



# The Capital Food Chain For Entrepreneurs

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# Agenda

- Introduction
- Angels and VCs
- Business plans
- How investors evaluate deals
- Doing deals
- Five lessons

# Friends & Family

Typical round: <\$US100K  
Each investor: \$US2-10,000  
**Investment/year:  
\$US60B**

Unsophisticated  
Investing in a friend, family  
Passive  
1-2 lifetime investments  
Equity, debt, gift?

# Angels

Typical round: \$US400,000  
Each investor: \$US35,000  
Investment/year: \$US20B

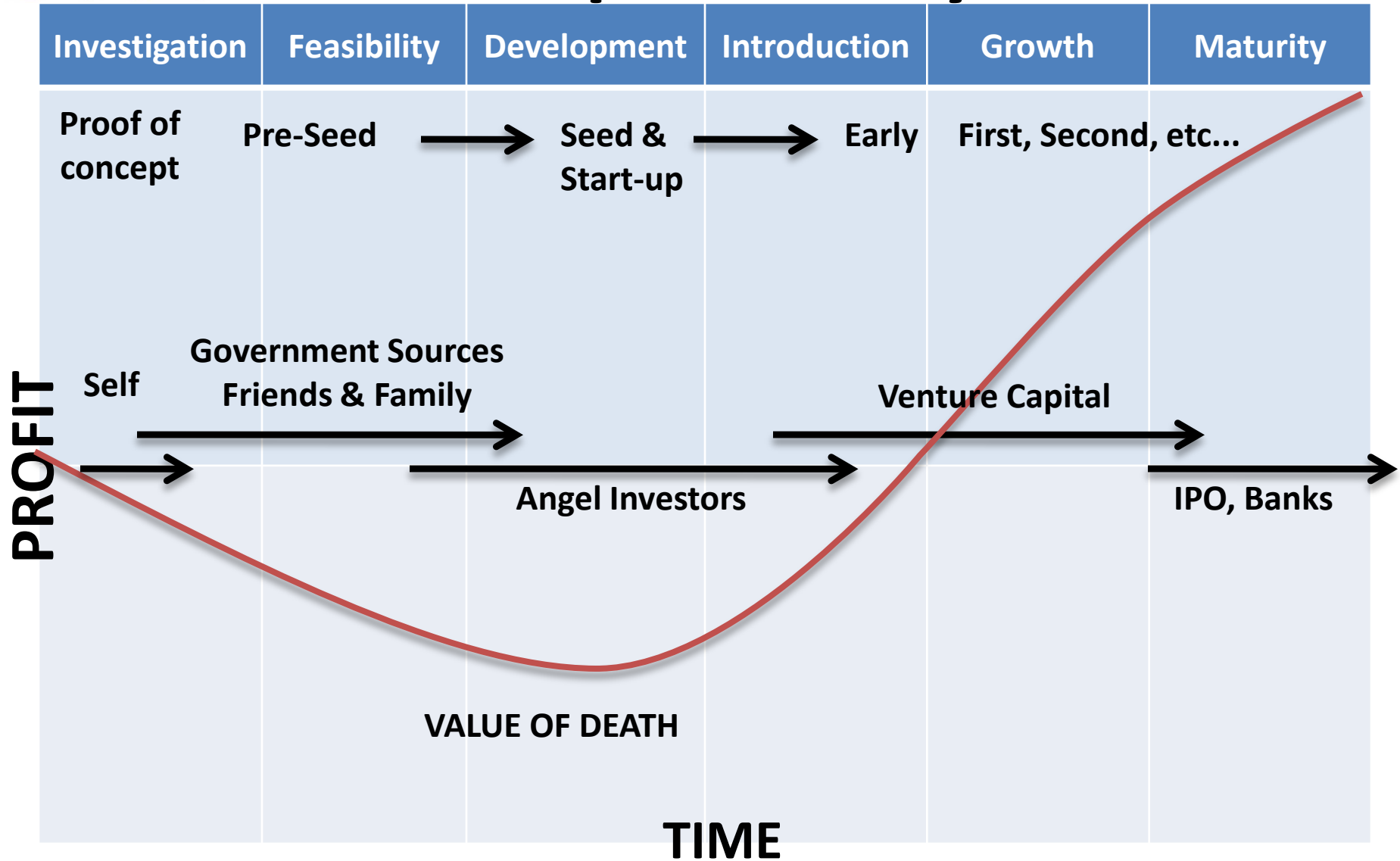
Accredited, savvy  
Investing time and money  
Active  
Investing in entrepreneur  
Portfolio of angel deals

