

FIN 623: Venture Capital Finance

VC Evaluation and Decision

Plan for today

Part I: Stages of Startup Development

Part II: Business Plan Evaluation

Part III: How do VCs Make Decisions?



Part I: Stages of Startup Development

Seed/Startup stage

- ❑ Objective: Funding to prove the concept
 - Product development
 - Market Research
 - Develop a business plan
 - Building a management Team
- ❑ Typically no VC at this stage

Early Stage

- ❑ Objective: Funding to launch product following testing
- ❑ First involvement by VC

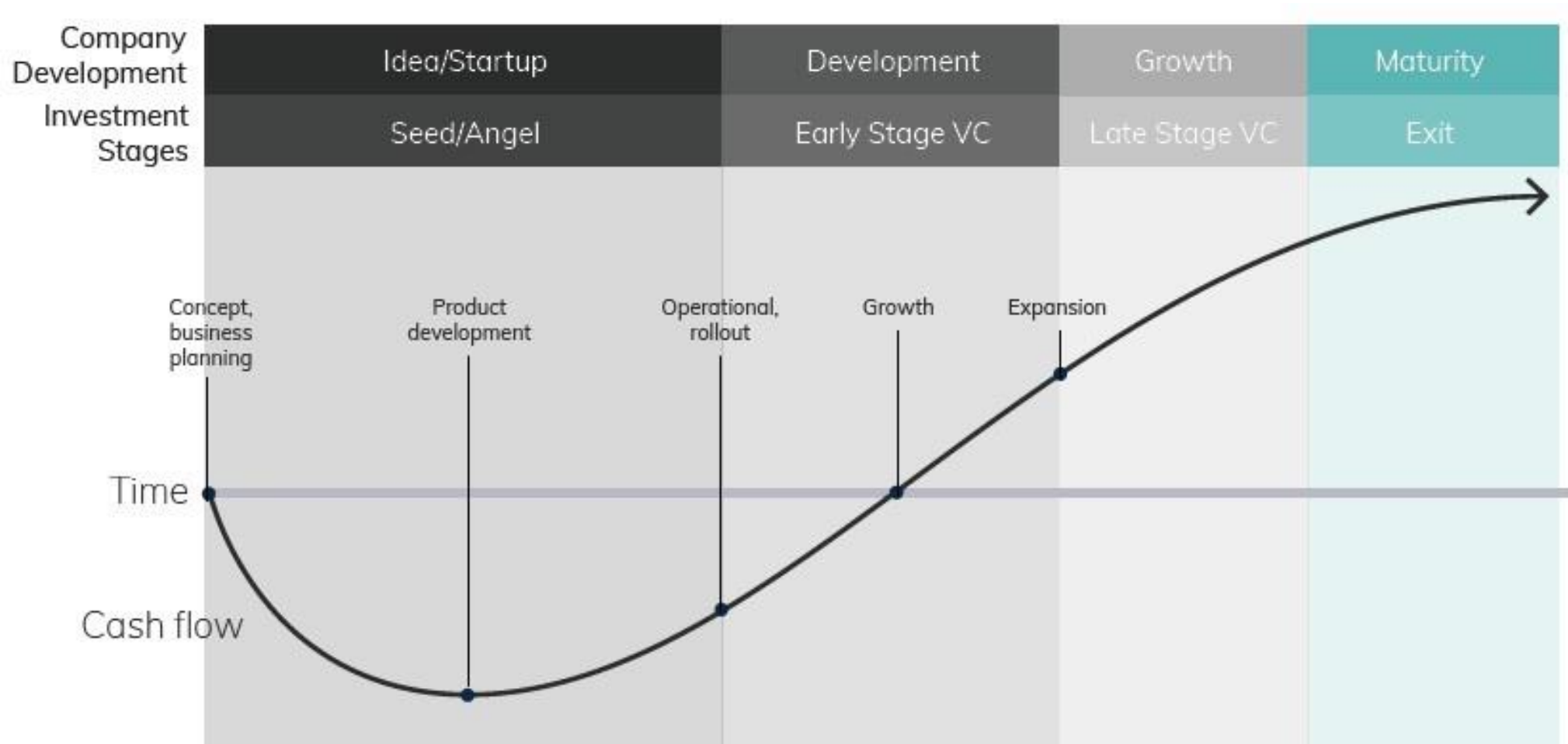
Expansion Stage

- ❑ Apply working capital to expand the company
 - Plant expansion
 - Marketing
 - Development of improved product

Later Stage

- ❑ Funding for companies with stable growth
 - Flat growth rate
 - Stable cash flows
 - Company is considering an IPO
 - There is trend towards later-stage investing

VC Plays a Vital Role in a Startup's Growth



How does company stage differ from funding round?

- Round of funding is a function of milestones
 - Development of a product
 - Acquisition of a major customer
 - Breakeven point

Challenges of Venture Financing

- Critical issues involved in financing young firms:

- Uncertainty
- Asymmetric Information
- Nature of Firm's assets
- Conditions of relevant financial and product markets

Multiple Rounds, Multiple Tranches

- Responses by VCs:

- Active Screening
- Stage financing
- Syndication
- Preferred Stock
- Use of Stock options/grants with strict vesting requirements
- Contingent control mechanisms – Covenants and restrictions
- Strategic composition of Board of Directors

TERM SHEETS!!



Part II: Business Plan Evaluation

Screening

- ❑ Goal: Identify investment opportunities
- ❑ Soft questions
- ❑ Takes a big chunk of the VC's time
- ❑ Most investments are screened using a **business plan** prepared by the entrepreneur. Two major areas of focus in screening:
 - Market test: Does this venture have a large and addressable market?
 - Management test: Does the current management have capabilities to make this business work?

How Will VCs Evaluate a Business Plan?

- ❑ When I look at an opportunity, I use the following framework:

OUTSIDE- IMPACTS Approach

Opportunity, Uncertainty, Team, Strategy, Investment, Deal, Exit.

- ❑ Other approaches exist - the ideas are similar.

OUTSIDE - IMPACTS

(O) Opportunity: Is this a positive present value opportunity?

- ❑ SWOT analysis, or... Does it have IMPACTS?
- ❑ (I) What is the idea / industry?
 - » Explain the idea / opportunity clearly and succinctly.
 - » What problem does it solve?
 - » What is the pain point
- ❑ (M) Is the target market large enough to support substantial growth / valuation?
 - » How large is the market segment you are targeting?
 - Who are the key customers?
 - How many are there?
 - What will they spend?
 - » Provide solid support for your analysis.
 - » Are there additional opportunities?

OUTSIDE - IMPACTS

(O) Opportunity: Is this a positive present value opportunity?

(Does it have IMPACTS?)

❑ (P) Why does the opportunity generate a positive present value? What is unique?

» The answer to this should be implicit in other parts of OUTSIDE-IMPACTS. But, doesn't hurt to be explicit.

» Why will you make money?

» How will you make money?

» "What is your edge?"

- first-mover advantage?

- network effect.

- switching costs.

- execution.

- technology?

- advantage?

- defensible?

OUTSIDE - IMPACTS

(O) Opportunity: Is this a positive present value opportunity?
(Does it have IMPACTS?)

❑ **(A) Acceptance:**

- » Will customers in that market accept / buy this new product / service?
- » Who is the customer in the target segment? Put yourself in shoes of a customer.
How does the customer spend the day?
- » Why will they buy your product / service?
What do they buy now?
Why do they buy what they do now?
Why will they switch from their current product?
- » How will you get to the customers?
Direct Salesforce? Resellers? Distributors?
– How much of each? How quickly?
Advertising?
How much will it cost?
Common to underestimate time / cost
- » How will you keep customers? How much will it cost?

OUTSIDE - IMPACTS

(O) Opportunity: Is this a positive present value opportunity?
(Does it have IMPACTS?)

- ❑ (C) Why won't the value be competed away?
 - » What will existing competitors do?
 - » What will other new entrants do? How will you respond?
- ❑ (T) Why is this a good time to enter?
 - » Why hasn't the opportunity been taken already?
- ❑ (S) Speed? How quickly can this be implemented?
- ❑ Good opportunities have positive **IMPACTS**.

If the opportunity does not have **IMPACTS**, then it should not be pursued.

OUTSIDE - IMPACTS

(U) Uncertainties: What are major uncertainties?

- ❑ Possible uncertainties:
 - » Market size.
 - » Customer acceptance.
 - » Customer approach.
 - » Competition.
 - » Management team.
 - » Potential real options.
- ❑ Which uncertainties can be managed so that outcome is more likely to be favorable?
 - » Choice of initial customers? Choice of investors?
- ❑ How do the answers affect the opportunity?

OUTSIDE - IMPACTS

(T) Team

- ❑ Can management team implement opportunity?
 - » How does previous experience relate to opportunity?
 - » How “hungry” is the management team?
- ❑ If management pieces are missing:
 - » What pieces are missing?
 - » What type of person will you look for to fill them?
 - » How will you find that person?
- ❑ For VCs, a good team and a good opportunity are necessities.

(S) Strategy

- ❑ Is strategy consistent with opportunity, uncertainty, team, and exit?

OUTSIDE - IMPACTS

(I) Investment Requirements

- ❑ Cash flow requirements.

(D) Deal

- ❑ Does deal structure provide appropriate incentives?
 - » Is the deal priced attractively?
 - » Do key individuals have incentives to do deal?
 - » Do key individuals have incentives to make deal work?
- ❑ Does deal structure provide / ensure appropriate governance?
- ❑ Does deal structure help manage the uncertainties?

(E) Exit

- ❑ Can investors exit the deal? How?

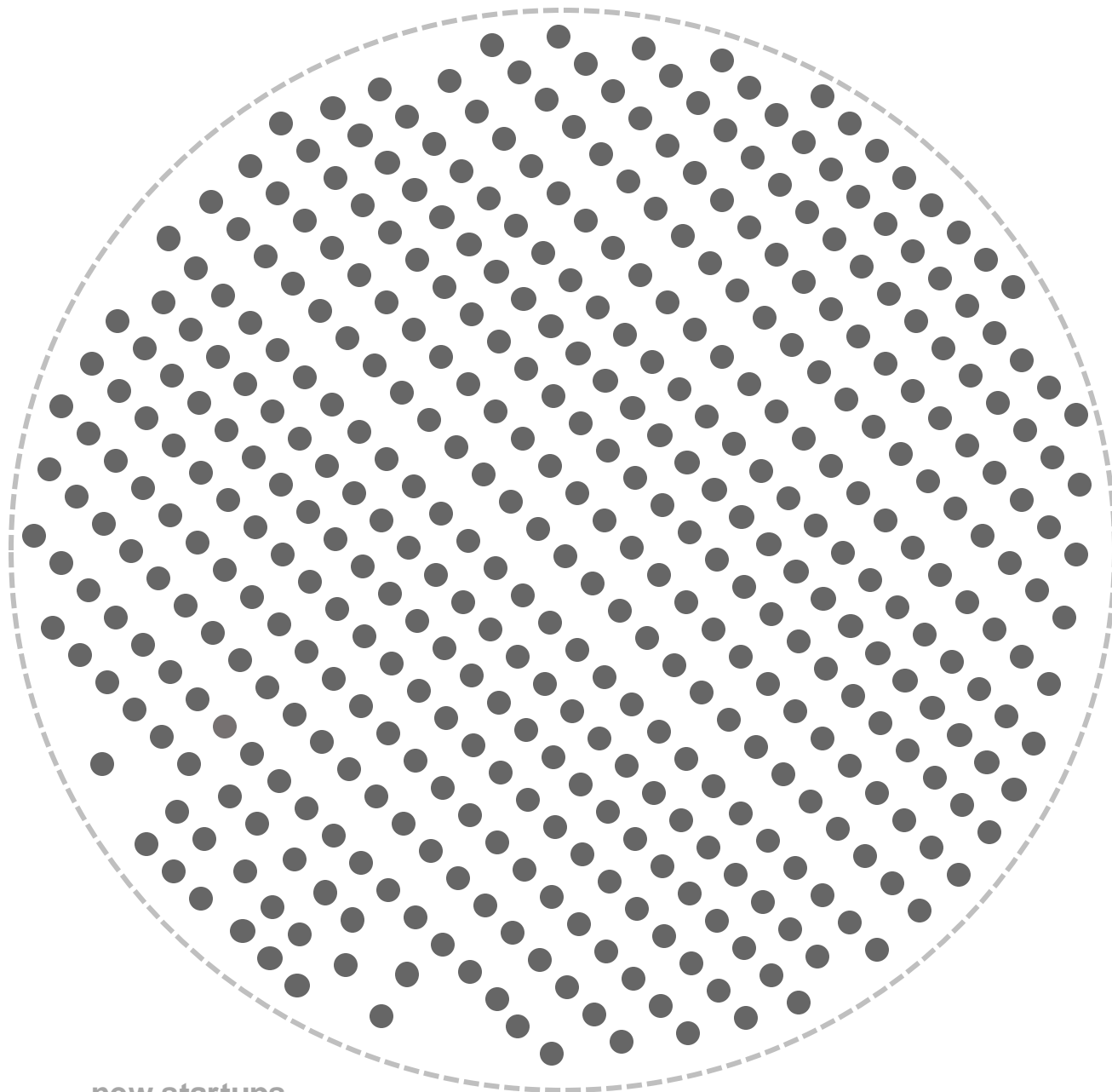
If an investment does not pass the OUTSIDE test, leave it outside!

