„From ideas to valued deals”

FROM PROJECT IDEAS TO PROJECT COMPANIES

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Masterplan for the lecture – What is a Business Case?

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- ✓Idea selected
- ✓Market Need indentified
- ✓Technology / Product Service identified
- ✓Management identified

BUT what else we need?

- ✓What is Business case?
- ✓How to create a business case
- ✓How and where to find investors

„How to create an investable business case

Warm up - Things needed for a business case

- ✓Good science?
- ✓Product?
- ✓Management?
- ✓Investable Business case?
- ✓Knowing your exits?

Definitely NOT these

What do you need to create a successful startup?

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✓Motivation: want something more than the other guy sitting in the lab next to you

✓Hire the right people

✓Wacth every penny

✓Taking decisions as fast as you can (even they are wrong)

OR YOU DESTINED TO FAIL

Things needed for a business case

In order to succeed, you need to know:

- What is your business model: what are you doing and where is the money coming from
- Who is your customer – who will spent money on you
- Who is your competitor, and why are you better than him
- What are your risks you need to limit
- What are your personal boundaries

The goal: understanding the investor

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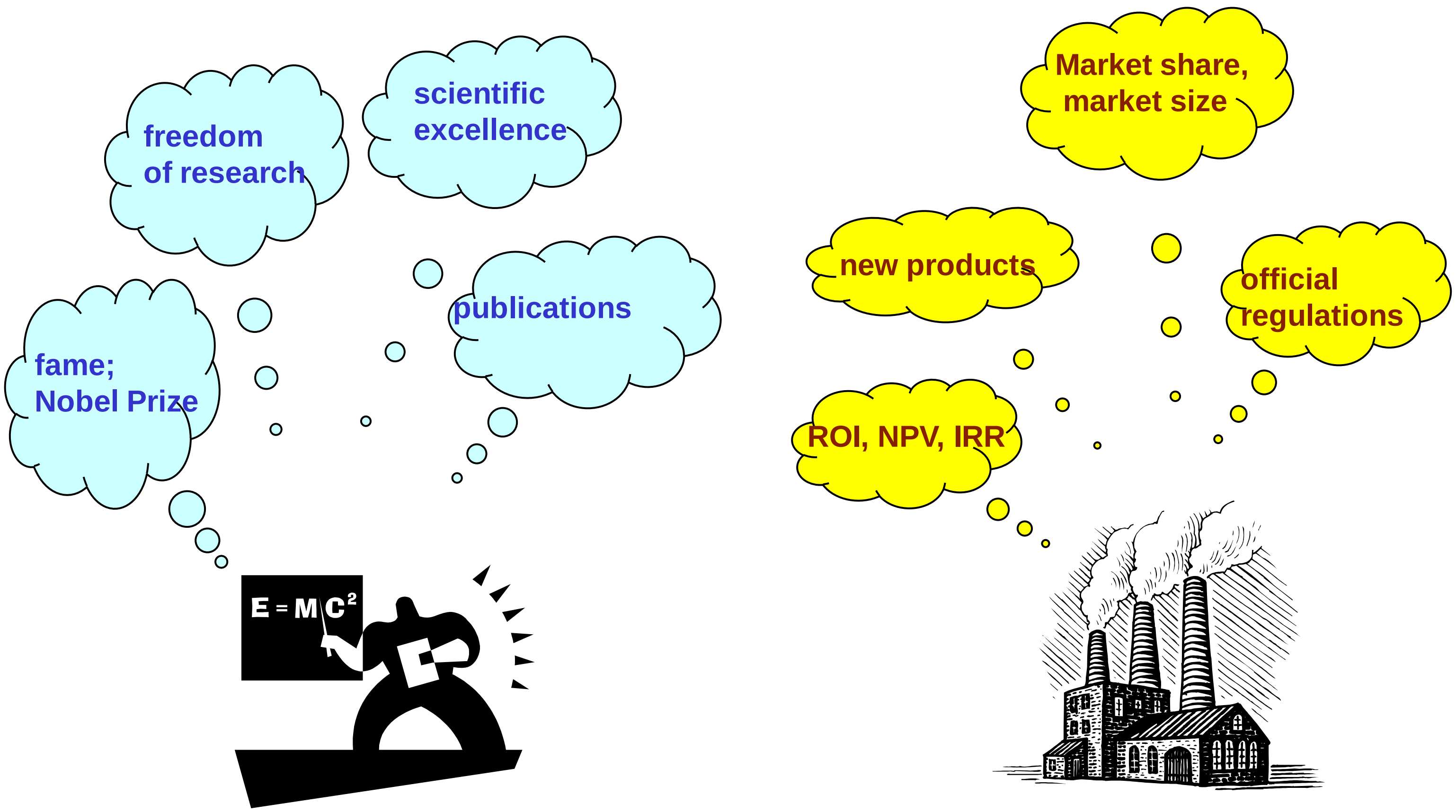
Differences in motivation



