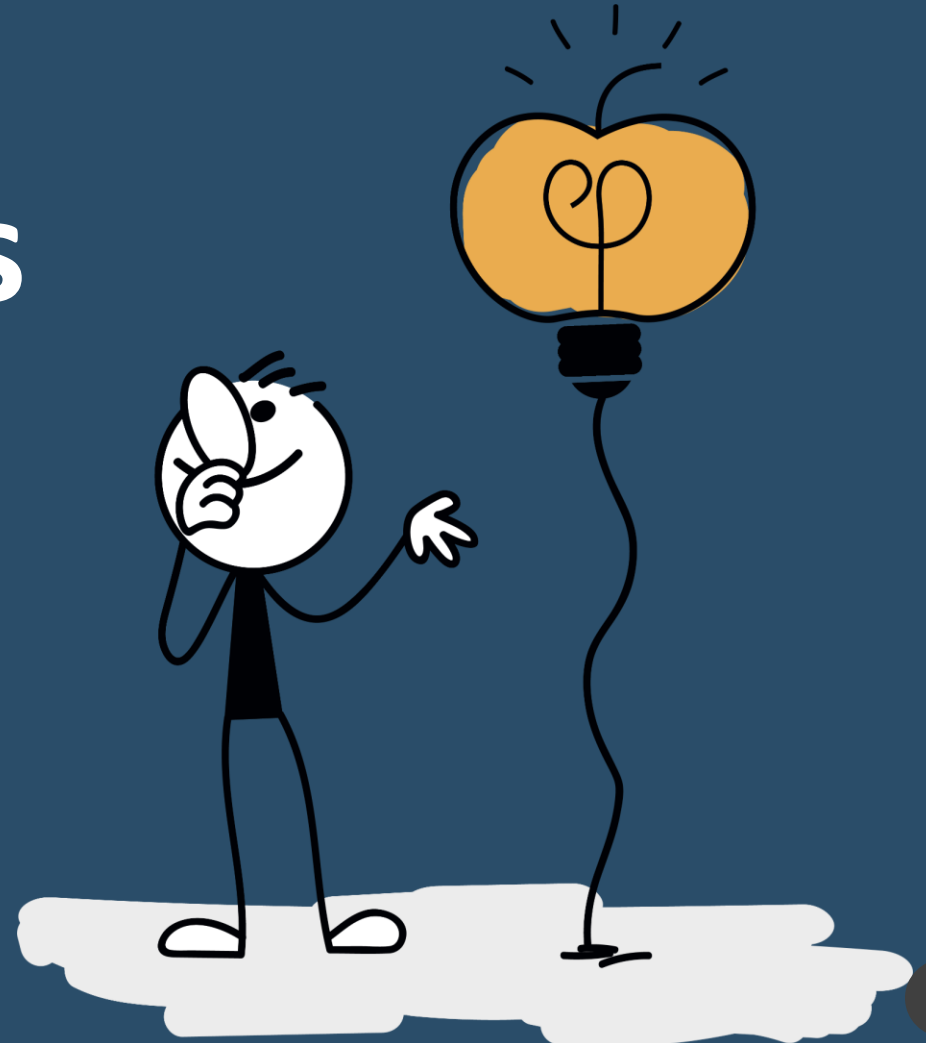
# Exiting Investments





Exit

# Exiting Investments



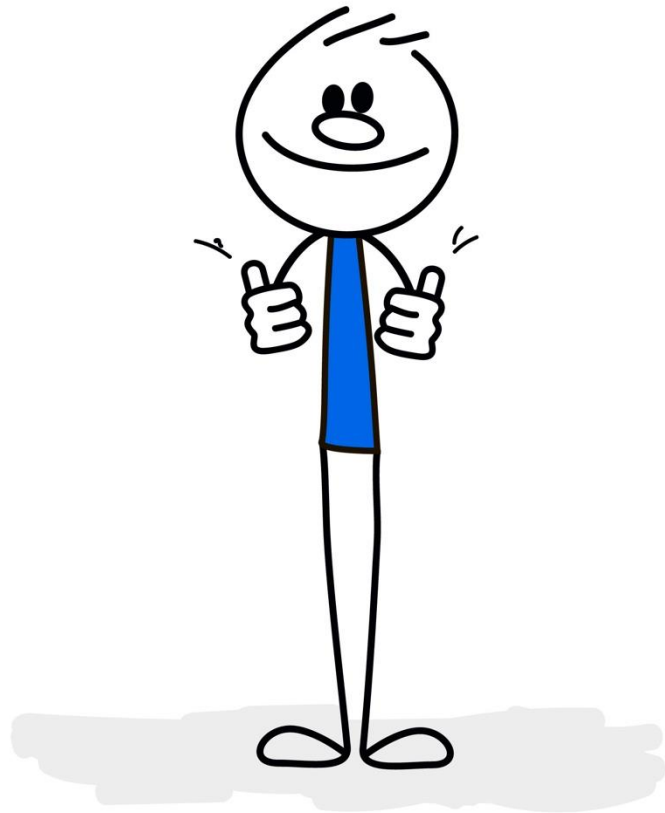
# Topics Covered In This Module



1. Reasons for exits
2. Main types of exit
3. Exit decision
4. Timing



# Exiting Investments



A successful exit is the **crucial goal for investors**

- exit is about reaping returns, not about raising money
- it is also called a '**liquidity event**' because it generates cash back to investors

Exit is also very important for **entrepreneurs**, financially and business-wise.

Exit timing and type is determined partially by **market conditions** and partly by **planning**. And in rare circumstances, **serendipity!**

# Exiting Investments

*Investors have three underlying reasons for exiting:*

## Liquidity

Private company shares are difficult to sell, unless the whole company is sold ('liquidity event').

All investors need liquidity, at some point.

## Need For New Owners

As the company matures, different inputs can benefit it (monetary and not).

## Market Timing

Investors can increase returns by timing the market, especially for IPOs, also acquisitions.