OUTSIDE-IMPACT, SWOT, and now... POCD!

People	Opportunity	Context	Deals
Does the team have the experience to exploit the opportunity?	Do you have a competitive edge you can defend?	How does is the current regulatory and macro- economic environment affect the likelihood of success?	Who is financing the venture?
Has the team has worked together in the past?	How will the company make money?	Why now?	How does the deal influence the incentives of the team?
Who is missing and how will they be hired?	How might the opportunity change?	Is the team aware of the context?	The structure of the deal should reflect your incentives and those of investors
How committed are the founders to the venture?	What is the execution plan?		
	Is a pivot possible?		



Part III: How do VCs Make Decisions?



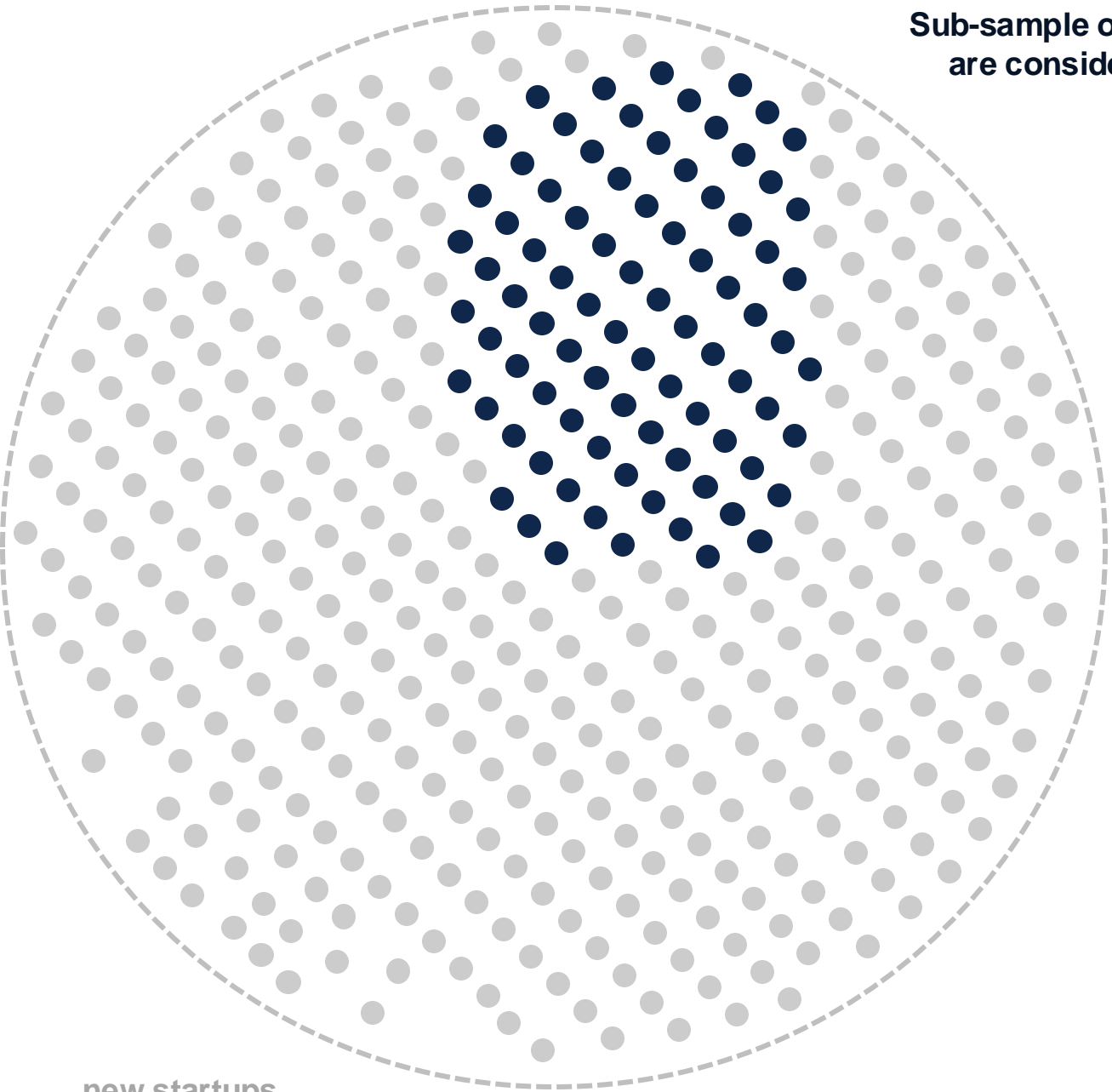
new startups



Which firms should VCs
invest in?



VC



Sub-sample of firms
are considered



6% **only** meet VCs
< 0.5% **receive** VC-backing



Which firms should VCs
invest in?



VC

new startups

Screening Strategies and Metrics

What do VCs Have to Say?

- *"This is a business of exceptional entrepreneurs with exceptional firms - 2/25 should return twice the size of the fund."*
- *"How much money is needed to get to the next milestone against the level of dilution to balance ownership and founders' incentives. Experience of the team, competitive nature of the deal and how attractive is this deal for the VC."*
- *"Top-down approach - market trends and how they affect revenue growth. Bottom-up approach - look at the firm and try to understand what are their growth drivers."*

Screening Strategies and Metrics

1. *How much the firm raised so far?*
2. *Is the money deployed responsibly?*
3. *Gross margins ~ 60% (Revenues – COGS)*
4. *Customer Acquisition Cost (CAC)*
5. *Sales Efficiency (Revenues/Sales Representatives)*
6. *MOM Growth ~ 10-15%*
7. *Retention Rate $[\#Customers(t+1)/\#Customers(t) - 1]$*
8. *Churn Rate $[1 - \#Customers(t+1)/\#Customers(t)]$*
9. *Revenue Churn*
10. *Account Expansion or Contraction (How many customers buy additional services?)*
11. *Net Dollar Retention $[Revenues(t+1) \text{ from Customer}(t)]$*
12. *Comparables [EV/Revenue]*
13. *M&A and IPO Scenario*
14. *Interviews with Customers*
15. *Discussions with Referrals*
16. *Market and Competition Analysis*
17. *Team Composition and Experience*
18. *Potential Collaboration with Portfolio Companies*
19. *Expert Calls*

After Screening: Due Diligence

1. Pitch meeting

- The meeting of VC with company management
- Redo management test

2. Preliminary diligence

- Management
- Market
- Customers
- Product
- Technology
- Projections
- Sales Channels
- Stakeholders' Relationship
- Financing
- Contract Design: Term Sheets

3. Term Sheets

- Contracts
- Preliminary offer.

4. Final diligence

How do VCs Make Decisions? A Survey

1. **Survey Design**
2. Pre-investment (Sourcing, selection, valuation)
3. Deal Structure
4. Post-investment value-added and exit
5. Sources of value
6. Organization of VC firm

Academic survey of 681 VC firms

	Respondents		Firms	
	<i>N</i>	%	<i>N</i>	%
Total responses	1110	100	860	100
Respondents at institutional VC firms	885	80	681	79
Respondents in corporate VC	141	13	120	14
Respondents at other investors	84	8	82	10
Sample: Respondents at institutional VC funds				
Total responses	885	100	681	100
Completed surveys	565	64	470	69
Surveys completed on behalf of someone else	11	1	11	2
Respondent is a partner	667	75	552	81
Matched to VentureSource	789	89	589	86

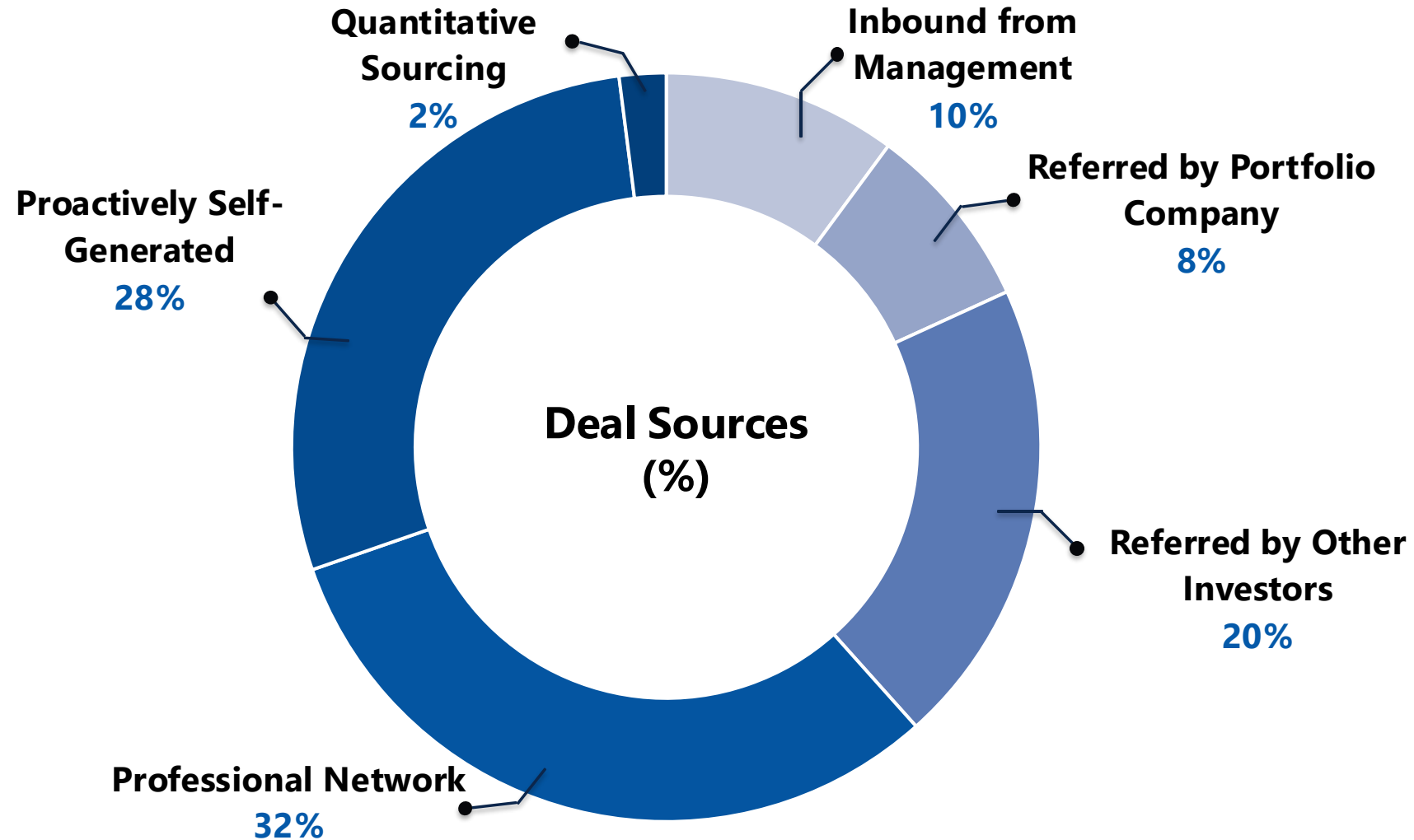
Statistics on VC firms responding to the survey