Business Models

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Value Creation from getting the key business elements right

What is a business model?

A simple definition . . .

- How *you provide value* to the customer, and how the *customer compensates you* for that value

In other words . . .

- *How are you going to make money?*

Some Dimensions

- Intellectual property as source of wealth
- Your customer
- Product features
- Internal vs. outsourced capabilities
- Functions in the value chain
- Marketing channels

Group Exercise I.

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The Need / Pain:

- Businesses need financial projections, budgeting, and financial decision-making capability

The Challenge / Risk:

- Develop alternative concepts for putting the venture together to respond to the need

Another Definition

A business model is the method by which an organization:

Uses its resources to *deliver value* to customers,

While *maximizing profits and growth* for itself.

(The Kaufman Foundation for Entrepreneurship)

Two Tests

- The Narrative Test--does the story make sense?
- The Numbers Test--does the P & L add up?

Functions of a Business Model

- Articulate the value proposition
- Identify a market segment
- Define the structure of the value chain
- Estimate the cost structure and profit potential
- Describe the position of the firm within the value network
- Formulate the competitive strategy

How will you perform the major activities of the value chain?

Value Chain: Product and service flow

R & D → Engineering (Product & Process Development) → Production & Manufacturing → Marketing → Sales & Distribution → Service → Disposal

IP is Key for Technology Companies

- If you do certain things, you can keep it
- If you do other things, or if you don’t do particular things, you lose it and open it up to others
- IP is necessary but not sufficient for wealth creation

Types of IP

- Patent
- Trade secret
- Copyright
- Trademark

- Key: treat IP as a product, not an input

A Business Model Taxonomy – Example for IT companies

- Brokerage model
- Advertising model
- Infomediary model
- Merchant model
- Manufacturer model
- Affiliate model
- Community model
- Subscription model
- Utility model

Rappa, Michael. Business Models on the Web. 2001.

Elements of the Model

- Value proposition
- The market offering
- Resources
- Financial model

Value Proposition

- Who is your customer?
- What will you provide them?
- Why they will pay for your product / service?
- Why should they buy from you rather than the competition?

The Offering

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- What are you offering the customer?
- What is their buying decision process?
- How does your offering respond to their process?

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Resources

- What are the key benefits you provide?
- What capabilities do you need to provide each benefit?
- What resources do you need for each capability?
- What will you provide in-house vs. outsource?

Financial Model

- How will you generate revenue?
- How will you create shareholder value?
- How will you grow financially?

Match your Business Model

- To the opportunity
- To financial resources
- To the capabilities of the team

You remember:

- Technology
- Market
- People – most important factor!!!

One More Definition

A business model is the sum of the key business decisions and trade-offs a company makes to earn a profit.

Source: Hamermesh, Marshall, Pirmohamed, “Note on Business Model Analysis for the Entrepreneur” (Harvard Business School)

Categories

- Revenue sources
- Key expenses
- Size of investment
- Critical success factors

Revenue Sources

- How many and what types of revenue stream:
  - Sales, Fees, Advertising, Subscription, Licensing
- Size and importance of each revenue stream
- Growth of each revenue stream

Cost Drivers

- Which cost drivers have the greatest impact on cost structure?
- Types of cost: fixed, variable, semi-variable, non-recurring
- Relative size and importance of cost drivers
- Change of cost drivers over time

Size of Investment

- How much cash is needed to launch?
- How much working capital is needed to sustain operations?
- Timing--when is the cash needed?
- Will the resulting business be viable?

Critical Success Factors

- What components of the business model are most important?
- Which components are the most difficult to execute?
- How will the elements of the business model change over time?

