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## **Venture Capital: What Investors Look For**

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I am often asked to explain the criteria used at Flywheel Ventures to make our investment decisions. It may surprise some to learn that our most important consideration is the entrepreneurial team. We care about the character of the individuals on the team and the culture they are creating as a team.

Evaluation of potential market opportunity ranks a close second. Projections – such as the size of the addressable market, its rate of expected growth and the amount of potential competition – are used by entrepreneurs to indicate market opportunity. In the end, however, entrepreneurs must satisfy us on four key criteria.

First, we must believe that prospective customers in the target market are aware of a financial “pain” arising from an unsolved problem in the market.

Second, we must understand the projected dollar amount that a prospective customer will be willing to pay for a solution to this problem.

Third, we need to see a credible plan for the new venture to not only develop the product that solves the customer’s problem, but to also market, sell, and deliver the solution in an economically viable means.

Fourth, we need to believe that, over time, the profits gained from delivering the solution to customers will grow.

In our experience, if these four questions can be satisfactorily answered, then a new venture’s likelihood of success is high. Simply put, while technologies and ideas are plentiful and cheap, true market opportunities to profitably solve real customer problems are rare and valuable. We seek the latter.

In considering our third criterion – a new venture’s proposed product or technology – venture investors care more about the long-term viability of the solution than we care merely about its technical advancement or novelty. This can sometimes come as a shock to inventors and innovators whose previous experiences in other sectors placed higher value on the uniqueness of technical breakthroughs. In our arena, successful entrepreneurial teams learn that the greatest

value derives from the uniqueness of their overall capability to (profitably) solve a problem to the (recurring) satisfaction of customers.

Our fourth criterion for investment is analysis of the venture's financial projections. Clearly, to generate a return of five to ten times our investment requires a venture to grow quite rapidly. A typical expectation of venture investors is that a venture must be capable of achieving \$50 million in revenue by its fifth year of operation, and we expect to see well-developed financial projections that justify this type of scale. However, a cautionary proverb from the advertising industry notes that "fifty percent of all advertising budgets are wasted; the problem is, no one knows which half." As venture investors, we know from similar experience that half of all the financial projections developed by a new venture will be proven wrong – but neither the entrepreneurs nor the investors can successfully predict at the outset which projections will actually be achieved. As a result, venture investors care much more about the quality and credibility of thought and analysis that the projections reveal about the entrepreneurs, than they care about the numbers that result. For this reason, we insist that they develop their own financial projections from scratch, and not rely on consultants or formulaic approaches. We may ultimately ignore the numbers, but they give us great insights about the entrepreneurs.

Finally, no venture investment process can ultimately be reduced to a checklist of criteria. Our business remains more an art than a science, better learned as an apprentice in the real world than via a textbook in graduate school. Successful entrepreneurs and ventures, similarly, follow no set pattern or rules except for one: a rapacious focus on defying great risks to achieve similarly great results.

Abbie Hoffman once noted that "the first duty of a revolutionary is to get away with it." Venture investors, likewise, are looking to partner with entrepreneurs who are dedicated not just to being revolutionary, but to winning the revolution.

*Finance New Mexico is an initiative of the New Mexico Small Business Investment Corporation (NMSBIC), New Mexico Small Business Development Center (NMSBDC), Empowering Business Spirit (EBS), the New Mexico Venture Capital Association (NMVCA) and other partners to assist individuals and businesses in obtaining skills and funding resources for their business or idea. To learn more about resources available to New Mexicans, go to [www.FinanceNewMexico.org](http://www.FinanceNewMexico.org).*