# Venture Capitalist

Typical round: \$US7M  
Each investor: \$US3M  
Investment/year: \$US20B

Limited partnership  
Institutional money  
General Partners active  
Invest in company  
Large portfolio

# The Capital Lifecycle

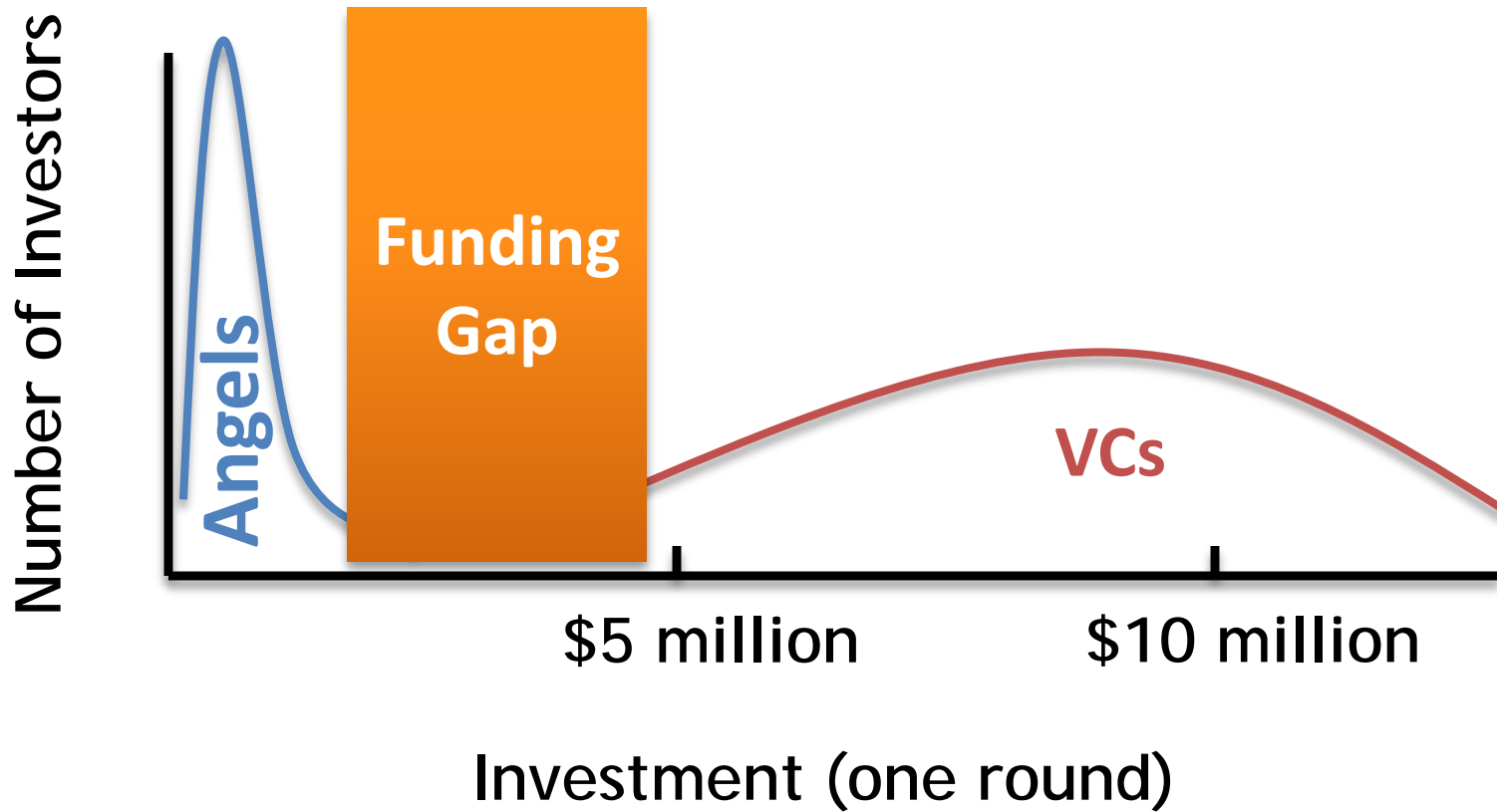


# The Funding Gap

Pre-Seed Stage	Seed/Start-up Stage	FUNDING GAP	Early Stage	Later Stages
Founders, Friends & Family	Angel Investors	<p>Very few angel deals done above \$1 million</p> <p>Very few VC deals done below \$4 million</p>	Venture Capitalists	