Missing timing could cost several years before new opportunity

# The Goal: Finding and Keeping Loyal, Satisfied, Long-Term Customers

*How Does Your Report Card Look RIGHT NOW?*



|                                     | Nascent                        | Developing           | Strong               | Extreme                |
|-------------------------------------|--------------------------------|----------------------|----------------------|------------------------|
| <u>H</u> air on Fire CVP (40% test) | 20%                            | 30%                  | 40%                  | 50%                    |
| <u>U</u> sage High                  | Varies by company and industry |                      |                      |                        |
| <u>N</u> et Promoter Score          | 40                             | 50                   | 60                   | 70                     |
| <u>C</u> hurn Low                   | B2C: 8%/Month<br>B2B: 5%/Month | 6%/Month<br>3%/Month | 4%/Month<br>1%/Month | 2%/Month<br>Neg. Churn |
| <u>H</u> igh LTV: CAC               | 2:I                            | 3:I                  | 4:I                  | 5:I                    |

*HUNCH Benchmarks at each stage of Product-Market Fit*

# Exiting Investments



**SUCCESSFUL**

**IPO**

**Acquisition**

**Sale to financial buyers**



**UNSUCCESSFUL**

**Zombie**

**"Fire Sale"**

**Closing down** Closures represent at least 50% of exits

# Exiting Investments

*Exit is a decision, not just an event*

**Continuation is  
nearly always  
possible**

**The decision  
needs to consider  
the opportunity  
cost of continuing  
vs. alternative  
uses of (i) capital  
and (ii) investor  
time and attention**

# Exiting Investments

*Exit may occur both in downside or upside conditions*

## DOWNSIDE



Continue

or



Close

## UPSIDE



Continue

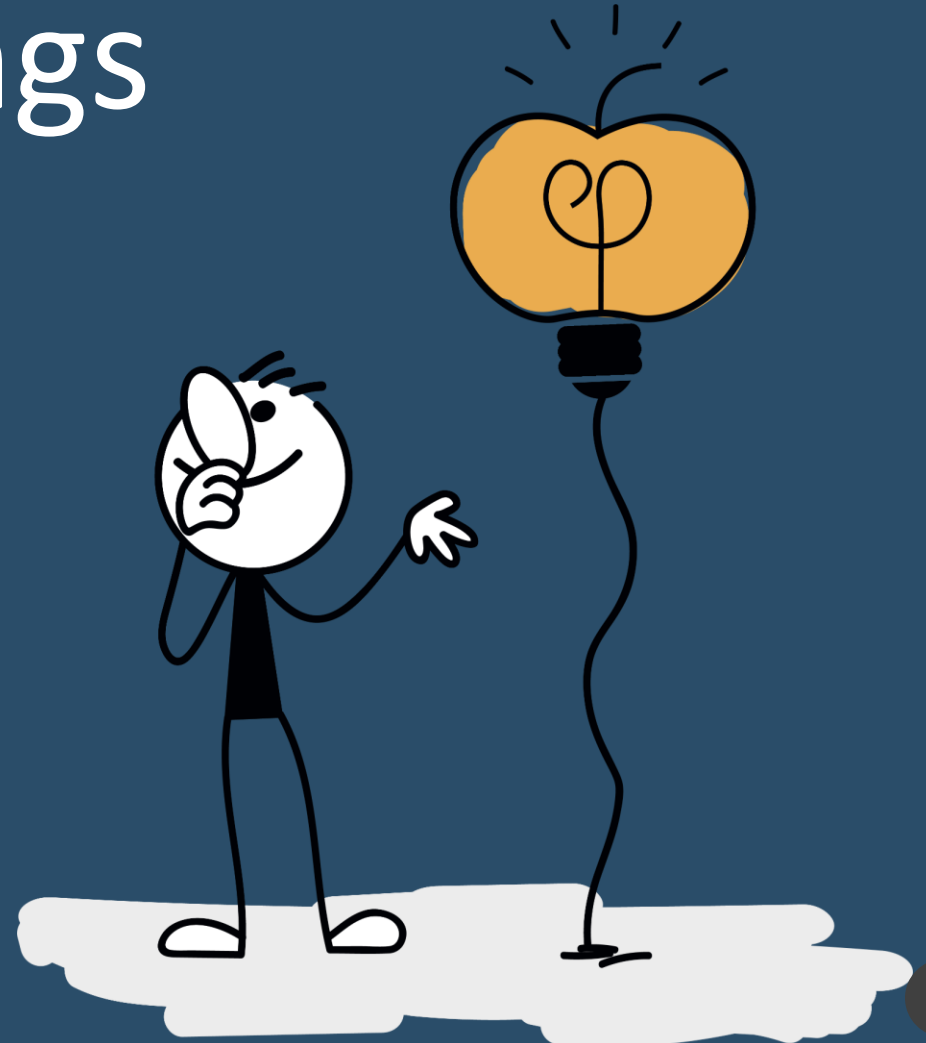
or



Successfully Exit  
(IPO, Acquisition,  
Sale by financial buyer)