	N	Mean	Pct 25	Median	Pct 75	Std dev
Fund characteristics						
Fund size (\$m)	557	286	58	120	286	775
Fund size (\$m) ^{vs}	471	370	34	100	253	1335
Vintage year	547	2012	2011	2014	2015	4
Vintage year ^{vs}	477	2010	2008	2012	2014	5
Firm characteristics						
Year founded ^{vs}	508	1998	1994	2000	2005	10
Number of partners	602	4.8	3.0	4.0	5.0	6.1
Number of investments ^{vs}	484	169	28	73	196	261
Average round size (\$m) ^{vs}	467	33	6	11	19	178
% of exited investments IPO ^{vs}	482	12	0	8	20	14
% of investments exited ^{vs}	484	71	58	77	89	22
% US deals ^{vs}	484	66	17	91	100	41
Intend to raise another fund	436	84	100	100	100	36
Previous fund decile	280	7.8	7.0	8.0	9.0	1.9
Previous fund vintage year	329	2007	2005	2008	2011	5

How do VCs Make Decisions? A Survey

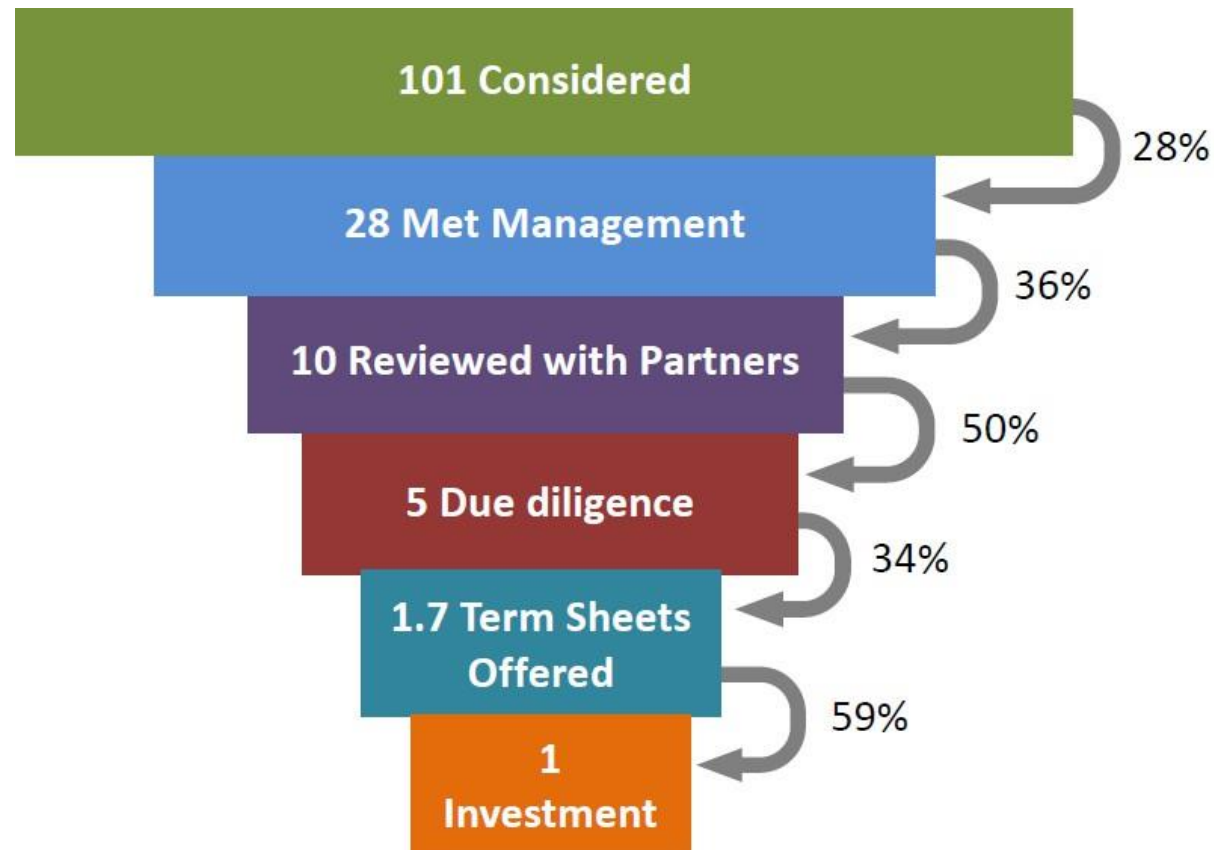
1. Survey Design
2. **Pre-investment (Sourcing, selection, valuation)**
3. Deal Structure
4. Post-investment value-added and exit
5. Sources of value
6. Organization of VC firm

Deal sourcing



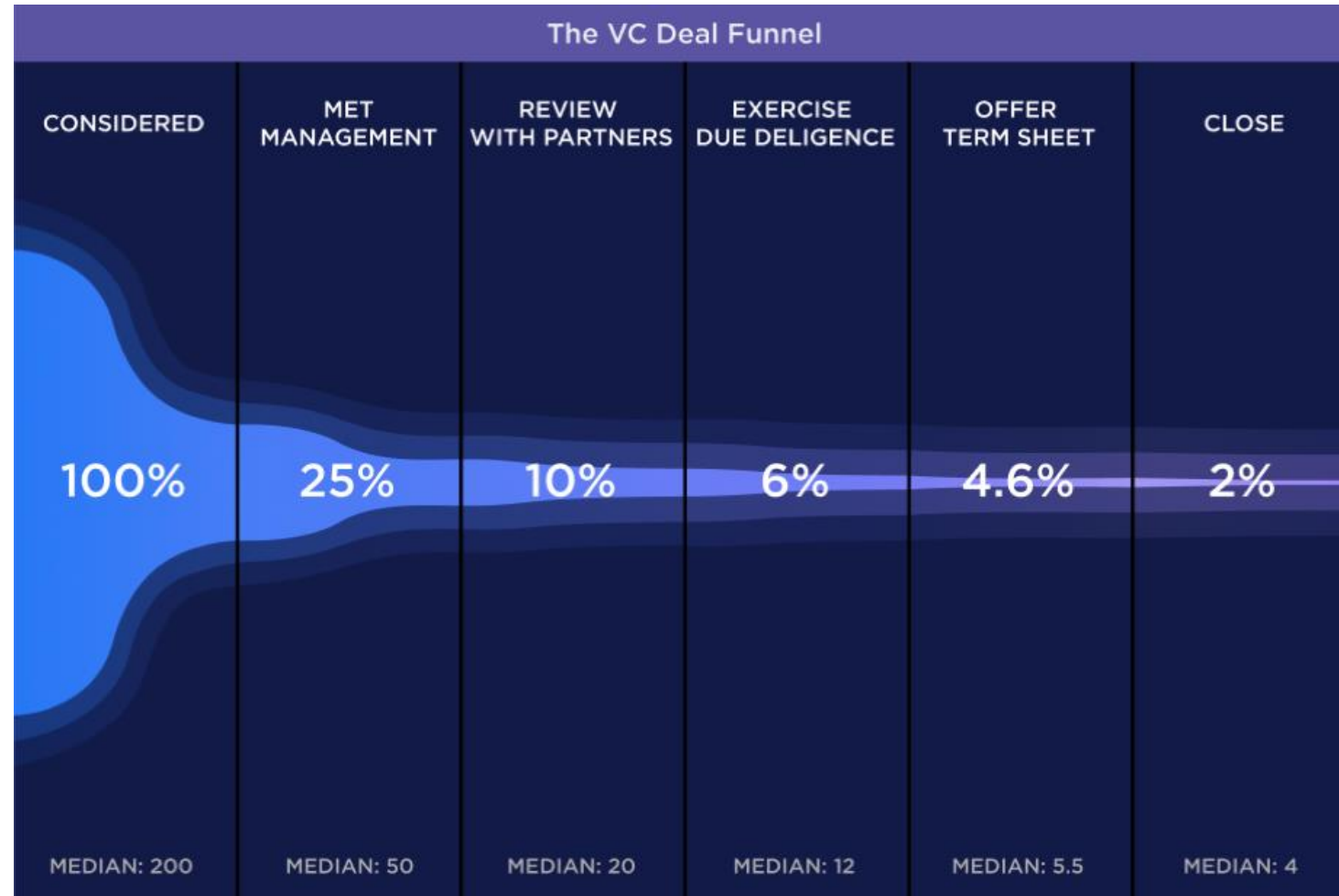
Source: Gompers, Gornall, Kaplan, Strebulaev (2019)

VCs invest in 1% of all deals they consider

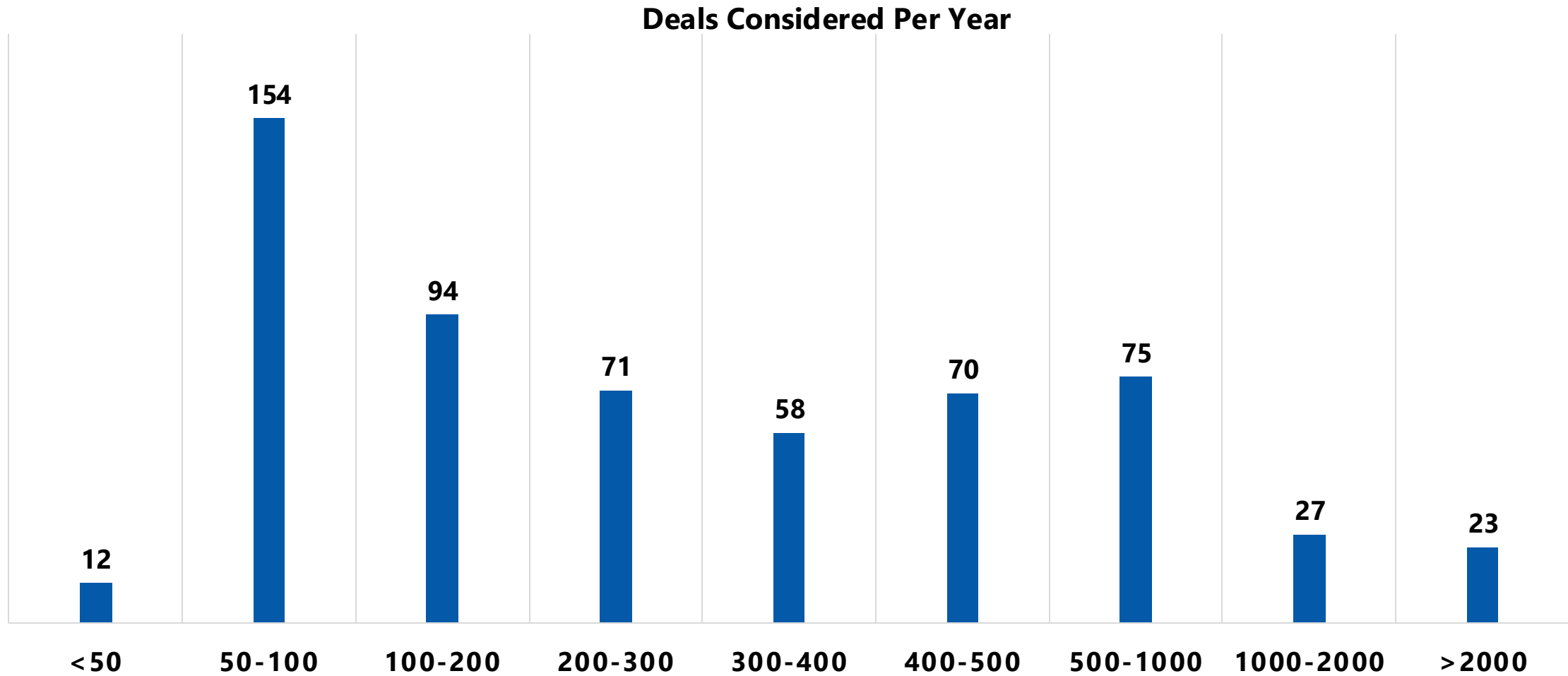


Source: Gompers, Gornall, Kaplan, Strebulaev (2019)

