FRAMEWORK A: TWO PERSPECTIVES

Idea Vs. Opportunity (module 1)

Realities of Business Operations (module 2)
SAMPLE OUTLINE OF TRADITIONAL BUSINESS PLAN

- Executive Summary
- Market Analysis
- Vision and Concept (Including Technology)
- Competitive Positioning and Marketing

- **Business Model**
- **Organization**
- **Financial Projections**
- **Ownership**

Amplify in E145 Module 2
ABC’S OF HOW VENTURES GET FINANCED

A
AMOUNT OF CASH NEEDED AND PURPOSE

B
SOURCES OF CAPITAL

C
DEAL STRUCTURE
A) AMOUNT: TWO KEY QUESTIONS

• **Q1**: How much money is needed for this “round” of financing?
• **Q2**: Which *white hot* risk will be reduced with this money?

**Typical Financing Stages (or Rounds):**

Seed ➔ Early ➔ Mezzanine ➔ Late (e.g., IPO)
FRAMEWORK F: “THE MOST IMPORTANT RISK RIGHT NOW” (QUESTION 2)

- Market Risk
- Financial / Capital Risk
- Team Risk
- Product / Technology Risk
RECALL THE YAHOO CASE

• **Yahoo**: What are the advantages and disadvantages of each of the three major options they could pursue to finance the venture in 1995 (e.g., venture capital, corporate partnerships and sponsorships, and acquisition to become an operating division of an established company)?

• "I suggest that Jerry and David [accept/do not accept] Sequoia's offer because..."
FINANCING TRADEOFFS

- More Costly Dilution of Equity
- M&A Selling 100% to Another Firm
- Partnerships Sponsorships or Strategic Investors
- VC Take Venture Capital Investment
- Increasing Entanglement Loss of Control
B) SOURCES OF CAPITAL

New Business Firm

- **ANGELS**
  - SEED OR SERIES A

- **INVESTMENT BANKS**
  - IPO & PUBLIC PLACEMENT

- **VENTURE CAPITAL FIRMS**
  - SERIES A, B, C

- **FRIENDS AND FAMILY**
  - SEED FUNDS

- **PENSION FUNDS**
  - PRIVATE INVESTORS CORPORATIONS

Table 18.4
B) SOURCES OF CAPITAL

Increasing Investment

Size

$10M

$1M

$100K

$100K

Strategic Partners

VC

IPO

Banks

Angels
(Groups & Syndicates)

Gov’t

fff

Crowd

FFF

Gov’t

Profitability

Sales

Beta

Prototype

Plan

Business

Idea

Decreasing Risk

Reference: Trevor Loy (Flywheel)
VENTURE CAPITAL FIRMS: LIMITED PARTNERSHIPS WITH A FINITE LIFE AND SUBSTANTIAL PROFIT SHARING

INSTITUTIONAL INVESTORS
Limited Partners (LPs)– e.g. Endowments, Pension Funds

VENTURE CAPITALISTS
Finding and Funding Entrepreneurial Companies

ENTREPRENEURS
Starting and Building Companies

High-Risk Equity Return Diversification
Management Fees Share of Profits
Management Help Financing Credibility

Capital
Capital + Time and Help
“Liquid” Stock
Preferred Stock
VC BACKED COMPANIES >20% OF US GDP

facebook
Apple
Intel
Google
Cisco
eBay
Genentech
WHAT DO VC’S OFFER BESIDES CASH?

• Your friendly neighborhood VC:
  - Expertise
  - Contacts (their own and the firm’s rolodex)

AS A STARTUP, THE DUE DILIGENCE YOU CONDUCT OF THE VC FIRMS YOU INTERACT WITH SHOULD BE AT LEAST AS IN DEPTH AS THEIR DUE DILIGENCE OF YOU
HOW DOES VC WORK?

• Size of VC Fund: $130 Million
  - Institutional LPs: 7 @ $5-30M Each
  - Individual LPs: 20 @ $50K - $2M Each

• Initial Investments Over 2-4 Years, Return within 10
• On Average, Delivers 30+% Per Year Return

WHAT SIZE DEAL WOULD BE INTERESTING?
WHICH DO YOU PREFER?

Suppose you were to invest $10 million...

- **Fund 1:**
  - 2x return on all 10 $1M investments

- **Fund 2:**
  - Loses all $1M investments in 8 deals
  - Wins 20x on the remaining 2 $1M investments

Source: Andy Rachleff
HOW DOES VC MAKE MONEY?

• Size of VC Fund: $130 Million
  - 2.5% annual management fee
  - 20% profit share (aka carried interest)

IN A 3X FUND, HOW MUCH PROFIT DO THE LIMITED PARTNERS MAKE? THE GENERAL PARTNERS?
Break