# Initial Public Offerings (IPOs)

EXIT TYPE #1



**Going public is considered lucrative for investors.**

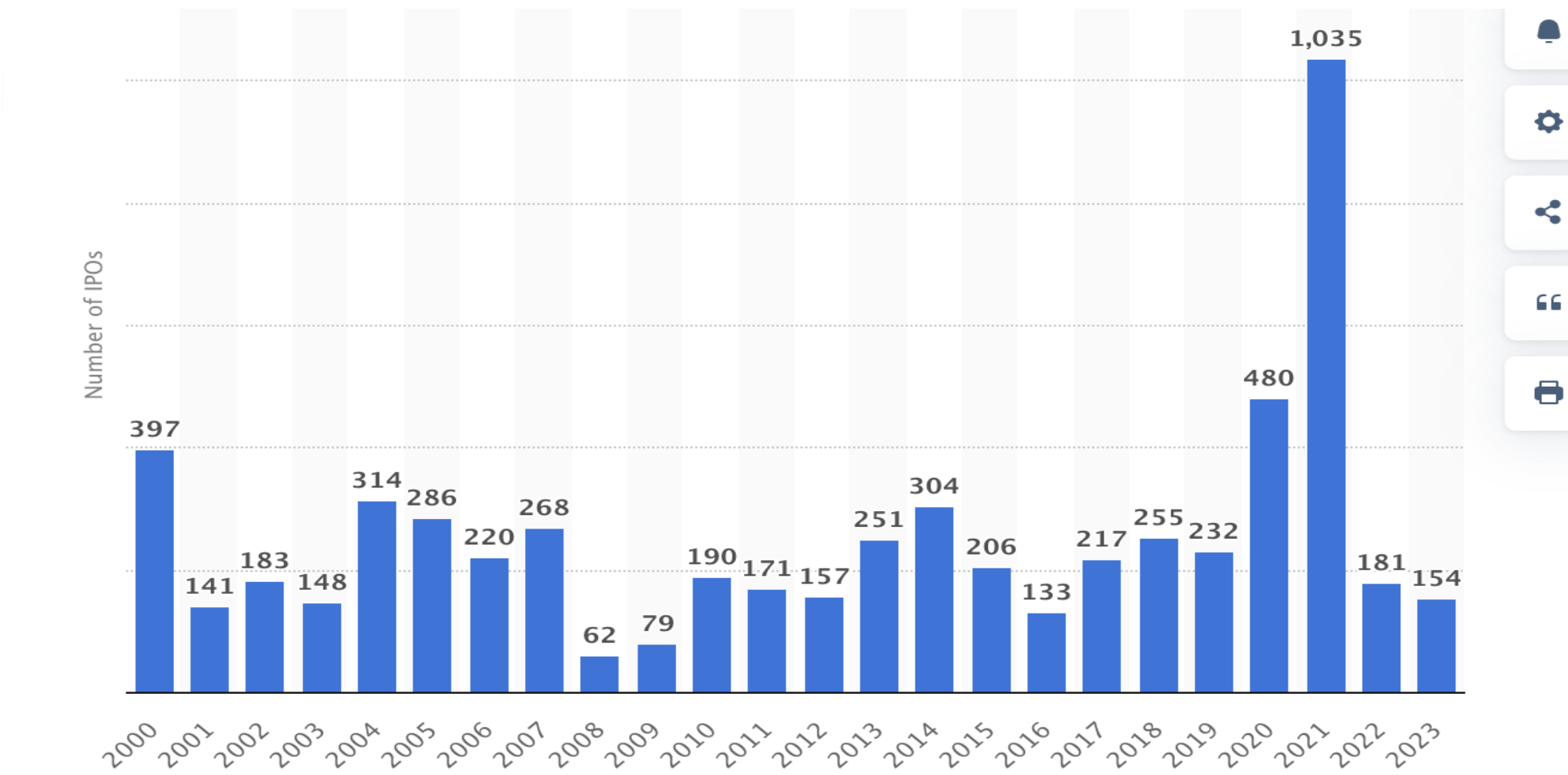
**It is a choice that entails both costs and benefits.**

## **Benefits:**

1. Liquidity for shareholders (return or diversification)
2. Visibility vis-à-vis banks, workforce, competitors, clients
3. Shares give 'acquisition currency'



# Number of IPOs from 2000 to 2023



© Statista 2024

# Cost Of IPOs

## Direct

**Time-consuming and expensive**

- **Underpricing**, which ultimately arises from asymmetric information (various channels)
- Costs of **investment bankers, auditors, advisors**
- **Listing fees** (also yearly)
- **Compliance and disclosure** costs (also yearly)

**Main costs of the process of going public**

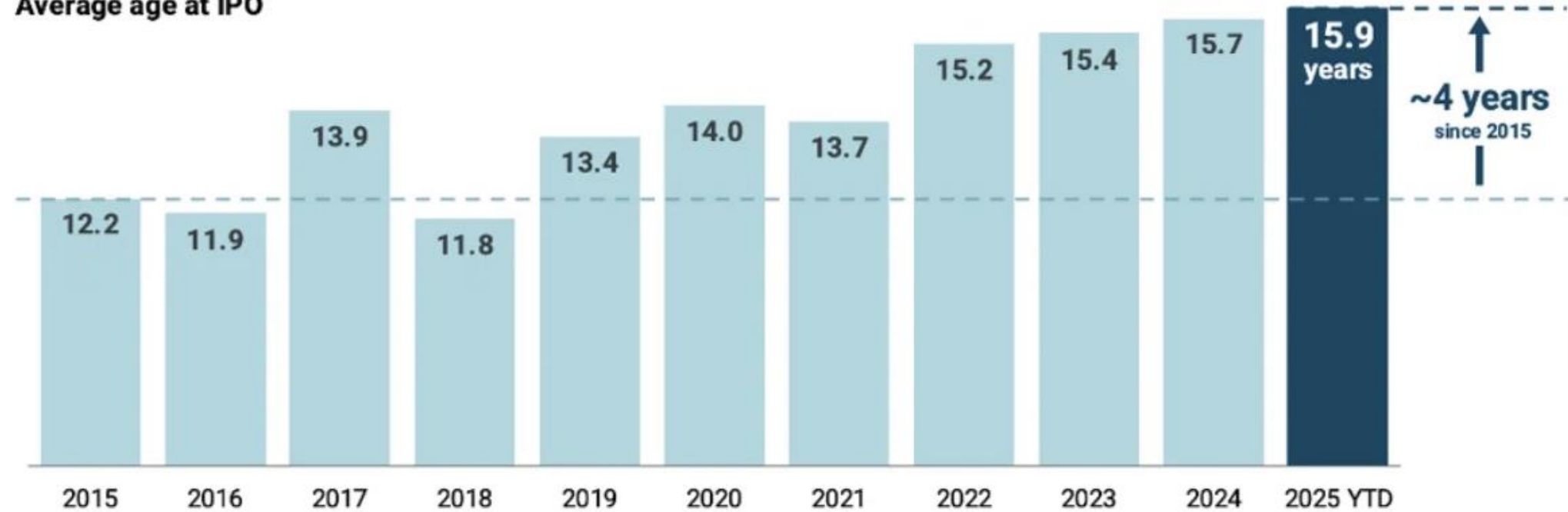
## Indirect

- **Opportunity cost** of managerial attention
- Disclosure of **sensitive information** at IPO
- Cost of **transparency**
- Costs of **monitoring** by shareholders