The VC Deal Funnel

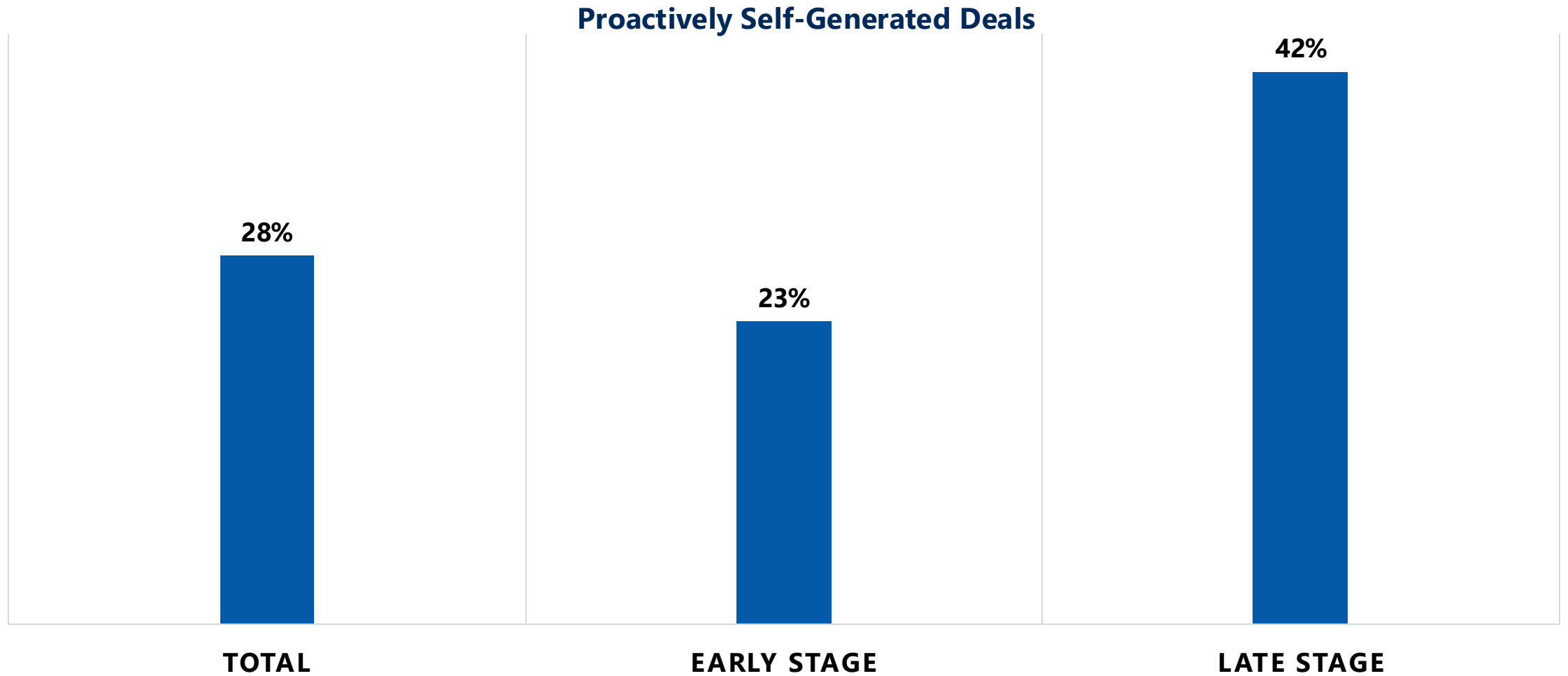


VC Screening and Investment Process



Source: Gompers, Gornall, Kaplan, Strebulaev (2019)

VC Screening and Investment Process



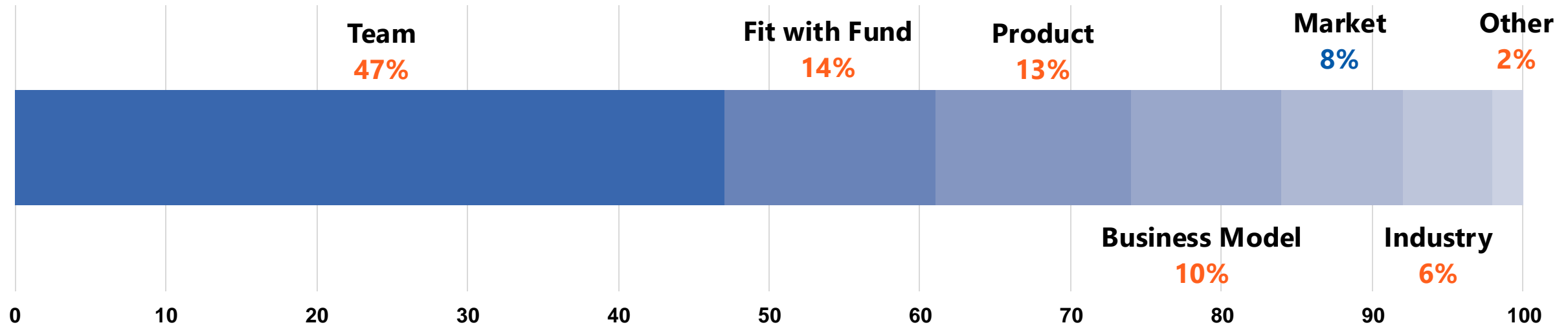
Source: Gompers, Gornall, Kaplan, Strebulaev (2019)

Which factors matter most for investment?

Important factor	All	Stage		Industry		IPO rate		Fund size		Location		
		Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
Team	95 (1)	96 (1)	93 (3)	96 (2)	91 (3)	96 (2)	96 (1)	96 (1)	95 (1)	97 (1)	93 (2)	96 (1)
Business model	83 (2)	84 (2)	86 (4)	85* (3)	75* (4)	79 (3)	82 (3)	83 (2)	82 (2)	83 (3)	84 (2)	81 (3)
Product	74 (2)	81*** (2)	60*** (5)	75 (4)	81 (4)	75 (3)	74 (3)	71* (3)	77* (2)	81** (3)	71** (3)	73 (3)
Market	68 (2)	74 (3)	69 (5)	80*** (3)	56*** (5)	68 (4)	74 (3)	67 (3)	70 (3)	76** (3)	66** (3)	64 (3)
Industry	31 (2)	30 (3)	37 (5)	33** (4)	19** (4)	25 (3)	29 (3)	30 (3)	31 (3)	31 (3)	37 (3)	24*** (3)
Valuation	56 (2)	47*** (3)	74*** (5)	54* (4)	42* (5)	59* (4)	49* (4)	59* (3)	52* (3)	63 (4)	60 (3)	46*** (3)
Ability to add value	46 (2)	44 (3)	54 (5)	41 (4)	45 (5)	39* (4)	48* (4)	41** (3)	51** (3)	46 (4)	48 (3)	46 (3)
Fit	50 (2)	48 (3)	54 (5)	49 (4)	40 (5)	38** (4)	50** (4)	46** (3)	54** (3)	48 (4)	51 (3)	50 (3)

Do VCs Bet on the Jockey or the Horse?

Factors in Decision to Invest



VC Firms Specializing in Technology Sector Bet on the Jockey

50% Consider Team as the Most Important Factor



VC Firms Specializing in Healthcare Sector Bet on the Horse

Only 32% Consider Team as the Most Important Factor



Early-Stage VC Firms Bet on the Jockey

53% Consider Team as the Most Important Factor

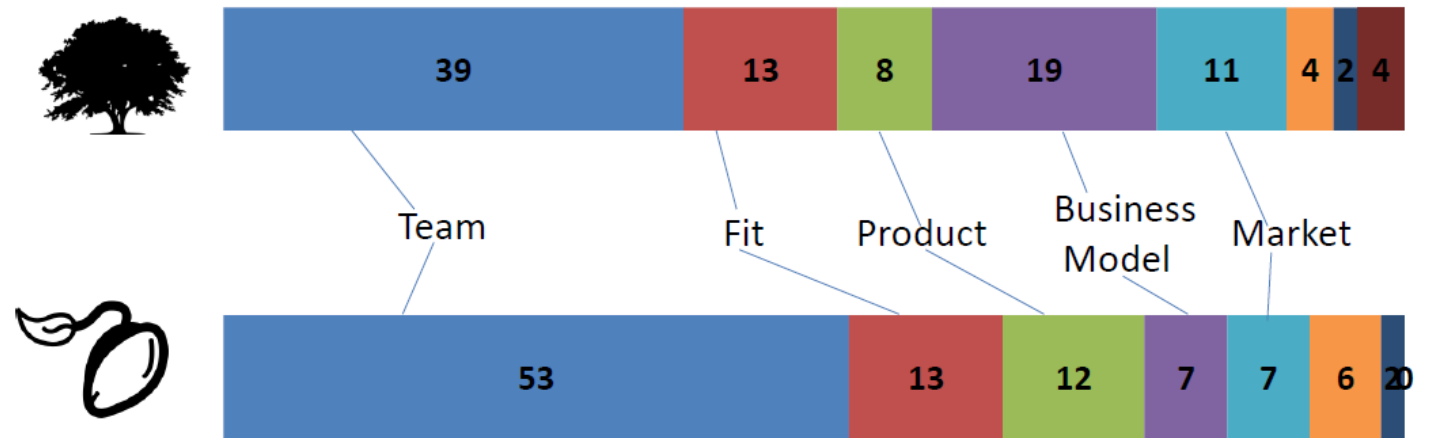


Late-Stage VC Firms Bet on the Horse

Only 39% Consider Team as the Most Important Factor

Jockey or Horse?

Jockey vs. horse for early vs. late stage VC firms



0 10 20 30 40 50 60 70 80 90 100



Early stage firms bet more on the jockey

53% consider the team the most important factor



Late stage firms bet more on the horse but jockey important

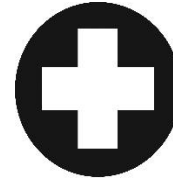
39% consider the team the most important factor

Differences Across VCs



VC Firms Specializing in Technology Sector

Consider, Meet Management, and Review **More** Investments



VC Firms Specializing in Healthcare Sector

Consider, Meet Management, and Review **Less** Investments



Early-Stage VC Firms

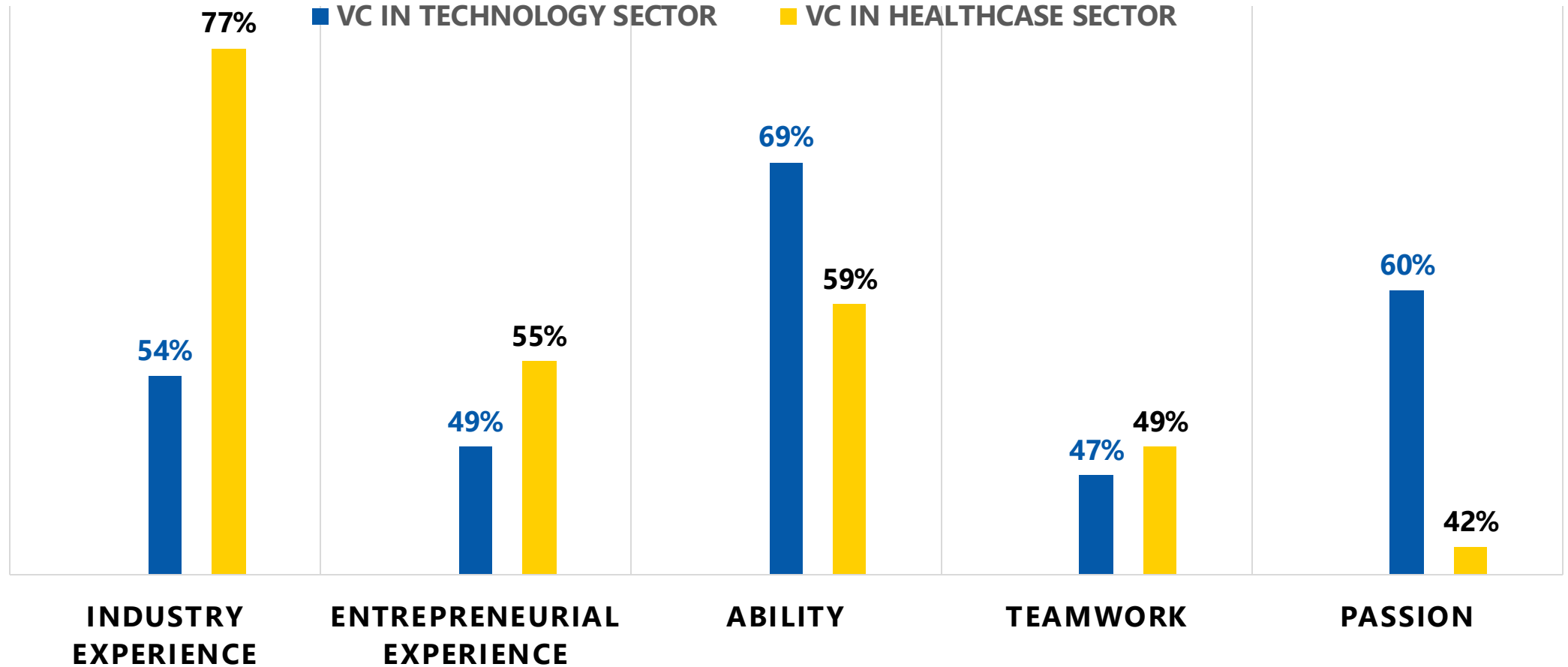
Offer **1.5 Term Sheets** Per Closed Deal



