MANAGING INVESTMENTS IN STARTUPS

The role of lead investors in seed Investing

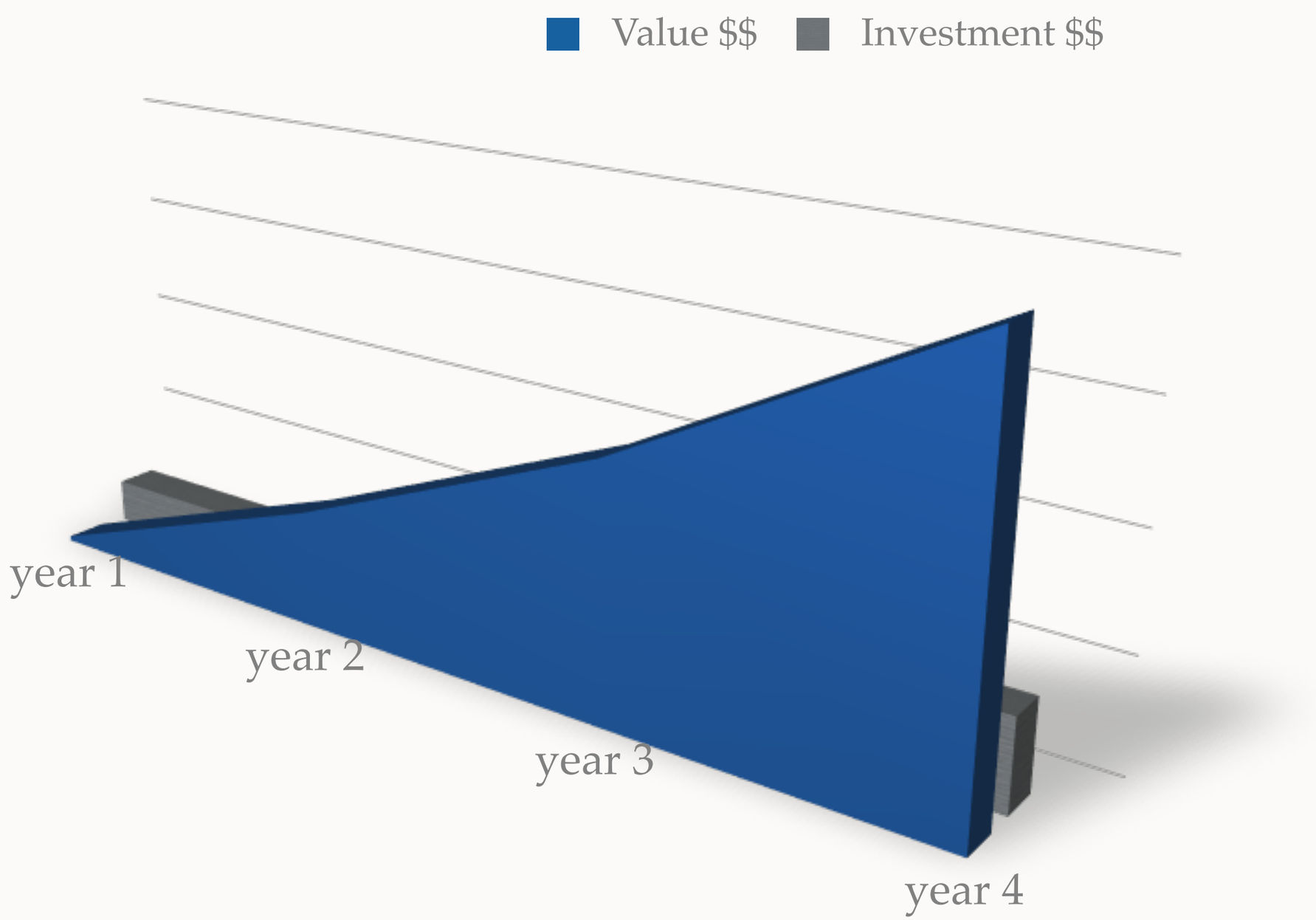
Dave Brown

ME

- 20 startups, 45 investment rounds
- Angel with Go-Beyond.net - pan European angel network
- Engineer -> Entrepreneur -> Angel/Mentor
- buy.at (AOL), Poken, ...