# IPO Reality Check

## Tech companies stay private for longer, going public 16 years after being founded compared to 12 years in 2015

Average age at IPO



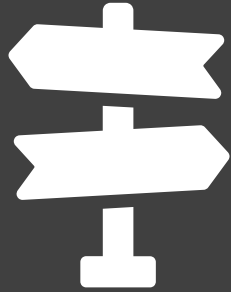
© 2025 CB Insights. Data as of 6/30/2025  
Note: excludes SPACs. Y-axis begins at 5 years

# IPOs

*What happens after the IPO?*



**The company is  
public, a big deal!**



**Investors need to  
choose when to  
divest their shares  
and when to leave  
their board seats**



**Founders and  
managers also  
obtain liquidity**



**Founders also need  
to choose their role  
in the public  
company**

# Exiting Investments



**SUCCESSFUL**

IPO

**Acquisition**

Sale to financial buyers



**UNSUCCESSFUL**

Closing down

Closures represent at least 50% of exits (and probably much more!)

# Acquisitions



---

**Most common  
successful exit  
route**

---

Have both costs  
and benefits

# Acquisitions

## Benefits

**Liquidity** for shareholders (return or diversification)

**Simplicity** and low-cost

No need for public disclosures

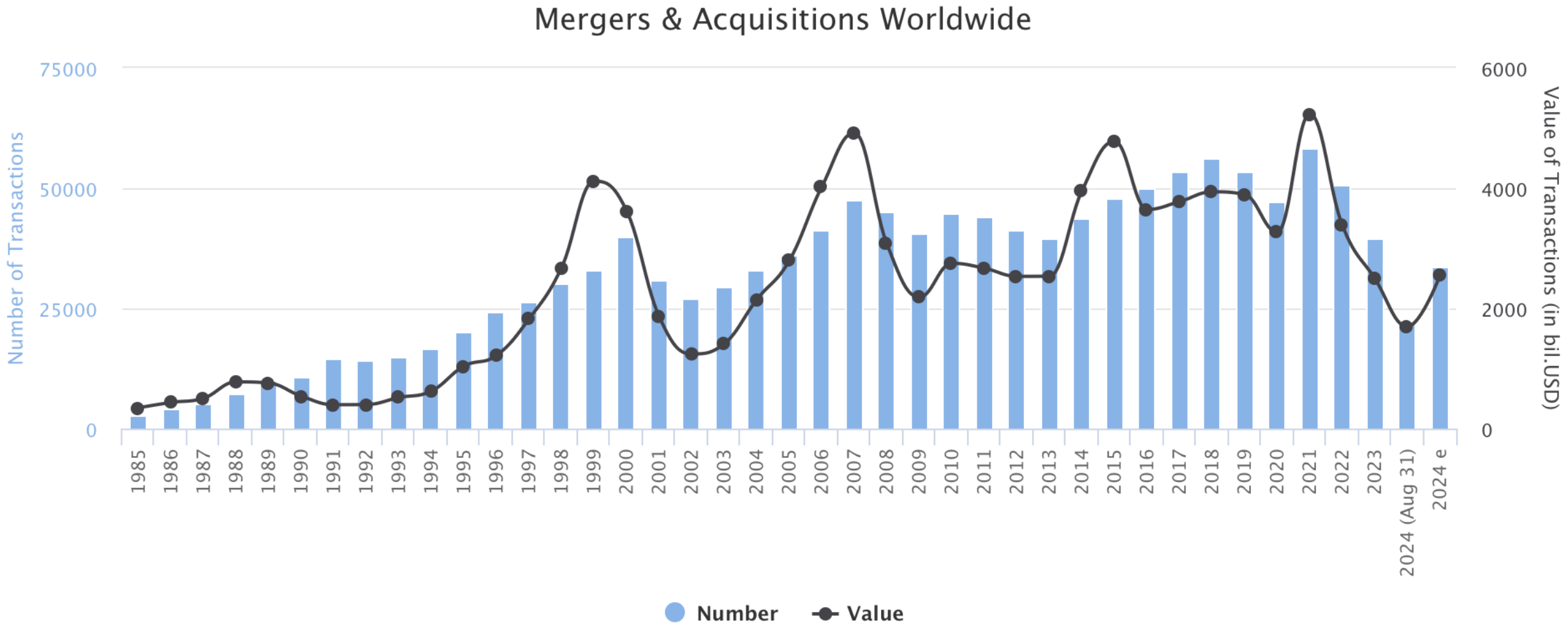
## Costs

**Direct:** The process is relatively inexpensive, but may involve earn-outs and fees to an investment bank, lawyers, accountants

**Indirect:** Scrutiny by potential competitors ('opening the kimono'), loss of control over the company



# M&A Worldwide, 1995- 2024



Source: IMAA analysis; [imaa-institute.org](https://www.imaa-institute.org)

# Acquisitions

---



Preparing for an acquisition requires placing the company in the market and making it visible:

- “companies are bought, not sold”
- trade-off specializing for an acquirer vs generating competition
- strategic investors may even become buyers

---

Some sellers choose to auction, others to negotiate.

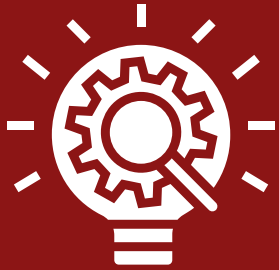
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Acquirers need to develop “absorptive capacity.”