Late-Stage VC Firms

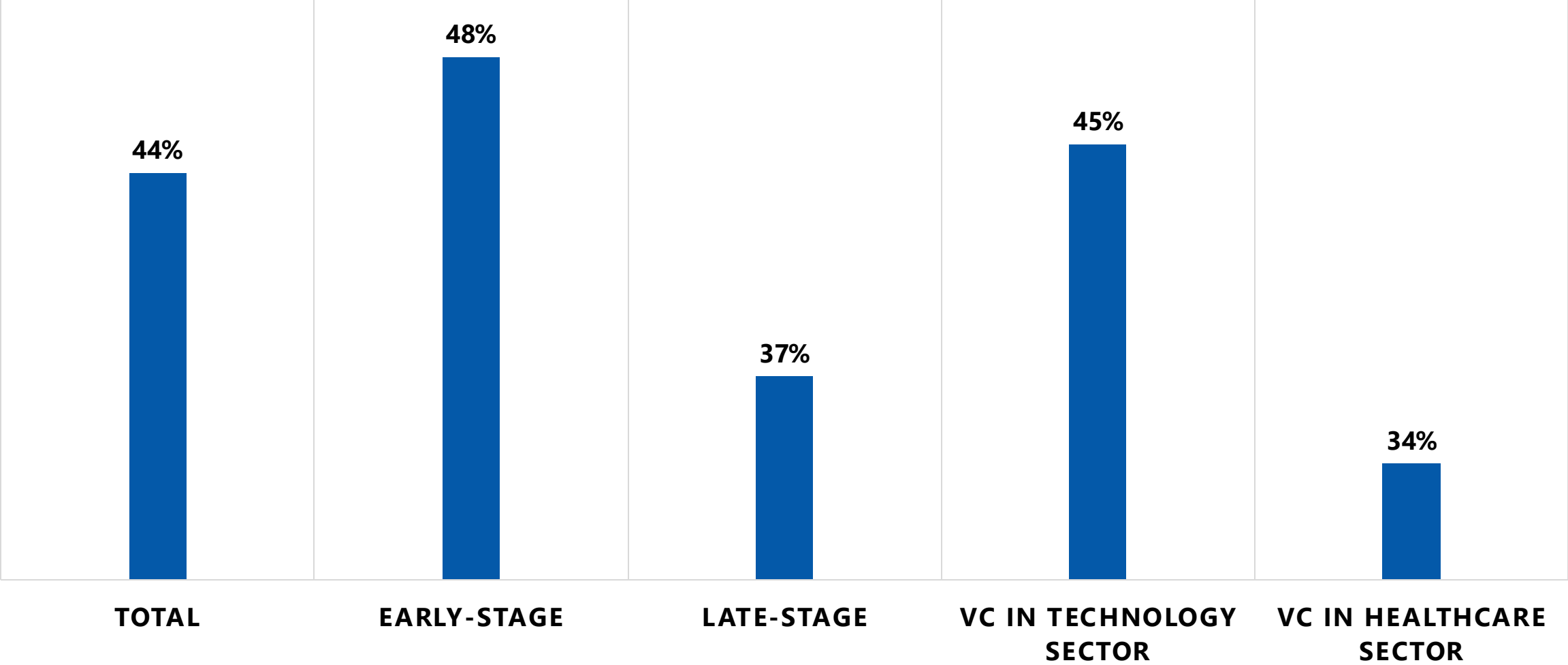
Offer **2.3 Term Sheets** Per Closed Deal

Important Qualities in a Management Team



Source: Gompers, Gornall, Kaplan, Strebulaev (2019)

Gut Investment Decisions



Source: Gompers, Gornall, Kaplan, Strebulaev (2019)

Investment Thesis

- What makes the VC choose a company for their portfolio?

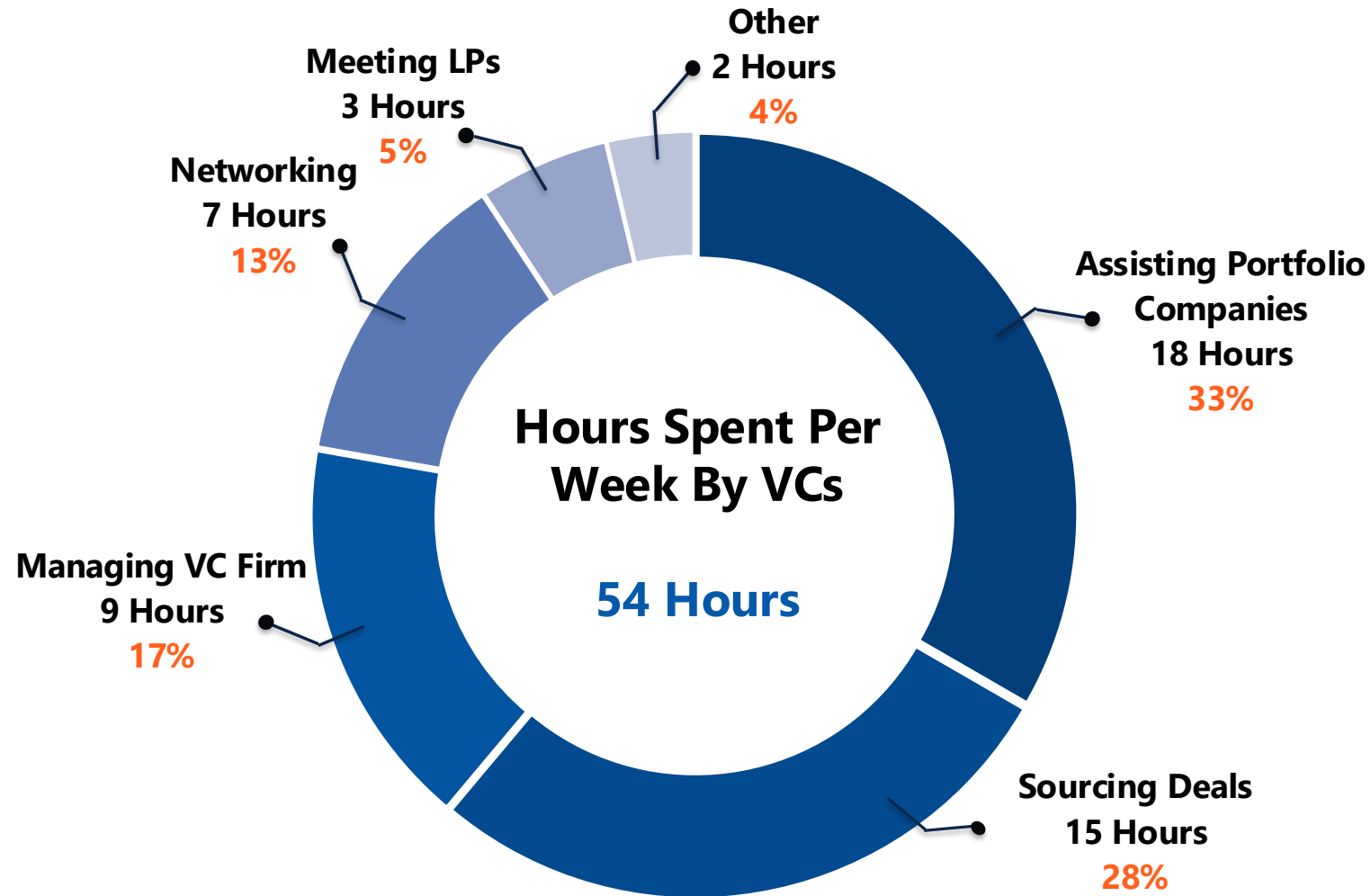
	BP	IPO	AR	BP to IPO				IPO to AR				BP to AR			
				Yes	Yes	No	No	Yes	Yes	No	No	Yes	Yes	No	No
				to	to	to	to	to	to	to	to	to	to	to	to
				Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
Unique product/technology	100	98	91	98	2	0	0	91	6	0	3	91	9	0	0
Comprehensive products	8	14	16	6	2	8	84	9	0	6	84	3	2	13	81
Customer service	10	18	28	10	0	8	82	16	3	13	69	6	0	23	72
Alliances/partnerships	14	12	9	8	6	4	82	3	13	6	78	6	9	3	81
Expertise	46	16	16	10	36	6	48	9	3	6	81	9	39	6	44
Scientific advisors	4	2	6	2	2	0	96	3	0	3	94	3	3	3	91
Reputation	6	8	9	4	2	4	90	9	0	0	91	3	3	6	88
Num. obs.	50	50	32	50	50	50	50	32	32	32	32	32	32	32	32

Percentage of companies that explicitly mention the following characteristics as those that distinguish the company: unique product, service, or technology; comprehensive product offerings; strong customer service; alliances, partnerships, and other business relationships; management and/or employee expertise; strength of scientific advisors; and reputation. We also report the percentages of companies that do or do not change what they consider their distinguishing characteristics over time (e.g., the “yes to no” column under “BP to IPO” reflects the percentage of companies that report a given item as a distinguishing characteristic in the business plan but not at the IPO).

Time spent at various stages

		Stage		Industry		IPO rate		Fund size		Location		
	All	Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
Days to close deal	83 (3)	73*** (3)	106*** (14)	59*** (3)	98*** (5)	83 (8)	83 (4)	80 (5)	86 (3)	65** (8)	83** (3)	96*** (4)
Number of responses	523	223	83	120	84	133	142	231	294	144	206	192
Hours on due diligence	118 (9)	81*** (6)	184*** (39)	76*** (7)	120*** (10)	101 (10)	121 (23)	125 (16)	111 (9)	81** (8)	129** (17)	132 (14)
Number of responses	433	194	68	95	72	116	115	201	232	127	178	144
References called	10 (0)	8*** (0)	13*** (1)	10 (1)	11 (1)	12 (1)	11 (1)	12*** (1)	9*** (0)	11 (1)	11 (1)	9** (1)
Number of responses	439	195	70	100	71	117	116	204	235	126	180	150

What do VCs do all day?



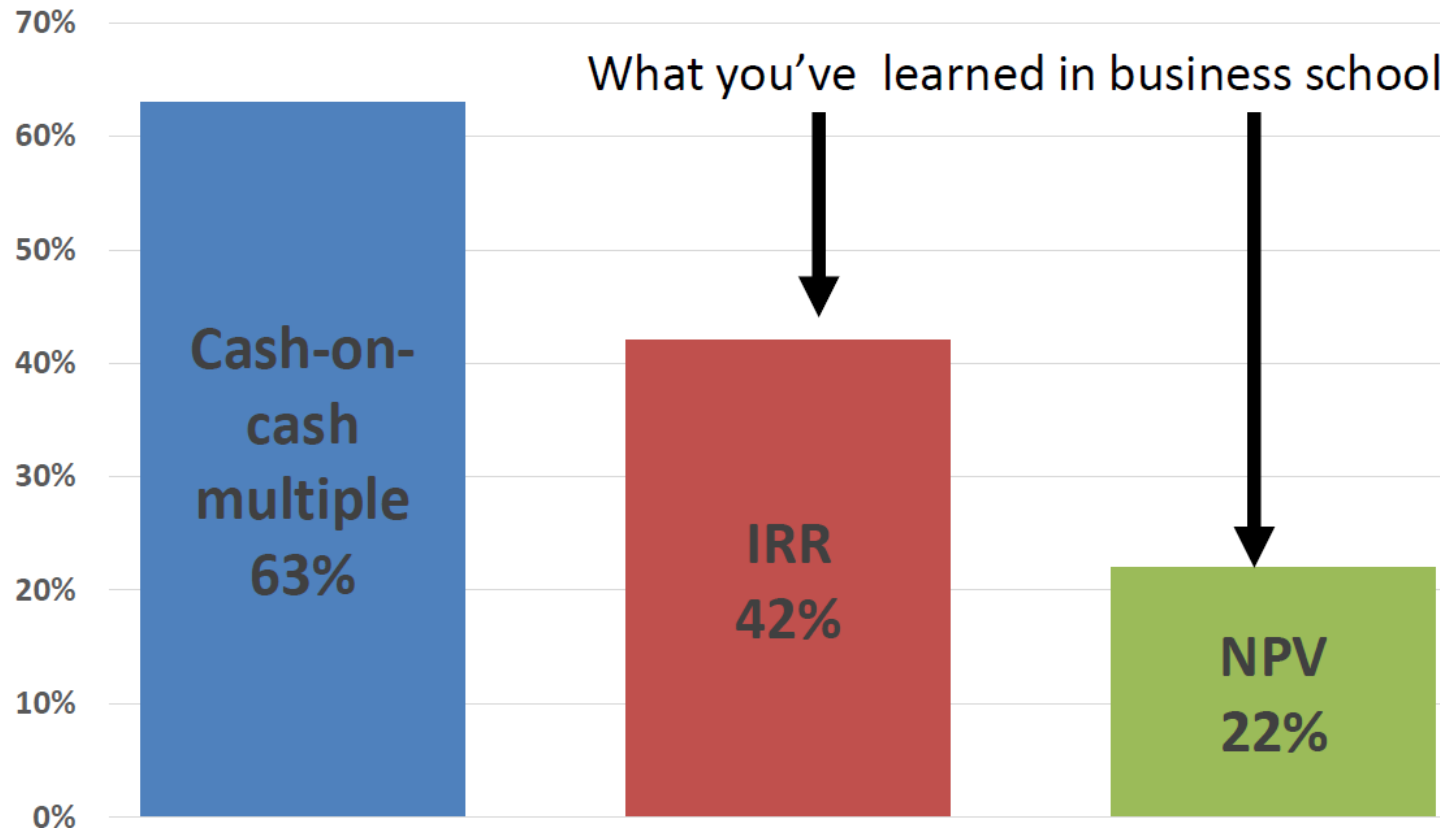
Source: Gompers, Gornall, Kaplan, Strebulaev (2019)

What metrics do you use to analyze investments?