Exercise II.

- What is the business model for your venture?
- How do you describe your business model through your financial statements?
- How your company generates revenues?
- What milestones are important for your company?
- What financial impact do these milestones have?

Discussion

- Why are presentations important?
- What do you want to achieve with presentations?
- What kinds of presentations will you be giving?

What Types of Investments VCs Like:

- **Disruptive technology (that works) and a disruptive business process**
  - Disruptive is what really changes the way things are on the market. Can be disruptive technology or process, or service.
- **Credible team with a track-record**
- **Fast growing market**
- **Large addressable market**
- **Ability to create barriers to entry for competitors**

Managing expectations while planning – What Types of Investments VCs Like

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Investment is all about minimizing risk and a maximizing market opportunity:

- Evaluate people, market and technology very critical
- Only work with those who are coachable
- Know who is you customer, and who will be your first customer, and what customers want
- Deal with risks, and find ways to limit them
- Desirable investors should bring value other than just money to an early-stage company

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Fund-raising Stages – who will invest

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- ***Friends and Family*: (money used for basic administrative details including corporate formation, market research and the creation of a business plan)**
  - Typical Round Size: F&F rounds can be as small as $5K and as large as $100K.
  - Investment Structure: Convertible note or common stock.
  - Hurdle For Next Stage: Business plan; management team.
- ***Seed*: (companies that have a business plan and a management team, but do not have a product)**
  - Typical Round Size: These are typically $100-500K but can be as large as $1M
  - Investment Structure: Convertible note or common stock.
  - Hurdle For Next Stage: Product.
- ***Series A*: (first institutional round; product that is ready to take to market)**
  - Typical Round Size: These are typically $2-5M but can be as little as $1M and as large as $10M.
  - Investment Structure: Participating preferred stock.
  - Hurdle For Next Stage: Market adoption.
- ***Series B*: (demonstrated market traction)**
  - Typical Round Size: These are typically $5-10M but can be as little as $5M and as large as $20M.
  - Investment Structure: Participating preferred stock.
  - Hurdle For Next Stage: Growth.

MBA Textbooks: Basic items that should be included in a business plan

- Executive summary
- Industry analysis
- Company description
- Product and services description
- Market description
- Marketing strategy
- Operations description
- Staffing description
- Financial projection
- Capital needs
- Milestones

Real Life Suggestion – Prepare in investor presentation first

- Executive summary
- Industry analysis
- What is the problem?
- Why your offering is a solution to the problem?
- Target market size and segmentation
- Technology
- Competition
- Competitive differentiation
- Service Offering
- Business Model
- Customers
- Company and Management
- Financial highlights
- Investment opportunity and basic terms

Important issues in new venture creation - People

- Does the management have good ideas and the courage to give them a chance?
- Is the management prepared to meet and master the test of strategy and competitive advantage?
- Can the management identify a market niche that is being missed by other established firms?
- Can the management identify a new market that has not yet been discovered by existing firms?
- Can the management generate first-mover advantage by exploiting a niche or entering a market before competitors?
- Who will sell the product /service? How these people can build credibility?

Market and customers

Questions that keep a new venture focused on its customers …

- Who is your customer?
- Who is your first customer? Where is he?
- How will you reach key customer market segments?
- What determines customer choices to buy or not buy your product/service?
- Why is your product/service a compelling choice for the customer?
- How will you price your product/service for the customer?
- How much does it cost to make and deliver your product/service?
- How much does it cost to attract a customer?
- How much does it cost to support and retain a customer?

Typical mistakes

- **Too much focus on theories – investors are interested in returns, not theories**
- **Too much focus on written business plan**
  - most investors does not want a written plan: an investment presentation coupled with executive summary and financial plan is usually enough
  - A written plan can be put together in 24 hours if needed
  - The plan is always wrong: more important to understand what you are doing
- **No focus on customer:**
  - as cash is the king, you need to know who is your customer
  - Everyone within the organization needs to know who are your customers and what they do

Typical mistakes

- **Not managing the expectations:**
  - Financial
    - **Investor wants good returns (10x)**
    - **Always milestone your investment**
  - People: always bet the jockey, not the horse
    - **most important asset, better to invest into a mediocre technology with a great team then to a great technology with a mediocre team**
    - **If you want an investment, you need to have someone who sells your technology to your customers**
  - Technology: everything has a competitor technology
  - Market :
    - **not understanding and knowing your customer**
    - **all market sizes can be quantified**
- **No short term focus: the most important is what will happen tomorrow.**

Early-Stage Investment Landscape

Who Invests in Early-Stage Companies?