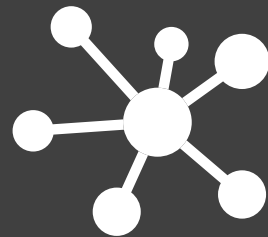


# Acquisitions

*The key structuring element is pricing, which responds to a negotiation logic (Module B)*



**What are the outside options and the ZOPA?**



**Perceived synergies determine the value to the buyer, and competition among bidders can be very important**



**Payment method: stock or cash?**



**Earn-out clauses insure the buyer from over-paying**

# Acquisitions

*What happens after the acquisition?*



**Investors cash in and  
leave the company**



**The acquirer has the  
challenge to  
integrate the  
company and to  
retain the key talent,  
including founders**



**Founders may  
remain for a  
transition period, or  
for longer**



**What about key  
employees?  
Many possible  
trajectories ...**

# Exiting Investments



**SUCCESSFUL**

IPO

Acquisition

**Sale to financial buyers**



**UNSUCCESSFUL**

Closing down

Closures represent at least 50% of exits (and probably much more!)

# Financial Sale

## *Types of buyout*



**MBO**

**Management  
Buyout**

(managers buy the  
company)

**MBI**

**Management  
Buy-in**

(new investors,  
new managers)

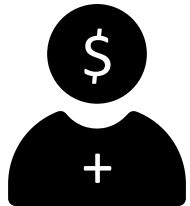
**LBO**

**Leveraged  
Buyout**

(debt-financed  
transaction)

# Financial Sale

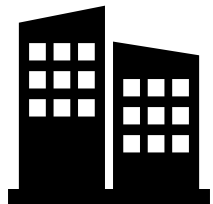
## *Three types of BUYERS*



**New Investors** — who buy from existing investors



**Existing Investors** — who buy from the others  
(via right of first refusal)



**The Company** (via right of first refusal)

# Exiting Investments



**SUCCESSFUL**

IPO

Acquisition

Sale to financial buyers



**UNSUCCESSFUL**

**Zombie**

**Closing down**

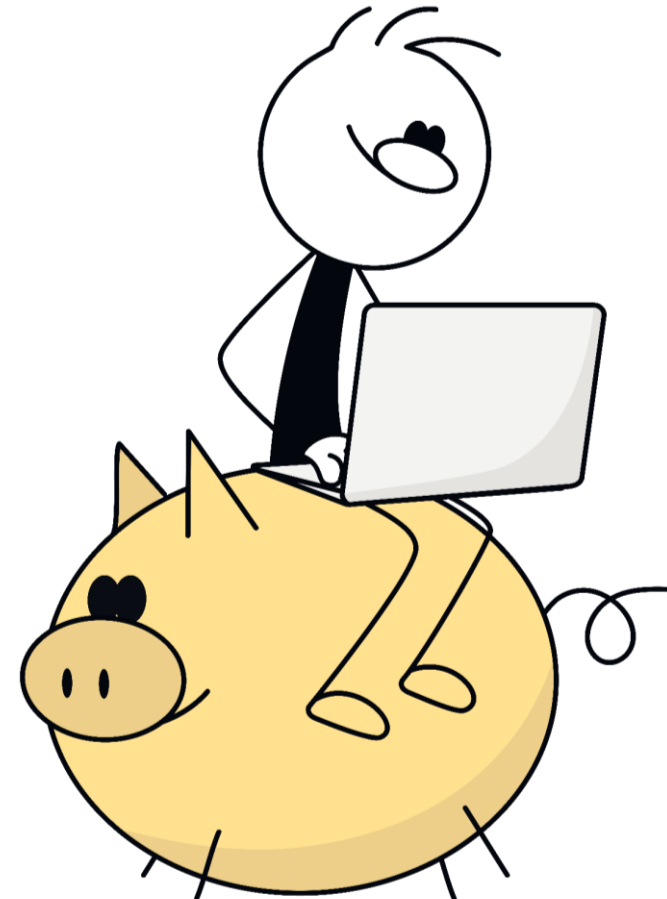
Closures represent at least  
50% of exits



# Closing Down

## Most common solution:

- Closing down simple if there are no creditors
- With creditors bankruptcy can be an option or even necessity
  - Legislation-specific*
  - Reorganization ('chapter 11') vs closing down ('chapter 7')*
- Bankruptcy is costly: direct and indirect costs
- Chews up lots of time and responsibility of board members



# Summary: Exiting Investments: Determinants

*Three main determinants*



**Market Forces**



**Economic  
Fundamentals**



**Company  
Dynamics**

# Exiting Investments: Determinants

## *Three main determinants*



### Market Forces

Market forces vary:

**Across countries** (regions, states)

- Institutional factors include: country culture, capital markets, taxation, regulation

**Across time**

- Dynamic factors include: business cycles, industry cycles, investors cycles

# Exiting Investments: Determinants

*Three main determinants*



**Economic  
Fundamentals**

## Shareholders

- As the company progresses and creates value, shareholders can choose (or move towards) the type of exit most suitable to them.

# Exiting Investments: Determinants

## *Three main determinants*



**Company  
Dynamics**

**Internal preference** for liquidity, and bargaining among investors

**Market appeal** of the company (public vs private markets)

**Value** of the continuation option

# Touraj Parang

*Founder, Private Investor, Author “Exit Path”, “How to Prepare a Venture for Positive Exit”*



- **Serve Robotics, President**
- **GoDaddy, VP Corp Development**
- **UpCounsel, Webs, Jaxtr, corporate positions**
- **Pear VC, Operating Partner**
- **Earlybird Ventures, Principal**
- **Stanford, AB**
- **Yale Law School, JD**



# “The Mythical J-Curve”

With Thanks To DC Palter

Published In Entrepreneur's Handbook

# Topics Covered In This Section



1. The J-Curve
2. Taking Stock of the individual investments in your personal portfolio
3. What I wish I knew before I got into Angel Investing
4. Creating and Managing your own fund (case study)



# What I Learned The Hard Way About Angel Investing

## When I started investing...

my strategy was similar to the way I play Monopoly:

- Allocate a block of money to invest in startups over the first 3 years.
- Then, starting Year 4, reinvest the returns from the earlier investments to make new investments.