	All	Stage		Industry		IPO rate		Fund size		Location		
		Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
None	9 (1)	17*** (2)	1*** (1)	13 (3)	7 (3)	10 (2)	12 (2)	9 (2)	10 (2)	11 (2)	8 (2)	10 (2)
Multiple of invested capital	63 (2)	56*** (3)	71*** (5)	57** (4)	72** (5)	72* (3)	63* (4)	65 (3)	61 (3)	66 (4)	66 (3)	58** (3)
IRR	42 (2)	26*** (3)	60*** (5)	33 (4)	42 (5)	35 (4)	36 (4)	40 (3)	42 (3)	31*** (4)	49*** (3)	42 (3)
NPV	22 (2)	12** (2)	21** (4)	16** (3)	29** (5)	19 (3)	16 (3)	24 (3)	21 (2)	16 (3)	20 (3)	29*** (3)
Other	8 (1)	9 (2)	4 (2)	7 (2)	10 (3)	8 (2)	8 (2)	8 (2)	7 (1)	9 (2)	6 (2)	9 (2)
Number of metrics	2.1 (0.0)	1.8*** (0.1)	2.4*** (0.1)	2.0 (0.1)	2.0 (0.1)	2.0 (0.1)	2.0 (0.1)	2.1 (0.1)	2.0 (0.1)	2.0 (0.1)	2.1 (0.1)	2.1 (0.1)
Number of responses	546	238	90	130	88	136	152	243	306	156	217	195
Often make gut investment decisions	44 (2)	48* (3)	37* (5)	45* (4)	34* (5)	42 (4)	43 (4)	40* (3)	47* (3)	41 (4)	41 (3)	49** (3)
Number of responses	563	243	91	132	88	140	158	251	315	162	221	202

Most VCs use Cash-on-cash multiples to analyze investments

How investments are analyzed



Do VCs forecast portfolio company financials?

	All	Stage		Industry		IPO rate		Fund size		Location		
		Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
Do not forecast	20 (2)	31*** (3)	7*** (3)	22 (4)	29 (5)	19 (3)	17 (3)	17** (2)	24** (2)	24 (3)	20 (3)	18 (3)
1–2 years	11 (1)	14 (2)	8 (3)	20** (4)	8** (3)	12 (3)	12 (3)	9 (2)	11 (2)	12 (3)	9 (2)	12 (2)
3–4 years	40 (2)	38 (3)	39 (5)	41* (4)	28* (5)	38 (4)	43 (4)	44* (3)	36* (3)	38 (4)	36 (3)	44* (3)
5–6 years	27 (2)	16*** (2)	42*** (5)	16* (3)	27* (5)	28 (4)	25 (3)	27 (3)	27 (3)	24** (3)	34** (3)	21** (3)
7+ years	3 (1)	1** (1)	5** (2)	1*** (0)	8*** (3)	4 (1)	2 (1)	3 (1)	2 (1)	2 (1)	1 (1)	5** (2)
Average	3.1 (0.1)	2.4*** (0.1)	3.9*** (0.2)	2.5** (0.2)	3.2** (0.3)	3.2 (0.2)	3.0 (0.1)	3.2 (0.1)	2.9 (0.1)	2.8 (0.2)	3.1 (0.1)	3.2 (0.2)
Number of responses	530	225	90	123	82	131	146	237	295	149	211	191
% of companies which meet projections	28 (1)	26*** (1)	33*** (2)	28 (2)	28 (2)	28** (2)	23** (1)	31*** (1)	26*** (1)	28 (2)	27 (1)	29 (1)
Number of responses	493	214	82	115	77	126	129	228	264	141	195	176

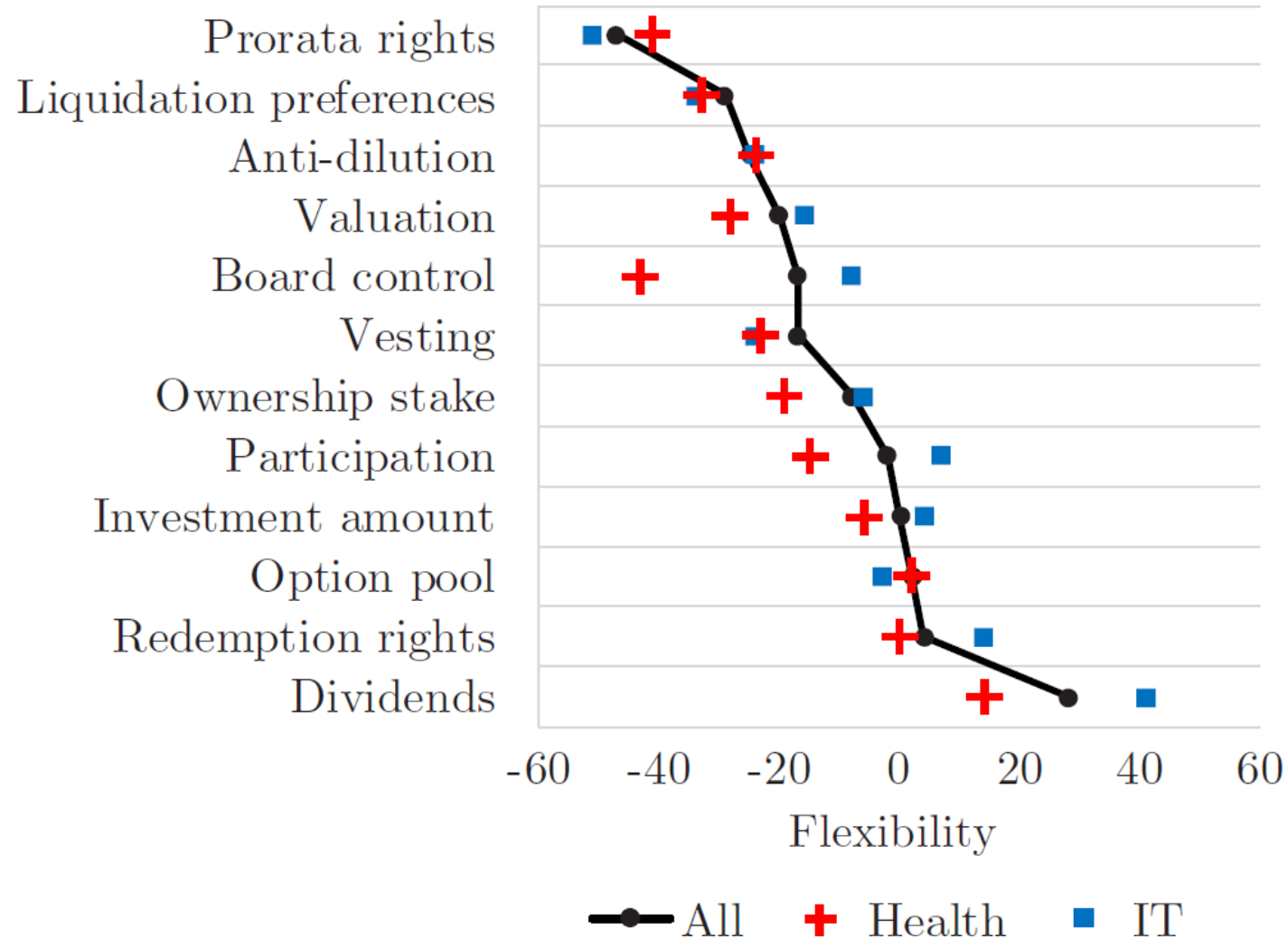
What factors are important for valuation?

	All	Stage		Industry		IPO rate		Fund size		Location		
		Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
Important factor												
Anticipated exit	86 (1)	81** (2)	91** (3)	80*** (3)	93*** (3)	90* (2)	83* (3)	87 (2)	84 (2)	85 (3)	85 (2)	87 (2)
Comparable companies	80 (2)	77 (3)	84 (4)	81 (3)	79 (4)	77 (3)	82 (3)	83 (2)	78 (2)	78 (3)	81 (3)	81 (3)
Competitive pressure	43 (2)	47 (3)	39 (5)	55*** (4)	27*** (5)	45 (4)	44 (4)	52*** (3)	37*** (3)	49 (4)	42 (3)	41 (3)
Desired ownership	63 (2)	75*** (3)	46*** (5)	70 (4)	67 (5)	59 (4)	62 (4)	62 (3)	65 (3)	65 (4)	62 (3)	63 (3)
Most important factor												
Anticipated exit	46 (2)	38*** (3)	58*** (5)	34** (4)	50** (5)	46 (4)	49 (4)	45 (3)	47 (3)	48 (4)	43 (3)	49 (3)
Comparable companies	29 (2)	30 (3)	31 (5)	35 (4)	29 (5)	28 (4)	24 (3)	31 (3)	27 (2)	25* (3)	33* (3)	26 (3)
Competitive pressure	3 (1)	2 (1)	2 (1)	2 (1)	1 (1)	5 (2)	3 (1)	4*** (1)	1*** (1)	5 (2)	3 (1)	1* (1)
Desired ownership	18 (2)	27*** (3)	5*** (2)	24 (4)	15 (4)	14 (3)	19 (3)	16 (2)	19 (2)	19 (3)	15 (2)	20 (3)
Number of responses	544	236	87	126	85	135	151	245	302	155	218	192
Set valuation using investment and ownership	49 (2)	63*** (3)	29*** (5)	59*** (4)	41*** (5)	47 (4)	53 (4)	48 (3)	50 (3)	55*** (4)	40*** (3)	54 (3)
Number of responses	544	237	89	129	87	135	150	243	304	156	216	194
Target ownership stake	23 (1)	20*** (1)	27*** (2)	21 (1)	23 (1)	22 (1)	23 (1)	25*** (1)	22*** (1)	21* (1)	23* (1)	25*** (1)
Number of responses	495	215	76	120	86	118	144	217	281	135	194	184

How do VCs Make Decisions? A Survey

1. Survey Design
2. Pre-investment (Sourcing, selection, valuation)
3. **Deal Structure**
4. Post-investment value-added and exit
5. Sources of value
6. Organization of VC firm