- Angel investors (individuals or angel circles)
- Venture Capital funds
- Family offices
- Corporate Ventures
- Hedge Funds
- Government sponsored investment groups

How Are Venture Capital / Private Equity Firms Organized?

- VC / PE firms are usually structured as partnerships (for tax transparency reasons)
- Partners in the firm are compensated through “carried interest” (usually 20% of profits generated by a fund)
- Funds usually charge investors ~2% annually to cover operating expenses
- Funds have a target rate of return and, often, a “hurdle rate”
- Funds have “investment period” and “harvesting period”
- A single firm/team can simultaneously manage more than one fund (as one fund is almost invested, another gets raised)
- VC firms tends to have a regional and vertical focus
- There is no real difference between PE and VC firms, other than focus and fund size
- There are some publicly traded VC funds (e.g. TINY, 3i)

Where Do VCs Have Their Money From?

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- Funds receive money from investors - Limited Partners (funds-to-funds, insurance companies, university endowments, pensions funds, asset management groups, private offices, high net worth individuals, etc.)
- The capital raise for a fund is a lengthy process (easily a year)
- Money from LPs is transferred to a fund when “called”
- Typically, funds are 8-10 years in length (i.e. that’s the timeframe in which the fund is supposed to generate returns)
- Average returns from VCs as an investment class have not been attractive lately
- Large variance in returns between individual VCs and geographic areas where they operate

How Do VC Funds Generate Returns?

- Funds typically make equity investments in companies and expect that they will exit them in a certain timeframe (usually 3-5 years)
- At the exit time, they expect be able to get a multiple on their investment. Because they need to return money and profits to the investors, they typically sell all of their equity when they exit (unless the LPs prefer distribution of shares)
- Funds keep very detailed information about the fund’s performance (required by LPs and needed for raising the next fund – track record)

Risk and Expected Return on Investment?

- Investments at various stages are associated with different levels of risk
- Commonly, VCs investing in pre-revenue companies will target a 10x return on investment
- VCs investing in companies with $3M-5M in annual revenue will target 4x-6x return
- Typically, the larger a fund, the later stage they are interested in. A fund can do only so many transactions a year and a minimum deal size will depend on the overall fund size

What Types of Investments VCs Like

- Disruptive technology (that works) and a disruptive business process
- Credible team with a track-record
- Fast growing market
- Large addressable market
- Ability to create barriers to entry for competitors

It is all about minimizing risk and a large market opportunity

Typical Transaction Structure and Valuation

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- Early-stage financial investors will typically take a significant equity stake in a start-up company.
- Sometimes, the investment will be structured as convertible debt that will convert to equity at a later stage (typically at the time of the next equity round)
- Investors will require Preferred Shares that give them additional rights
- Valuation – no standard methodology for establishing a company valuation (it's a negotiation…)

"Dumb money" vs. "Smart money"

- Desirable investors should bring value other than just money to an early-stage company
- Part of valuation negotiation
- Purely financial investor vs. strategic investor

Fundraising Process

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- Will take longer than you conservatively expect
- Have Company information well prepared: Executive Summary (Teaser), Investor Presentation, Business Plan
- Be prepared, anticipate questions and be ready with answers
- Term Sheet
- Due diligence process

Placement Agents

- Firms or individuals who raise capital for funds or companies
- Well connected in investor circles, but quality and track record vary greatly
- Typical fees are 5% of money raised plus 5% warrants plus expenses

Intellectual Property – Patents

- Way of creating initial value in the company and a method for building potential barriers to entry for competition
- Expensive to maintain and prohibitively expensive to litigate
- Value of patents differs in various sectors (e.g. Pharma vs Engineering vs IT)

More Information

- www.nvca.org – templates of VC Term Sheet, etc.
- www.markpeterdavis.com – VC blog
- www.thefunded.com – resource for entrepreneurs, provides feedback on VC firms

Top 10 ways to prepare your company for angel investment

1. Befriend local angels.
2. Attend workshops on investing.
3. Reduce risk for investors.
4. Manage expectations.
5. Tell the good story well.