## Why 3 years?

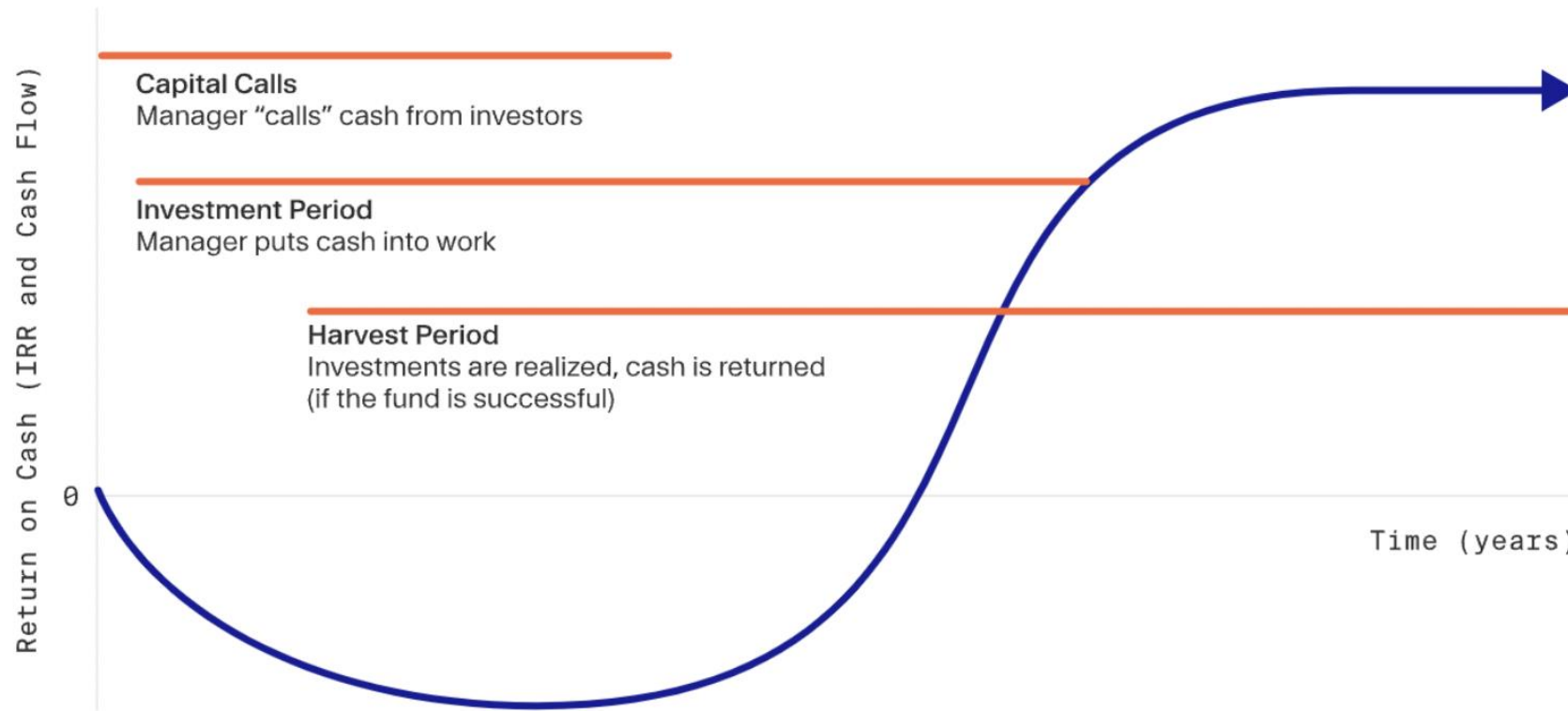
Because every startup says they'll have an exit (acquisition or IPO) in 3–5 years.

- For each 2x exit, I could invest in 2 more startups.
- For each 10x exit, I could invest in 9 startups and and enjoy a luxury cruise of the Mediterranean.

## Of those 29 individual investments over 12 years:

- only 3 have had exits, 4 were write-offs, and the other 22 remain sitting in my portfolio
- waiting for something to happen.
- That's the **J-Curve**.

# Conceptual J-Curve Over 3 Angel Firm Stages



A conceptual J-Curve graph that illustrates return on cash over time throughout 3 distinct stages of capital calls, investment and harvest period.

# What Is The J-Curve?

*Let's say I allocate \$1,000,000 to invest in a portfolio of 10 companies over 2 years.*

## **EXPECTED** SCENARIO OVER 8 – 10 - 12 YEARS

### **End of 2<sup>nd</sup> year**

piggybank is empty  
(see J-Curve)

### **First 4 years**

Number of failures  
& exit or two that  
return some/all my  
money

### **1-2 good investments**

raising bigger  
rounds but need  
me to invest more!

### **Finally, successful investments**

cash out with big  
returns!