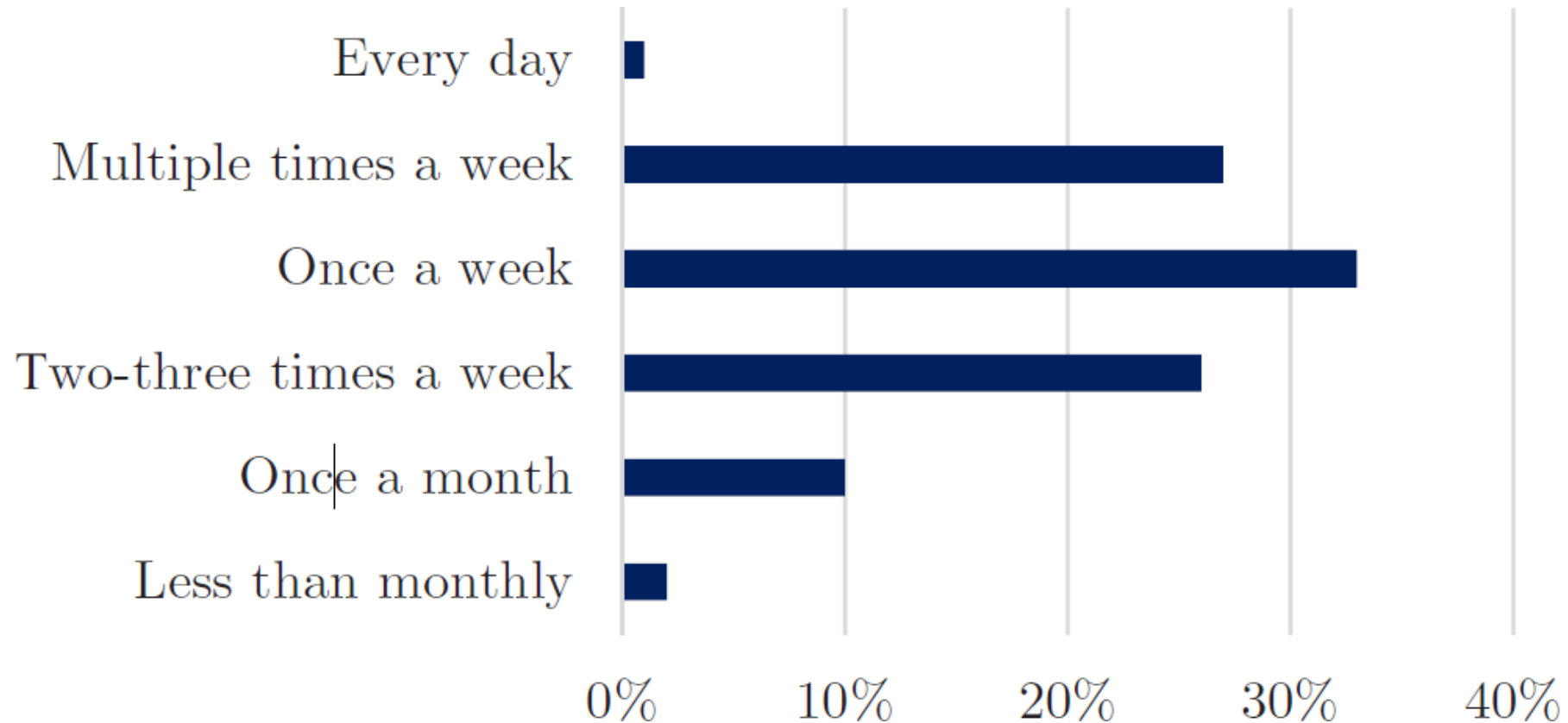
How flexible are you on various contractual terms?



How do VCs Make Decisions? A Survey

1. Survey Design
2. Pre-investment (Sourcing, selection, valuation)
3. Deal Structure
4. **Post-investment value-added and exit**
5. Sources of value
6. Organization of VC firm

How involved are you with your portfolio companies?



What are your activities in your portfolio companies?

	All	Stage		Industry		IPO rate		Fund size		Location		
		Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
Hire board members	58 (2)	55 (2)	60 (4)	52*** (3)	70*** (3)	65 (3)	61 (3)	60 (2)	57 (2)	56 (3)	59 (2)	61 (3)
Hire employees	46 (2)	51** (2)	41** (4)	49 (3)	43 (4)	46 (3)	49 (3)	44 (2)	48 (2)	52* (3)	46* (3)	41** (3)
Connect customers	69 (1)	69 (2)	67 (4)	71 (3)	71 (3)	70 (2)	67 (3)	68 (2)	69 (2)	74** (2)	67** (2)	67 (2)
Connect investors	72 (1)	81*** (2)	58*** (4)	76 (3)	81 (3)	74 (3)	76 (2)	69*** (2)	76*** (2)	76** (3)	69** (2)	75 (2)
Strategic guidance	87 (1)	86 (1)	88 (2)	87 (2)	89 (2)	87 (2)	89 (2)	86 (1)	88 (1)	87 (2)	87 (1)	87 (1)
Operational guidance	65 (1)	65 (2)	62 (4)	67 (3)	66 (3)	66 (2)	67 (3)	63 (2)	67 (2)	68 (3)	66 (2)	61** (2)
Other	20 (2)	19 (2)	17 (4)	23** (4)	12** (3)	18 (3)	19 (3)	20 (2)	21 (2)	19 (3)	23 (3)	19 (3)
Number of responses	444	196	71	101	75	118	122	202	243	125	180	154

How do VCs Make Decisions? A Survey

1. Survey Design
2. Pre-investment (Sourcing, selection, valuation)
3. Deal Structure
4. Post-investment value-added and exit
5. **Sources of value**
6. Organization of VC firm

What are the most important factors to value creation?

	All	Stage		Industry		IPO rate		Fund size		Location		
		Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
Important factor												
Deal flow	65 (2)	68 (3)	65 (5)	73*** (4)	49*** (5)	62 (4)	64 (4)	69 (3)	62 (3)	73 (4)	67 (3)	57*** (4)
Selection	86 (1)	87 (2)	87 (4)	91** (3)	81** (4)	89 (3)	88 (3)	88 (2)	85 (2)	87 (3)	87 (2)	84 (3)
Value-add	84 (2)	85* (2)	77* (5)	78** (4)	89** (4)	87 (3)	83 (3)	84 (2)	83 (2)	86* (3)	79* (3)	89** (2)
Other	4 (1)	3 (1)	6 (3)	3 (1)	3 (2)	5 (2)	4 (2)	4 (1)	4 (1)	2 (1)	4 (1)	5 (2)
Most important factor												
Deal flow	23 (2)	27 (3)	19 (4)	29*** (4)	13*** (4)	19** (3)	31** (4)	27 (3)	21 (2)	27 (4)	25 (3)	18** (3)
Selection	49 (2)	44 (3)	52 (5)	49 (4)	52 (5)	57** (4)	46** (4)	51 (3)	46 (3)	48 (4)	50 (3)	48 (4)
Value-add	27 (2)	27 (3)	27 (5)	21** (4)	35** (5)	22 (3)	22 (3)	22*** (3)	32*** (3)	23 (3)	23 (3)	34** (3)
Other	1 (0)	1 (1)	2 (1)	1 (1)	0 (0)	2 (1)	1 (1)	1 (1)	1 (1)	1 (1)	1 (1)	0 (0)
Number of responses	509	226	82	122	78	129	139	231	281	145	205	179

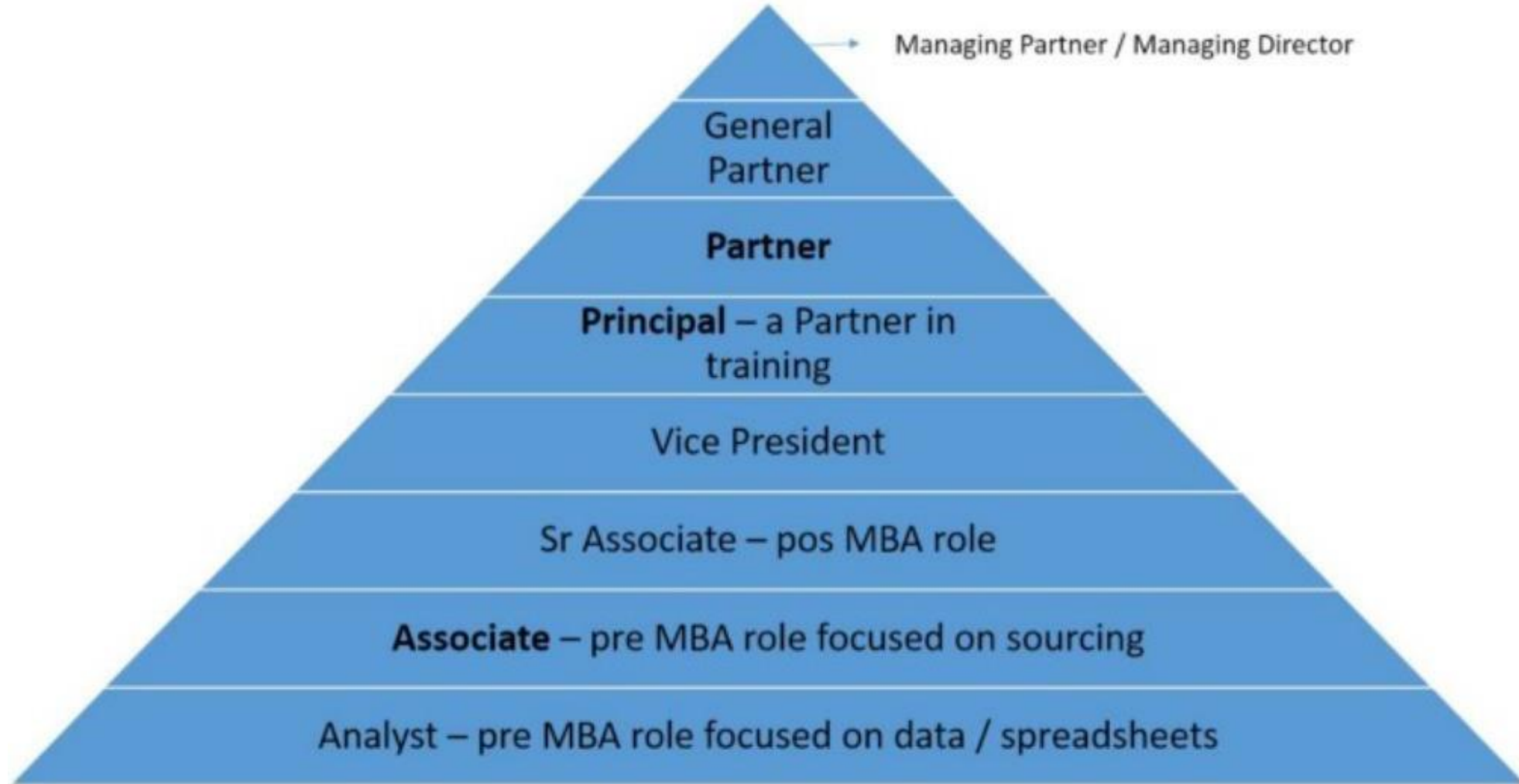
What is the most important factor for success or failure?

	Stage			Industry		IPO rate		Fund size		Location		
	All	Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
Successful investments: Most important factor												
Team	56 (2)	64*** (3)	42*** (5)	55* (4)	42* (5)	53 (4)	59 (4)	52* (3)	59* (3)	55 (4)	55 (3)	60 (4)
Business model	7 (1)	4*** (1)	18*** (4)	8 (2)	3 (2)	5 (2)	6 (2)	8 (2)	7 (1)	6 (2)	8 (2)	7 (2)
Technology	9 (1)	6 (2)	11 (3)	7*** (2)	31*** (5)	12 (3)	10 (2)	10 (2)	9 (2)	9 (2)	9 (2)	10 (2)
Market	2 (1)	1* (0)	4* (2)	0* (0)	3* (2)	4 (2)	2 (1)	3 (1)	1 (1)	2 (1)	2 (1)	2 (1)
Industry	7 (1)	6 (2)	10 (3)	6 (2)	6 (3)	6 (2)	8 (2)	8 (2)	6 (1)	6 (2)	7 (2)	6 (2)
Timing	12 (1)	11 (2)	11 (3)	16* (3)	7* (3)	7 (2)	9 (2)	10 (2)	13 (2)	11 (3)	11 (2)	11 (2)
Luck	6 (1)	7 (2)	5 (2)	6 (2)	3 (2)	9 (2)	6 (2)	7 (2)	5 (1)	11* (2)	5* (1)	3* (1)
Board of directors	1 (0)	0 (0)	2 (2)	1 (1)	4 (2)	2 (1)	1 (1)	1 (1)	1 (1)	0 (0)	1 (1)	1 (1)
My contribution	0 (0)	0 (0)	0 (0)	0 (0)	1 (1)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	1 (1)	0 (0)
Failed investments: Most important factor												
Team	55 (2)	60* (3)	48* (5)	57*** (4)	34*** (5)	51 (4)	59 (4)	50** (3)	59** (3)	54 (4)	52 (3)	59 (4)
Business model	10 (1)	7** (2)	16** (4)	13 (3)	10 (3)	7 (2)	9 (2)	6** (1)	12** (2)	8 (2)	11 (2)	10 (2)
Technology	8 (1)	6 (2)	7 (3)	3*** (1)	36*** (5)	16*** (3)	7*** (2)	13*** (2)	5*** (1)	8 (2)	9 (2)	8 (2)
Market	3 (1)	3 (1)	1 (1)	3 (1)	3 (2)	4 (2)	2 (1)	0*** (0)	4*** (1)	6** (2)	2** (1)	1** (1)
Industry	10 (1)	10 (2)	16 (4)	13 (3)	7 (3)	9 (2)	8 (2)	14** (2)	8** (2)	9 (2)	13 (2)	9 (2)
Timing	9 (1)	8 (2)	10 (3)	9 (3)	5 (3)	8 (2)	9 (2)	10 (2)	8 (2)	10 (2)	9 (2)	9 (2)
Luck	3 (1)	4 (1)	1 (1)	2 (1)	1 (1)	4 (1)	4 (1)	3 (1)	2 (1)	4 (2)	3 (1)	1 (1)
Board of directors	3 (1)	2 (1)	1 (1)	2 (1)	4 (2)	1 (1)	3 (1)	2 (1)	3 (1)	1 (1)	2 (1)	4 (1)
My contribution	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)
Number of responses	511	226	82	120	78	130	141	235	279	145	205	181