OPPORTUNITY

THE BASIC IDEA

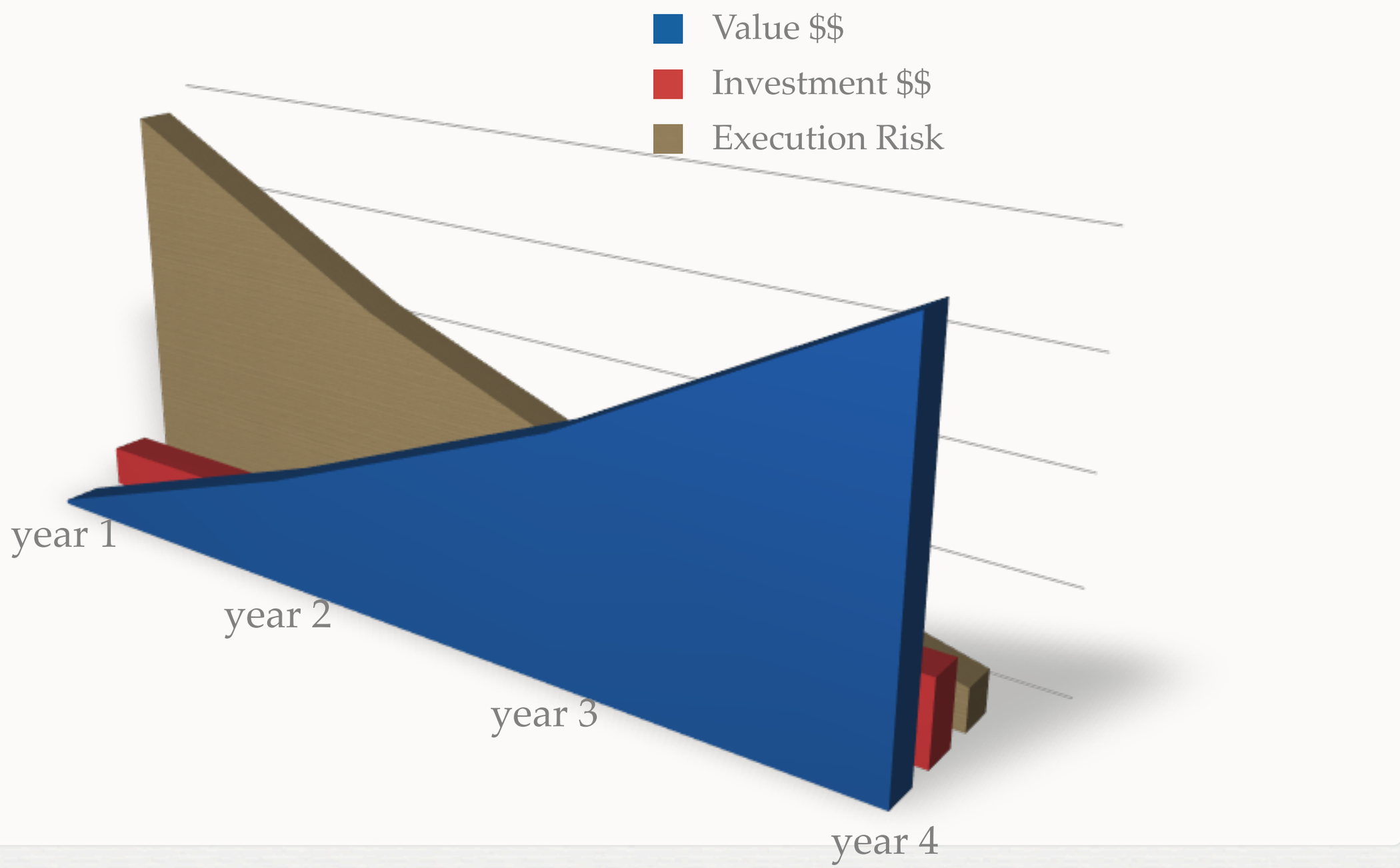


VALUE CAN BE CREATED FASTER THAN IN A BIG CO

- 2 x working harder (longer hours)
- 3 x more productive as a worker
- 2 x more productive as an organisation (leaner decision making, pivoting)
- 3 x smarter as a worker
- **36 x** total multiplier