10 ways to prepare your company for angel investment

6. Make sure you are prepared.
7. Help them speak the language of returns.
8. Insist they have an exit in mind.
9. Focus them on the top 4 reasons to invest in their company.
10. Put an offer on the table.

Financing Terms

Offering:	$1,000,000
Minimum to Close:	$500,000
Minimum Investment:	$25,000
Price Per Share:	$1.00
Type of Security:	Series A Convertible Preferred Stock
Pre-Money Valuation:	$2,000,000
Use of Proceeds:	Marketing support, working capital & product engineering

Group Exercise - Presentations

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- How to prepare and hold a presentation
- What are the types of presentation

Two Types

- Elevator speech / pitch
- 10 to15-minute pitch (investor presentation)

The Elevator Pitch

- **Short explanation used for**
  - Chance encounters
  - Getting appointments
- **Significant challenge**
- **Presents the essence**

The Elevator Pitch

- Be clear and concise
- Leave the listener wanting to learn more
- Get them interested
- Forces you to focus on what really matters
- Requires deep understanding and clear thinking

Challenges

- Covering information quickly while sounding natural
- Use non-technical language
- Must be prepared in advance
- Practice and refine it as necessary
  - Practice with people who are not familiar with the area

Exercise – Prepare your Elevator Pitch

Tips and Traps

- **Tips**
  - Give overview
  - Show enthusiasm
  - Stress benefits, not features
  - Focus on audience
- **Traps**
  - Technical language
  - Too much detail
  - Too long

The Investor Presenation

- **Formal presentation that includes visuals**
- **Competing for funding against others**
  - Need to stand out
  - Time constraint
- **Address factors of interest to investors**
- **10-15 minute presentation**
- **10 – 12 slides**
- **Bullet points on slides, do not make audience read text**
- **Anyone on the team who shows up speaks**

Preparation

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- **Initial preparation**
  - Who is your audience?
  - What's the desired result?
  - What do you want them to remember?
  - What is the story?
- **Developing the content**
- **Delivering the presentation**

Think About

- What bullets do they have
- How can you steal their bullets
- Concrete examples
- Keeping them involved

Presentation Components

- Introduction (1 slide)
- Need (1)
- Team (1)
- Technology (3)
- Markets (2)
- Value (1)
- Financials (1-2)
- Summary (1)

Introduction

- Introduce who you are
- Who is with you
- The “hook”
- Give your primary message
- Tell them what you will tell them

The Message

- Tell them
- Reinforce your main message
- Support your message with facts and logic
- The importance of internal consistency
- Remember the narrative

Need

- What is the perceived need for the new product or service?
- What specific pain does it address?
- What are the competing products?
- What are the compelling features about your product?

Team

- Segue from need to origin of company
- Entrepreneur (possess one or next hire)
- Experience
- Commitment
- Priority of skill sets
- Who is going to do the work?

Technology

- Novel versus incremental
- Intellectual property
- Scalable
- Regulatory issues
- Component, product, or platform for business

Markets

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- What is your business model?
- Who is the customer?
- Price of product
  - Current estimate
  - Best guess at scale
- New or existing industry?
- Regulated industry?

Value

- What value does your company add?
- Where is value created?
- How else can value be added?

Financials

- Product pricing
  - COGS
  - Gross profit
  - Overhead
  - Net profit
- Five year forecast
  - Cash flow
  - Profit and loss statement
  - Balance sheet
- Liquidity
- Uses of new funding
- How do you translate funding into value accretion?

Summary

- Tell them what you told them--reinforce the message
- Review key points
- Summarize current status
  - product development
  - personnel
  - fund raising
  - marketing/sales status
- Call to action
- End on energy
- Open for questions

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Q&A

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- Listen to the question
- Do NOT interrupt
- Repeat the question to make sure you have it right
- Pause before you answer
- Stay focused and succinct
- Direct questions to your teammates
- Remember to close after the questions

Good visuals

- Are big
- Are simple
- Have few words
- Pictures make text at least six times as effective as text alone.
- Do NOT make pictures complicated – they will decrease attention.