\$0                      \$250K                      \$1.5 million                      \$4 million                      \$10 million up

# ENTREPRENEURS: Go Where Investors Are



# Nondisclosure Agreements (NDAs)

- **Most angels and VCs will not sign**
  - See too many deals
  - Integrity is key to continuing business
  - Not motivated to steal technology
- **May sign NDA...**
  - During due diligence, not earlier
  - Covering a very narrow set of issues
- **Business Plan - no proprietary information**

# Friends and Family Investors

- **Pre-seed financing**
  - To develop product
  - To find customers
- **Unsophisticated**
  - Equity? Debt? Gift?
  - Limit the number of investors

# *Angels and VCs*

# Who Are These Angels?

- Wealthy individuals – “accredited investors”
- “Been there, done that” entrepreneurs
- “Mad money”
- Generally \$25K-\$250K per deal per angel
- Several angel investments
- More than 400,000 active angels
- Range of involvements
  - Lead investor – Chairman of the Board
  - Investor/advisor
  - Passive investor

# Venture Capitalists

- **General partners**
  - Salaried managers
  - Minimal investment, huge upside
- **Limited partners**
  - Corporations, pension funds, wealthy individuals
  - Totally passive involvement
- **1000 venture capital funds ↓**
- **Size: \$5 million to >\$10 billion**

# Motivation

**VENTURE CAPITALISTS: make money**

## ANGELS

- Return on Investment is the metric
- Staying involved (sense of usefulness)
- Give back to community
- Affection for entrepreneurs



# Investing Comparison

	Angels	VCs
Dollars	Approximately \$25 Billion	Approximately \$25 Billion
Number of Investments	50,000	3,000
Number of Start-up Deals	25,000	<200
Number of Investors	250,000	1,000
Per Round	\$400,000	\$7-8 million
Each Investor	\$25,000 and up	\$2 million and up
Typical Investment	Early Stage	Later Stage



# *Business Plans*

<b>Elevator Pitch</b>	<b>Two minute verbal summary</b> <b>Product, opportunity, differentiation</b> <b>Attract interest – not closing</b>
<b>Executive Summary</b>	<b>2-4 page written summary</b> <b>Balanced presentation</b> <b>Attract interest – not closing</b>
<b>PowerPoint</b>	<b>20 minute verbal presentation</b> <b>Cover whole plan</b> <b>Find serious investors</b>
<b>Full Business Plan (write full plan first)</b>	<b>20-50 pages plus appendices</b> <b>Validation scorecard (due diligence)</b> <b>Basis for all other plan forms</b>

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# Writing Business Plans

- Entrepreneur **MUST** write plan (no consultants)
- Use editors for clarity and brevity
- Resources
  - The Business Mentor - [www.fasttrac.org](http://www.fasttrac.org)
  - SBA - [http://www.sba.gov/starting\\_business/index.html](http://www.sba.gov/starting_business/index.html)
  - Inc. Business Plan Building, Section by Section  
[http://www.inc.com/guides/write\\_biz\\_plan/20660.html](http://www.inc.com/guides/write_biz_plan/20660.html)

# *Evaluating Deals*

*What do investors look for?*

# Angel Rating System

Management team	0-30%
Size of opportunity	0-25%
Product & technology	0-15%
Sales channels	0-10%
Competitive advantage	0-10%
Size of this round	0 - 5%
Need for more funding	0 - 5%

# Fundable Management Teams

- **CEO**
  - CEO experience
  - Vertical experience
  - Coachable (very important)
  - Leadership
- **Team**
  - Balance and complete
  - Experience working together

# Size of the Opportunity

- **Scalable**
  - \$30 million (min.) in revenues in 5 years
  - (VCs look for >\$100 million)
- **High gross margins**
- **Large niche market**
- **Unfair competitive advantage**
- **Ready for customers**