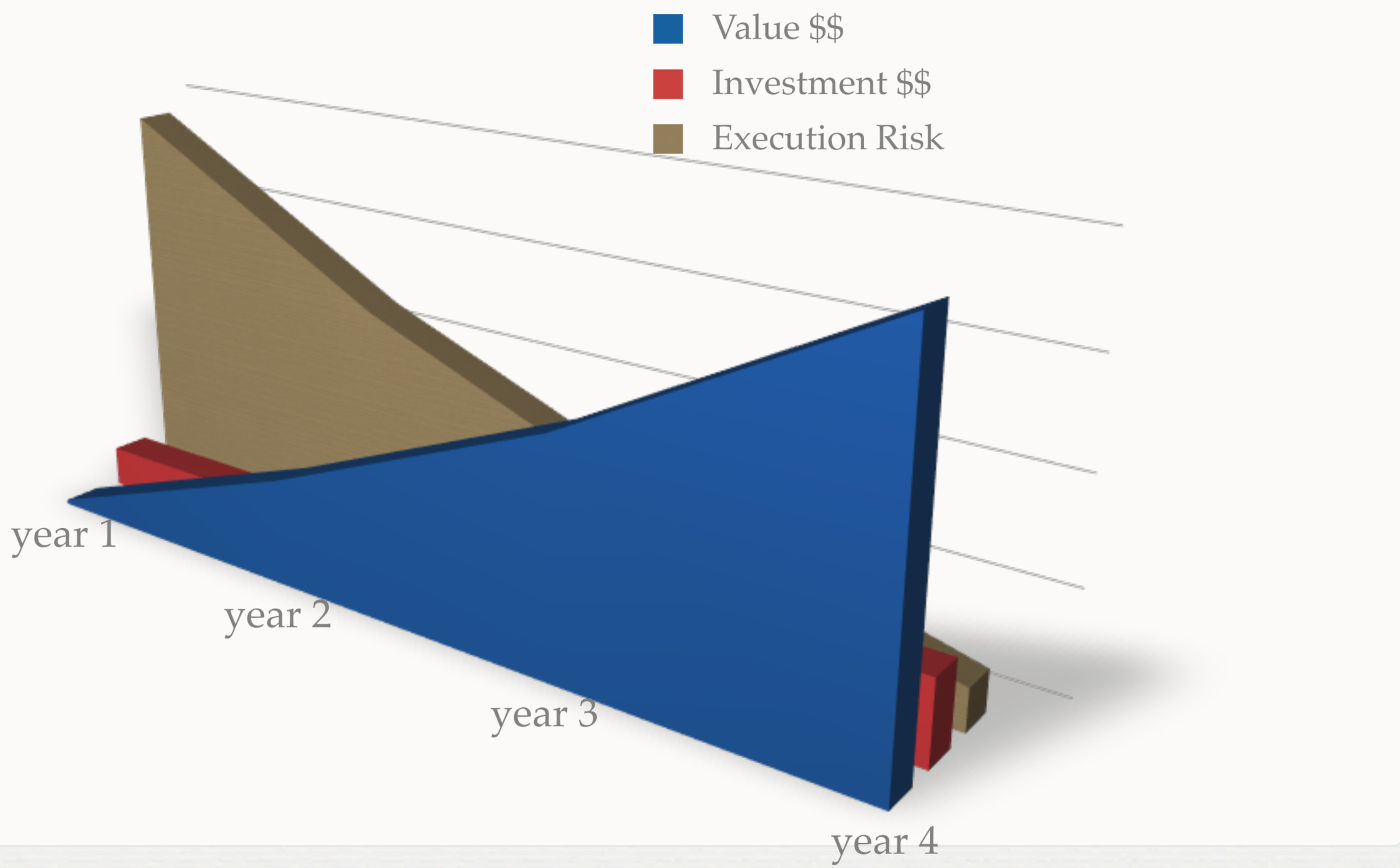
A startup compresses your whole working life into a few years
- Paul Graham, the Y-Combinator accelerator