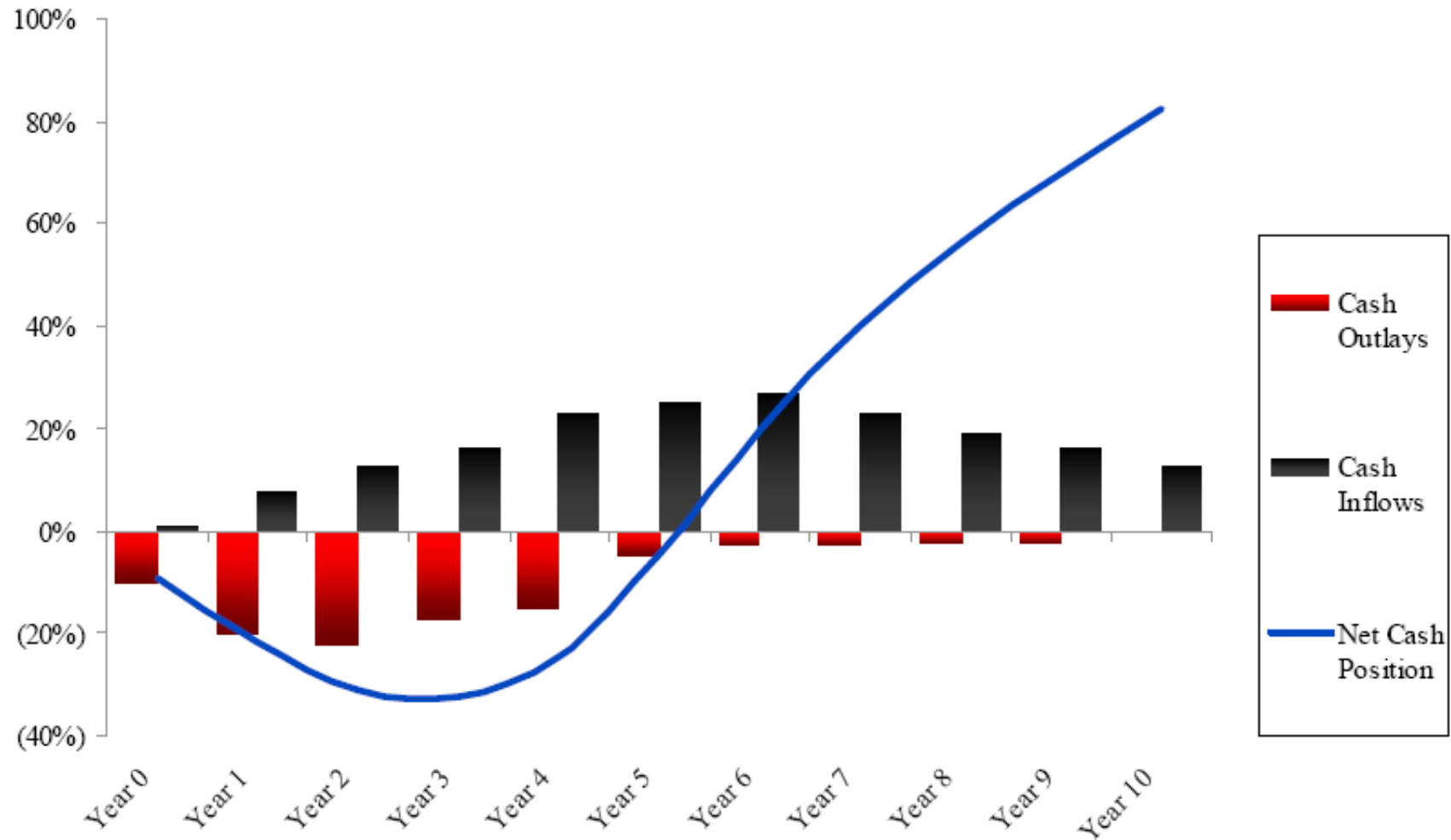
Total return = 3x investment

...but for 4 years I have received nothing.

**It's not until year 6 or 7 or even 10/12 (if I'm lucky) that I've even gotten my investment back**



# The Angel/Venture Capital “J-Curve”



# In Simple Language...



**my losers fail fast,**



**my winners take a long time to mature.**

**THAT'S THE J-CURVE!**

**You need to factor the J-Curve into your investing strategy.**

# VC Economics

**A Fund needs 3x return to achieve a “venture ROI”**

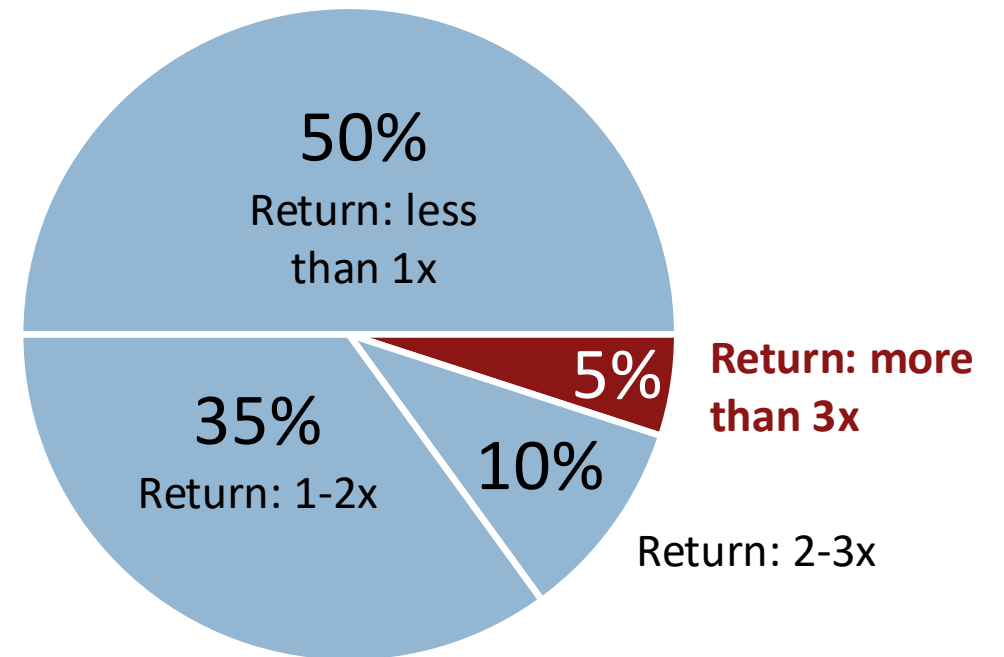
**Not many firms achieve this on a regular basis (<5%)**

**Tough to accept this reality**

**Success = 12% return/year**

**Why?  $1.12 \times 10 \text{ years} = 3.10$**

## VC Fund Return on Investment





# What I Wish I Knew Before I Got Into Investing

With Thanks To Angel Investor David Rose

# Topics Covered In This Module



Some very smart advice from someone who has been through the Angel Investing Curve



