McCombs Knowledge To Go

February 14, 2012

Are you on Twitter? Join the conversation at #KTG.
Entrepreneurship and Venture Capital

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Entrepreneurship, combined with support from venture capital, is a major force driving economic growth in the United States. Thomas McConnell of New Enterprise Associates said, “Venture capital investment is a national phenomenon that helps set the U.S. economy apart from others in the world.” Venture capital financed groundbreaking research and untold improvements in infrastructure and technology. The average venture-backed company employs nearly 100 workers within five years and creates almost twice as many jobs as their nonventure-backed competitors.
Reason #1: VC Is Hugely Productive!

For every dollar of venture capital invested from 1970 to 2010, $6.27 of revenue was generated in 2010.

Annual venture investment equals less than 0.2 percent of U.S. GDP. Annually, VC-backed companies have generated revenue equal to 21 percent of U.S. GDP.
Reason #2—Chaotic Disruption

5 years ago…

- Nokia, RIM, Motorola
- Everyone else
HOW. CAN. THIS. BE?

Top Cell Phone Manufacturers’ Estimated Revenues Compared to Apple’s

68% Combined, all others make up 68% of the total industry profit

32% The Apple iPhone only accounts for 8% of the total industry revenue, but 32% of the total industry profit.

The infographic shows the revenues and operating margins of various cell phone manufacturers, with Apple leading significantly.
Everything Is Changing—Quickly!

- **Months to sell the first million Palm Pilots**: 18
- **Hours to sell the first million iPhone 4S**: 24
- **Market value of Netflix (in billions)**: $16.4, at July 13, 2011, peak (one year after Blockbuster was delisted)
- **E-books as a percentage of total trade-book sales**: 0.6% in 2008, 18% in 2011
- **Mobile-Phone Users in Africa (in millions)**: 134 in 2005, 660 in 2011
- **Mobile sales on eBay (in millions)**: $600 million in 2009, $5 billion in 2011

**Number of mobile apps available in October 2008**: 8,000

**Number of mobile apps available today**: 1 million+
Reason #3: We’re All Affected

- Social media
- eCommerce
- Mobile platforms
- Biotech...
  - Which impacts

- How you do business
- Where
- With whom
- When
- Impact on brand equity, reputation
Reason #4: We’re Choking It
So, what can we learn?

- Finding passion, while...
- Understanding risk/mitigation...
- To pursue smart opportunities...
- To unlock value creation.
Peter Drucker

Business exists to create a customer.
Business has only two basic functions: marketing and innovation.

Peter Drucker
Strategic Focus

Product Differentiation

Product

Price

Operational Efficiency

Risk

Relationships or niches
Understanding the Big Risks

- Market
- Product
- Team
- Financial
A compelling market need:

- Size; characteristics; growth rate
- What is the customer need; pain?
- Who gets hurt; now and in 6 months?
- Strategic partners; alliances
VC Investing – 2\textsuperscript{nd} Risk

A Solution (Product/Service):

- What problem do you solve? For whom? How?
- What is innovative about your solution? What is the USP/UVP?
- What are the technology risks?
- Strategic marketing plan: pricing, branding, distribution.
**VC Investing – 3rd Risk**

- **Economic Model:**
  - Unit economics
  - How do you make money? What is innovative?
  - FC v. VC; burn rate
  - Scalability and sustainability

- Size of investment needed—now and later.

- Financial partners.
VC Investing – 4th Risk

Management Team

- A players will find a way to be successful
- A players attract other A players
- Only sustainable competitive advantage
- Integrity + intelligence + intensity + incentives
- Relevant experience
- Willingness to accept help
Institutional Investors Portfolio

- VC’s must average 35%+ returns
- Most investments fail
- Hurdle rate = 50%+
Hypothetical Facts - Newco

- Required IRR: 50%
- Investment: $3.5 million
- Term: 5 years
- Year 5 CF: $2.5 million
- Year 5 P/E: 15
Required Future Value

Req’d FV = \((1 + IRR)^{\text{years}}\) X (investment)

= \((1 + .50)^5\) X ($3.5 million)

= $26.6 million
Total Newco Valuation

Total terminal value = P/E X terminal CF

= 15 X $2.5 million

= $37.5 million
Required Ownership %

Final ownership % req’d

\[ \text{Final ownership % req’d} = \frac{\text{Req’d FV}}{\text{total terminal value}} \]

\[ = \frac{26.6M}{37.5M} \]

\[ = 71\% \]
In order to average 35% fund returns, the VC uses a 50% hurdle rate which translates into high required equity (71%).