# Competitive Advantage (IP)

- **Patents**
  - Important, but difficult to defend
- **Trademarks/copyrights**
- **Trade Secrets**
- **Very important at exit**

# *Typical Angel Deals*

# Typical Angel Group Deals (p1)

- Management team has:
  - Integrity
  - Experience (management, business vertical)
  - Identified key advisors/directors
  - Key players in the wings

And...CEO is coachable

# Typical Angel Group Deals (p2)

- **Scalability**
  - Build revenues to >\$30 million in five years
- **Serving large niche market**
- **Expecting large gross margins**
- **M&A exit feasible within 5+ years**

# Typical Angel Group Deals (p3)

- **Prototype ready to show customers**
- **Customers identified** and have been shown product or prototype
- Customers can validate that the product is a **pain killer, not a vitamin pill**
- **Unfair competitive advantage**

# Typical Angel Group Deals (p4)

- Validated business model
- Reasonable sales channels are available
- Low customer acquisition costs
- Competition is fractured (Microsoft is not lurking around the corner)

# Typical Angel Group Deals (p5)

- Entrepreneurs is flexible on terms
- 20+X ROI is possible (*not all angels agree..*)
- Reasonable valuation
- Deal structure allows input/control by investors
- Board representation is available
- CEO is willing to step aside

Once you have attracted investors...

# *Doing the Deal*

# Summary of the Angel Investing Process

- Pre-screening
- Screening
- Due diligence
- Investment presentation
- Follow-up discussions and meetings
- Closing

# Deal Flow Statistics

- **Prescreening** ➤ 1 in 4 to Screening
- **Screening** ➤ 1 in 3 to Due Diligence
- **Due Diligence** ➤ 1 in 3 to Investment Meeting
- **Investment** ➤ 1 in 2 raise money
- **OVERALL** ➤ 1 in 72 who apply receive investment

# *Five Mistakes to Avoid*

# 1. Don't take dumb money!

# Look For Smart Money –

Investors eager to invest **money** and **time** in your company, bringing their skills and experiences to help you grow

Check the references of possible investors before signing a term sheet

## 2. When pitching investors, don't elaborate in describing your product/technology

# Tell Investors about your business, not your product

- What is the competitive landscape?
- What is the size of the opportunity?
- Will IP be a useful barrier to entry?
- Cash required to positive cash flow?
- Can you make the product?

# 3. Don't overestimate the size of the market



# Accurately determine the addressable market

(assuming you had 100% market share)

Hypothetical example:

An entrepreneur in the sheepskin seat cover business estimates the size of the opportunity to be \$200 billion per year – the size of the automobile market!

**Don't fall into this trap...investors can see right through this deception**

# 4. Don't "ball park" revenues as a percentage of the total market



# Do not develop proforma revenues as a percentage of addressable market

“The total market is \$350,000,000 and we will capture 1% in year one (\$3.5 million) and 10% in year five (\$35 million)”

**Build your revenue plan from the bottom up – define which customers will buy how much in the first year... second year...etc.**

# 5. Don't press the first mover advantage



# 'First Mover Advantage' is usually a fraud

It is frequently the 3rd or 4th company in the space that is successful

First-to-market often demands missionary sales (developing entirely new markets), requiring huge amount of money and expertise to thrive.

Accurately access the first mover advantage, if any, and especially how much it will cost to penetrate this market.

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# Lessons for the Day

- Raising money is difficult and time-consuming
- Spend the time necessary to understand the capital food chain for entrepreneurs
- Learn what motivates investors to fund companies
- Pursue funding as smart entrepreneur
- Time spent preparing will save substantial time in raising money

# Resources

- *Definitive Guide to Raising Money from Angels*, B. Payne (2006)  
\$37 from [www.billpayne.com](http://www.billpayne.com)
- *State of the Art: An Executive Summary Briefing on CuttingEdge Practices in American Angel Investing*  
J. May & E. O'Halloran (2003)  
\$35 from [www.amazon.com](http://www.amazon.com)
- *Term Sheets & Valuation – A Line by Line Look at the Intricacies of Venture Capital Term Sheets & Valuation*, A. Wilmerding (2003)  
\$10 from [www.amazon.com](http://www.amazon.com)
- *The Art of the Start*, (2004) G. Kawasaki,  
\$18 from [www.amazon.com](http://www.amazon.com)

# Questions??

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