# Common Mistakes By First-time Angels/Investors

- Investing in one of the first deals they see
- Not doing thorough due diligence
- Investing outside their domain of experience
- Investing at too high a valuation
- Investing on an un-capped convertible note
- Signing the company's documents without having a lawyer review them
- Not reserving additional capital for the inevitable follow-on round
- Investing in fewer than 20 deals
- Becoming an angel without a long-term (10 years or more) commitment
- Dragging out the investment process unnecessarily

# Remember: Applying Portfolio Theory To Startups

## *HARD FACTS:*

1

Most startups will fail (either entirely, or to return capital, or to achieve original expectations)

2

Unfortunately, no one knows which startups will fail, nor which will succeed

3

The more investments that are made, the better the chances of achieving good returns (graphic)

4

Most investments follow a pattern of losing money before make money for investors (graphic)

5

All companies need money for growth, or to deal with hard times

**If you understand these facts and are disciplined, you can do well in angel investing**

# Understanding Facts And Following A Recipe...

**IF**

Accredited Investor

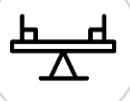
- + prepared to invest at least \$100K to \$200K per year
- + reserve quite a bit for follow-on financings
- + develop a strong deal flow of good companies
- + invest consistently so that you have at least 20 companies (ideally more) in your portfolio
- + professional in your due-diligence investigation and deal-term negotiation
- + knowledge that you are going to be in it for at least a decade, holding completely illiquid assets
- + add value to your portfolio companies above and beyond simply money
- + follow the advice on all of the above that I've taught you...

---

**THEN**

You are ready to be an Angel Investor

# Desired Characteristics Of An Angel, Super-angel And Small VC

|                                                                                     |                                                           |                                                                                      |                                                       |
|-------------------------------------------------------------------------------------|-----------------------------------------------------------|--------------------------------------------------------------------------------------|-------------------------------------------------------|
|    | Long term view                                            |   | Good interpersonal skills with many personality types |
|    | Strong personal economic base and tolerance to lose money |   | Self-discipline                                       |
|    | High ability to deal with risk                            |   | Understand all experiences are learning opportunities |
|   | Can handle and learn from failures                        |  | Genuine interest in entrepreneurs and startups        |
|  | Even temperament                                          |                                                                                      |                                                       |

# Nonfinancial Rewards

**Staying current with new technology, breakthrough innovations and radical business models**

**Staying close to entrepreneurs and startups without emotional ups and downs and ridiculously long hours**

**“Giving back’ so that others can learn from your experiences**

**Doing some good for society**

**Hanging out with very interesting people**

**Having a hell of a lot of fun!**



# MY EXPERIENCE- Lucky.. Or right place at right time?



1. Semiconductor Capital Equipment (Applied Materials)
2. Voicemail Products (Octel)
3. Resume/CV Processing (Resumix)
4. All eventually became big companies in huge markets.... But....it took time

## Amara's Law:

"We tend to **overestimate** the effect  
of a technology in the short run



and **underestimate** the effect in the  
long run."



# Questions?



**End Of Day 3, End Of Course!**

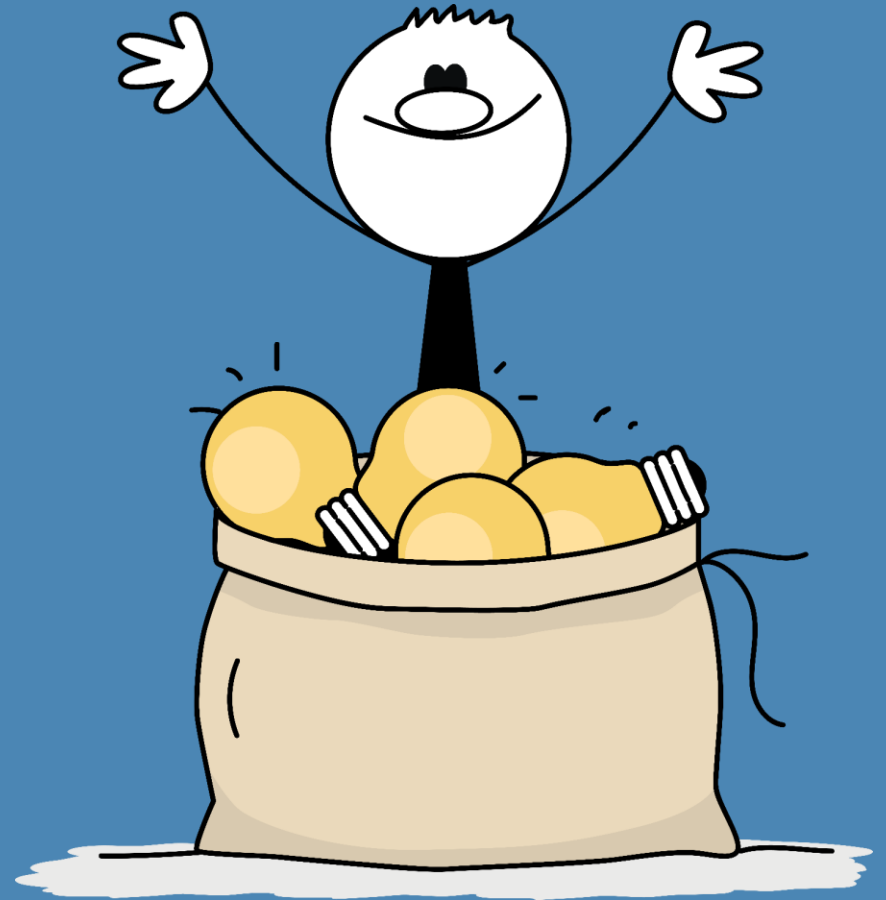
**It's Been A Real Pleasure to Host You!**



From Gus and Friends (and Diane)...



Thank You!!  
Steve Ciesinski



# Reception!

End of Day 3