How do VCs Make Decisions? A Survey

1. Survey Design
2. Pre-investment (Sourcing, selection, valuation)
3. Deal Structure
4. Post-investment value-added and exit
5. Sources of value
6. **Organization of VC firm**

People working at VC fund



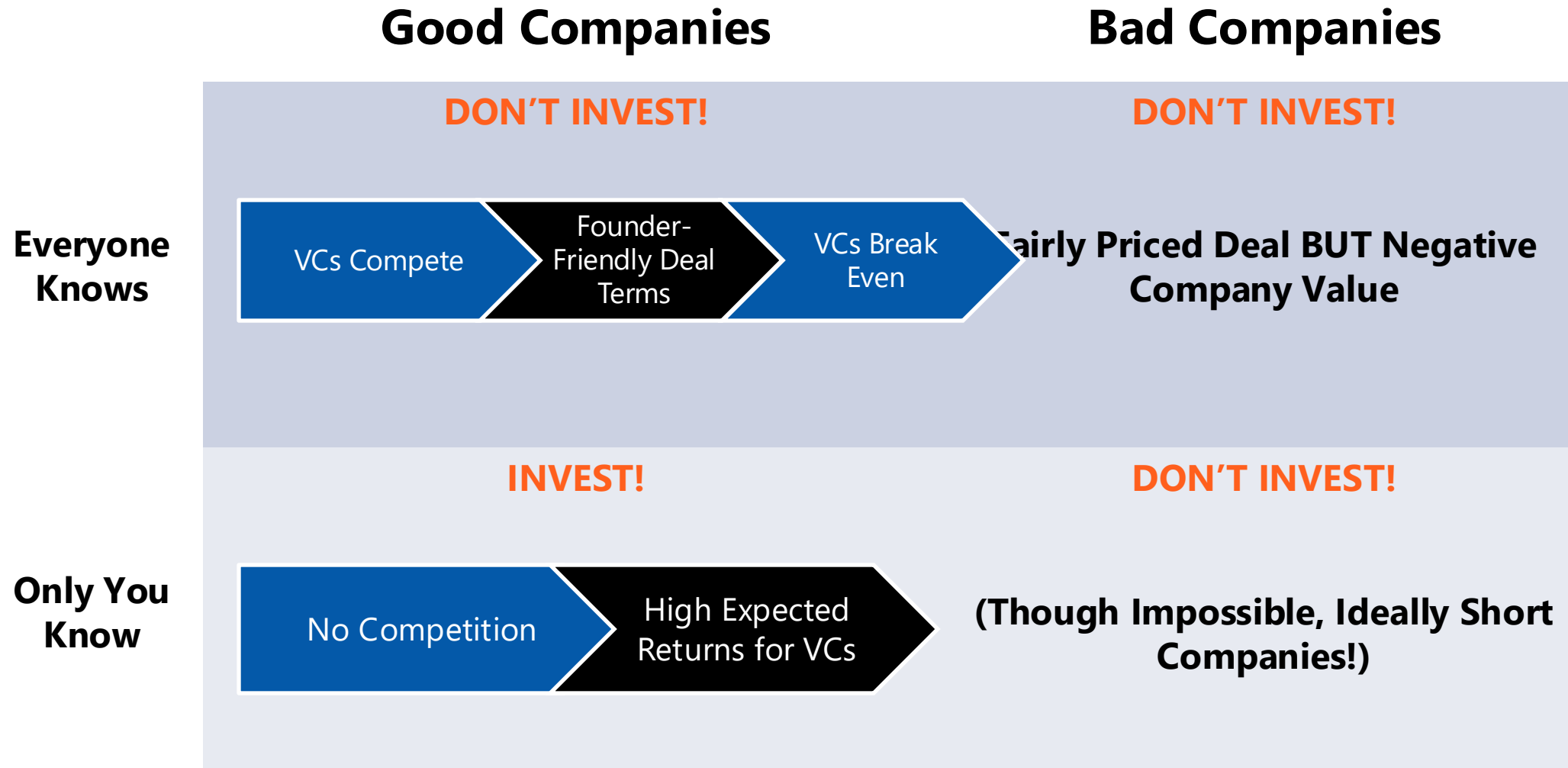
Number of people working at VC fund

	All	Stage		Industry		IPO rate		Fund size		Location		
		Early	Late	IT	Health	High	Low	Large	Small	CA	OthUS	Fgn
Partners	4.7 (0.2)	3.9*** (0.2)	6.3*** (1.2)	4.1 (0.2)	4.4 (0.3)	7.2*** (0.7)	4.2*** (0.2)	6.2*** (0.3)	3.5*** (0.2)	5.3 (0.5)	4.5 (0.2)	5.3 (0.7)
Venture partners	1.3 (0.1)	1.2 (0.1)	1.4 (0.3)	0.9*** (0.1)	2.1*** (0.3)	1.9** (0.2)	1.3** (0.2)	1.8*** (0.2)	1.0*** (0.2)	1.6 (0.3)	1.2 (0.2)	1.4 (0.2)
Associates	2.9 (0.2)	2.0*** (0.2)	4.7*** (0.7)	2.4 (0.3)	2.2 (0.3)	4.4*** (0.7)	2.4*** (0.2)	4.4*** (0.4)	1.7*** (0.1)	2.7 (0.3)	2.7 (0.3)	3.7** (0.5)
Other	4.5 (0.7)	3.2** (0.4)	5.3** (0.9)	5.0 (1.4)	3.1 (0.5)	9.9*** (2.6)	3.1*** (0.4)	7.8*** (1.5)	2.2*** (0.3)	5.8 (1.3)	4.5 (0.9)	4.6 (1.4)
Total	13.5 (0.9)	10.3*** (0.7)	17.7*** (2.4)	12.3 (1.7)	11.8 (0.9)	23.5*** (3.4)	11.0*** (0.7)	20.2*** (1.9)	8.4*** (0.6)	15.4 (1.8)	12.9 (1.4)	15.0 (1.9)
% Partners	48 (1)	50** (2)	43** (2)	48 (2)	47 (2)	44 (2)	48 (2)	42*** (1)	53*** (1)	51 (2)	49 (2)	44*** (2)
% Venture partners	10 (1)	10 (1)	8 (1)	8*** (1)	15*** (2)	11 (1)	11 (1)	10 (1)	10 (1)	11 (1)	9 (1)	10 (1)
% Associates	20 (1)	18*** (1)	24*** (2)	20 (2)	17 (2)	20 (1)	19 (1)	22** (1)	19** (1)	17* (1)	20* (1)	24*** (1)
% Other	22 (1)	22 (1)	25 (2)	24 (2)	21 (2)	25 (2)	22 (1)	25*** (1)	19*** (1)	21 (2)	22 (1)	22 (1)
Number of responses	610	245	96	131	87	144	165	263	335	176	239	219

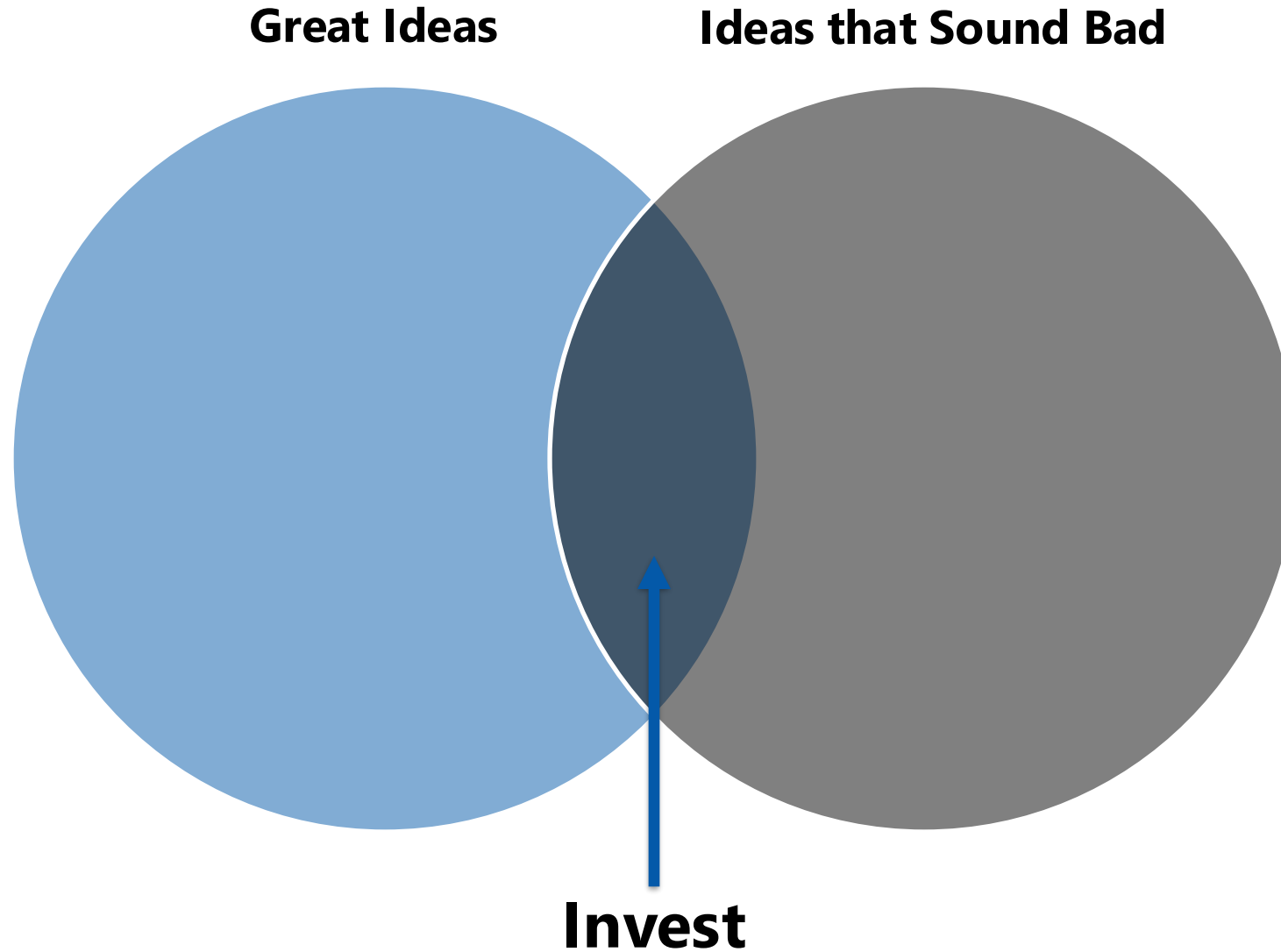


Conclusion

It's Not Enough to Invest in a Good Company



Invest in Ideas that Generate Unique Insights



Source: First Round Capital

The Paradox of Consensus Investing



Source: Charles River Ventures, Title By Derek Watson

Takeaways: How Do I Get Funded?

- ❑ Fundraising is a never-ending process
- ❑ Better start before you (desperately) need money
- ❑ Network and personal introductions are the best path forward
- ❑ Meet as many investors as possible
- ❑ Finding a lead investor is key
- ❑ Prepare solid responses to potential questions
- ❑ Prepare business plan
- ❑ Prepare a pitch and practice, practice, practice!

Next: Valuation