Newco must grow from $1.4 million valuation to $37.5 million terminal value in five years, on a $3.5 million investment.
State of the VC Industry

- Investing down 32%
- Fundraising down 56%
- IPOs non-existent (8)
- Exits down 14% (slowest since 1995)

- 2005: 243 funds raised $29B
- 2009: 140 funds raised $16B

- NVCA
Total Venture Capital Investment By Year 2007 – Q3 2011

Amount Invested (Billions)

Number of Deals

- 2007: $30.7 billion, 4,102 deals
- 2008: $28.8 billion, 4,100 deals
- 2009: $19.7 billion, 3,056 deals
- 2010: $23.4 billion, 3,496 deals
- Q3 2011: $21.2 billion, 2,725 deals

Source: PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ Report, Data: Thomson Reuters
Questions

- There are clearly physical limits, e.g. a perpetual motion machine.
- There are clearly economic limits.
- Are there intellectual limits?
- Are there social/political limits?
- Does wealth creation depend on technological progress?

Holman W. Jenkins Jr., The Weekend Interview with Peter Thiel, WSJ, Oct 9-10, 2010

Jonathan Huebner, A possible declining trend for worldwide innovation, www.sciencedirect.com
What If We Fail?

When, not if....
Sony
Apple
CPG Too!
Failure Is An Option

- Lack of focus.
- Wrong target.
- Too much capital.
- Wrong application.
- Too late to market.
- Too soon to market.
- Lost standards war.
- “Leveraging” the brand.
- Poorly defined value proposition.
- Technology push to a non-existent market.
What To Do?

- Probe and learn.
- Aim at lead users, not early adopters.
- Involve customers ASAP.
- Tolerate (plan for!) failure.
- Avoid point predictions.
- Hedge the "known unknowns."
- Beware corporate momentum.
Innovation Management

The Market Development Life Cycle

- Disruption
- Product
- Application
- Experiential
- Business Model
- Process
- Promotion
- Structural

Revenue Growth

Time
Business has only two basic functions: marketing and innovation.

Peter Drucker
What is entrepreneurship?

- Relentless pursuit of opportunity...
- With a contrarian strategy
Entrepreneurs

- *Driven* by the urge to create.

- Solution oriented.

- “Nothing is ever accomplished by a reasonable man.”  *J. Fred Bucy*
Common to Great Success

- Conceptual clarity (Focus, not strategy)
- Customer orientation/responsiveness
- Execution DNA
- Simplicity
- Ability to learn/change
- Contrarian strategy
- Luck/timing
“But I’m Not an Entrepreneur/VC”

- Yes, you are:

  ![Bar Chart]

  **Steady Job**

  The amount of time U.S. adults have spent with the same employer hasn’t changed much in recent years.

  | 9.0% | 20 years or more | 10.3% |
  | 16.8 | 10 to 19 years    | 16.8  |
  | 19.8 | 5 to 9 years      | 20.2  |
  | 15.2 | 3 to 4 years      | 16.9  |
  | 13.3 | 1 to 2 years      | 13.0  |
  | 26.0%| 12 months or less | 22.9% |

  Source: Labor Department
The Entrepreneurial Professional

- What are you passionate about?
- Where are you making investments?
- Can you tolerate failure?
- What is your value proposition?
- How are you creating value?
Sources

- National Venture Capital Association
- Fast Company magazine
- iSmashPhone.com
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Percentage of Alumni Giving

Dartmouth (Tuck)
Virginia (Darden)
Rice (Jones)
Notre Dame (Mendoza)
Harvard Business School
Northwestern (Kellogg)*
UCLA (Anderson)
Duke (Fuqua)
USC (Marshall)
MIT (Sloan)*
Chicago (Booth)*
Emory (Goizueta)
Berkeley (Haas)
UNC (Kenan-Flagler)
Texas A&M (Mays)
Michigan (Ross)
Indiana (Kelley)
SMU (Cox)
NYU (Stern)
Texas-Austin (McCombs)

Percentage of Alumni Who Give to Business School (FY2010)
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