



Organizing the Business Enterprise

An Investors Perspective

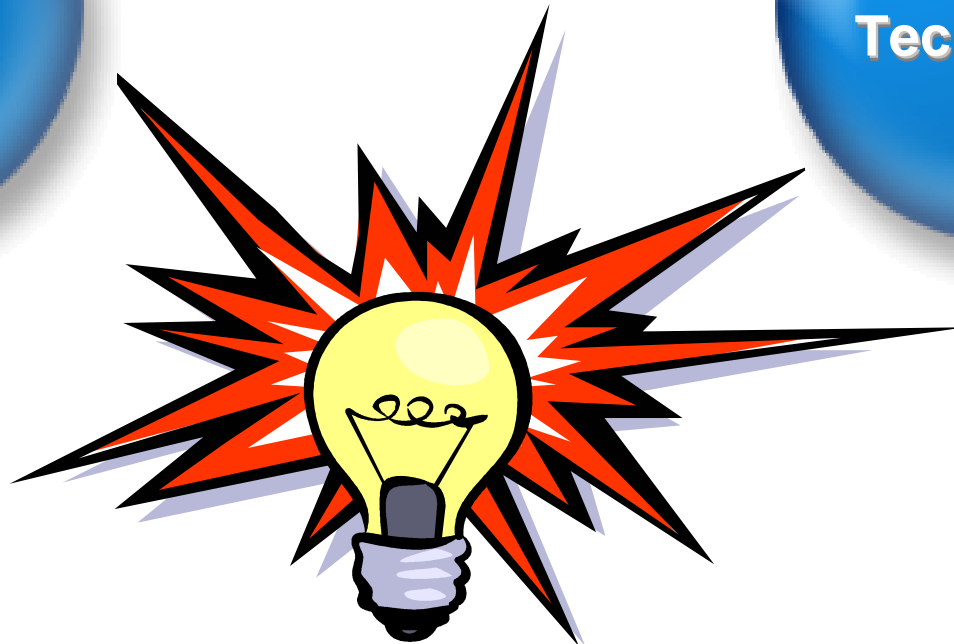
Agenda

- Defining the business
- Ownership
- Avoiding mistakes

The Genesis of New Opportunities?

Unmet
Need

New
Technology



Defining the Business

- Focus on customer Pain
 - Is the pain is severe?
 - Large market?
 - Ability to pay?
 - Entrenched competitor?
- Validate, Validate, Validate! - with customers
- Barriers to Entry
 - Ideally a deep technological barrier
 - Patentable?

Defining the Business (2)

- Do things properly
 - Raise capital from top tier VCs
 - Enable the business to be structured in a way which is credible to customers and future employees
 - Will help to attract and vet top executives
 - Hire professional executives with startup experience
 - Still willing to work in startup conditions

Equity / Ownership

- A useful lesson:
 - Better to own a little of something highly valuable than to own a lot of something worthless
- Key elements worth giving up equity for:
 - Capital
 - Management team
 - Employees
 - Board members
 - Advisors

Seed funding

- Appropriate when idea needs further validation
 - Either technical, or market
- Options
 - Structure as a loan, that converts to equity as part of subsequent Series A
 - Straight equity – highly variable cost
 - Depends on value of entrepreneur and idea

Series A

- Stage
 - Idea is well formulated
 - Possibly a product prototype
 - Some market validation
 - Beginnings of a management team
- VCs will value the team and the idea
 - Prior experience of the team plays a huge role
 - For software co. expect pre-money of \$4m to \$6m
 - E.g. raise \$5m on \$5m pre-money = 50% to VCs
 - 50% is common for Series A
- VC's will want an Option Pool set aside to hire the management team, BOD, and employees

Management Team

- Assuming two technical founders, need to hire:

■ CEO	6-9%
■ VP Sales	1-1.5%
■ VP Marketing	1.5%
■ VP of Engineering	1.5%
■ VP of Bus Dev	1-1.5%
■ CFO	1%

- Total 12-16%

- Note:

- Mgt team is shown to have enormous impact on likelihood of success

Employees

- Series A stage through to end of Beta
 - Engineers 4-5%
 - Initial Sales 1%
 - Initial Marketing 0.3%

- Total 5.3 – 6.3 %

Outside Board members and Advisors

- Board members joining early .3% to .5%
- Advisory board members .1%

Subsequent Rounds

■ Series B

- Pre-money \$12m to \$30m
- Likely raise: \$8m to 12m
- Dilution approx. 30%

■ Series C example

- Pre-money \$50m
- Raise \$10m
- Dilution 16%

Avoiding Mistakes

- Huge difference between top tier VCs and B/C players
 - They can easily make or break your company
 - Pick carefully, there is no divorce
- Approach top tier firms first, and only 2-3 at a time
 - They don't like to spend time on a deal if it is being shopped
- Stay away from Angels if possible
 - Unable to step up to future financing needs
 - Causes them to block those financings
 - They are not professionals – leads to other problems

Our Normal Investment Criteria

- Should be solving an area of acute pain
 - Where customer is clearly prepared to pay
- Large and growing market
- Extraordinary entrepreneur with a unique insight
- Sustainable, unfair advantage over limited competition
- Beginnings of a strong management team
- Attractive valuation

Approaching VCs

- Try to get an introduction via a trusted 3rd party
- Use an executive summary (2-3 pages)
- Plus a supporting PowerPoint presentation
- If you are new to this:
 - Try to get your plan validated by an advisor first
 - Try to a strong, experienced executive to the team
- The most compelling investment stories have strong customer validation

Reference Slides – Not for use

Matrix Partners: Background & Strategy

- Founded in 1977
- 11 partners: 4 on West coast, 7 on East coast
- Focus on A-round lead investing
- Extensive CEO, entrepreneur network
- Deep, focused expertise
- Low partner to company ratio
- Focus on working with the highest quality people
- Looking to build next market leaders

Matrix Partners - Performance

- Over \$100 billion of market value created
- 2 /3 of investments IPO'ed or sold for over \$100M
- Very low failure rate despite taking big risks
- Helped create, as lead investor, market leaders
 - Communications: Cascade, Sycamore, Alteon, Arrowpoint, Sonus
 - Software: Veritas, Tivoli, Geotel, Clarify, Phone.com
 - Hardware: Stratus, Apple, Apollo
- Avoided trendy areas: B2B, B2C, online content

San Jose Mercury News - (Univ. of Michigan Data)

