

Opportunity Recognition:

1. Basis for screening an opportunity
2. Industry and Market
3. Economics
4. Harvest Issues
5. Competitive Advantage issues
6. Management team
7. Fatal Flaw Issues
8. Fatal Flaws of New Ventures
9. Opportunity Screen (example)
10. Rules

Basis for screening opportunities

The venture investment community screens opportunities constantly. They have a discipline that is seldom used inside corporations. You can learn from them.

- Industry and Markets
- Economics
- Harvest Issues
- Competitive Advantage
- Management Team
- Fatal Flaw

Rule: “You don’t have to be the best, just better than the competition”.

Your initial competition is for resources; money and people.

- You have competition at the investment level for capital; there are other opportunities to fund.
- You have competition at the “team” level; there are other teams to join.

Rule: “A top quality team, in a high growth industry, has a high chance of success”

Industry and market

<u>Criteria</u>	<u>High Attractive</u>	<u>Low Attractive</u>
Industry and Market	Changes peoples lives	Incremental improvement
<u>Market:</u>	Market-driven	Unfocused
Customers:	Reachable	Loyal to others
User Benefits:	<1 year payback	>3 year payback
Value Added:	High	Minimal impact
Product Life:	Durable	Perishable
Timing:	With the Tide	Against the Tide
<u>Market Structure:</u>	Imperfect, emerging	Concentrated, declining
<u>Market Size:</u>	\$100 to \$1000 million	<\$20 million, or >\$3 billion **
<u>Growth Rate:</u>	30-50%	<10%
<u>Potential Market Share:</u>	Leader, greater than 20%	<5%

Rule: “Never stop assessing your market”

** The current capital markets have changed this somewhat, especially for Current Venture Backed "Valley" startups. We will discuss this in class.

*** Wow, did that change in a hurry.

Economics

<u>Criteria</u>	<u>High Attractive</u>	<u>Low Attractive</u>
Economics:	Controls margins and cash flow	Margins are Controlled by others
<u>Time to Break-Even</u>	<2 years	>4 years
<u>ROI Potential</u>	>25%	<15%
<u>Capital Requirements</u>	Low to moderate	High
<u>Free Cash Flow</u>	Sustainable, 20-30% of Sales	<10%of Sales
Sales Growth	15-20% per year	<10%
Asset Requirements	Low per \$ Sales	High
Gross Margins	Durable, >40%	<20%
After Tax Profits	Durable, >10%	Low
<u>Room for Error</u>	Forgiving	None

If you don't understand something here, go to business school, or otherwise learn, until it is clear

Rule: "You need a real business model to build a real company with lasting value"

Harvest issues

<u>Criteria</u>	<u>High Attractive</u>	<u>Low Attractive</u>
Harvest Issues	Strategic to customers, Identified exit options	No strategic value, Unidentified options
Valuations Multiples	Price/Earnings = (20+) Price/Revenue = (2+)	Price/Earnings <5x Price/Revenue <0.4x Other: Book Value
Discounted Cash Flow:	Significant value above “discount rate” Large "goodwill"	Value below “discount rate”

For Publicly traded companies, the "harvest" may be in the eventual earnings and the reflected price of the companies' stock

For non-public companies, the "harvest" may be the income stream.

For the start-up, the "harvest" may be a sale of the business to another company or to the public

MOST companies treat their businesses as a saleable asset.

Rule: “You have to have a way out. You can’t sell a job”

Competitive advantage issues

<u>Criteria</u>	<u>High Attractive</u>	<u>Low Attractive</u>
Competitive Adv.:	Significant	Not evident
<u>Fixed and Variable Costs:</u>	Lowest	Highest
<u>Control over Costs, Prices, and Distribution:</u>	Strong	Weak
<u>Barriers to Entry:</u>		
Proprietary Protection	Have or can gain	None
Lead Time	Significant	Aggressive competition
Legal, Contractual	Proprietary or exclusivity	None
Contacts, Networks	Well developed	Limited
Key People	Top talent	Unimpressive team
<u>Technology/Concept</u>	Superior, groundbreaking	Substitutes available

Rule: “Patents protect you from “Honest” people”

Management team

<u>Criteria</u>	<u>High Attractiveness</u>	<u>Low Attractiveness</u>
Management Team	All Star	Evident weakness
<u>Entrepreneurial Team</u>	Visionary, radiates competence, listens	Weak or solo entrepreneur
<u>Industry or Technical Experience</u>	Top	Weak
<u>Integrity</u>	Highest Standards	Questionable
<u>Intellectual Honesty</u>	Know what they don't know, and listen well	Does not listen
<u>Stress Tolerance</u>	Thrives with pressure	Low

Rule: “The three most important things to a venture's success are the team, the team, and the team”

Fatal flaw issue

<u>Criteria</u>	<u>High Attractiveness</u>	<u>Low Attractiveness</u>
Fatal Flaw Issue	Nonexistent	One or more

Rule: “Any Fatal flaw can kill a venture”

You must analyze your failures and develop a list of fatal flaws that are relevant to your organization and business.

Rule: "All successful Businesses are the same, all unsuccessful ones are different"

- ❑ Success: All factors are addressed
- ❑ Unsuccessful: Each with a different fatal flaw

Fatal Flaws of new Ventures:

(A representative list from previous sessions)

- ❑ No real customer
- ❑ Wrong corporate culture
- ❑ Inappropriate team (Unmotivated, wrong skills)
- ❑ Ignorant of market
- ❑ Arrogance
- ❑ Over engineering of product
- ❑ Failed to stress test properly
- ❑ Over promise - under deliver
- ❑ Poor sub suppliers or partners
- ❑ Trying to do too much
- ❑ Green team, no diversity
- ❑ “Family” in the business
- ❑ Wrong location
- ❑ Competition dropped their price, killed them
- ❑ Market window had closed
- ❑ Microsoft (or equal) in your space
- ❑ Authority to act not given to team
- ❑ Lack of focus of leaders and management
- ❑ Monarch or King syndrome
- ❑ Egos in the way ("I have to be CEO")
- ❑ No consensus on team – no “buy-in”
- ❑ Not properly financed
- ❑ No sense of Urgency
- ❑ Hidden Liability
- ❑ _____
- ❑ _____
- ❑ _____
- ❑ _____

Opportunity Screen (Simple example)

Opportunity Assessment

Criteria	<u>Weight</u>	<u>1.</u>	<u>2.</u>	<u>3.</u>	<u>4.</u>
1. Industry and Market	1.0				
2. Economics	1.0				
3. Harvest	1.0				
4. Competitive Advantage	1.0				
5. Management Team	1.0				
6. Fatal Flaws	1.0				
<u>Total Score</u> (Add the ratings)					

Rule:

- You have to have multiple opportunities to make an assessment

Rules: Opportunity Recognition

- “Any fatal flaw can kill a venture”
- “Never stop assessing your market.”
- "The economics of the opportunity must be clear. You need a business model"
- “You don’t have to be the best, just better than the competition”
- “Your initial competition is for resources; money and people”
- “A top quality team, in a high growth industry, has a high chance of success”
- “You can't sell a job.”
- “Patents protect you from “Honest” people”
- “ The three most important things are the team, the team, and the team”
- All opportunities are “relative”.