FINANCIAL MODEL (IN THEORY)

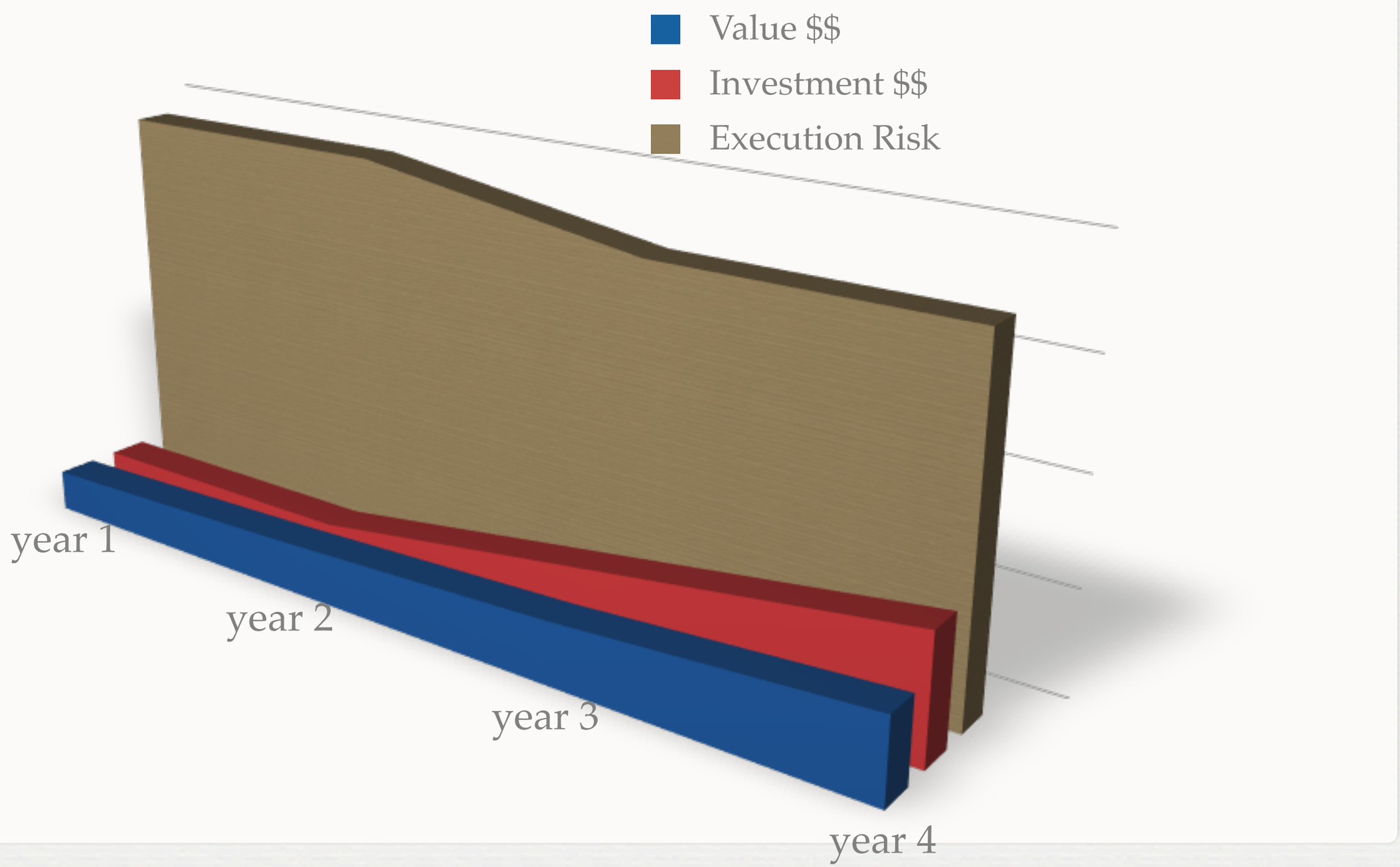


INDIVIDUAL INVESTMENT RISK

FINANCIAL MODEL (IN THEORY)



FINANCIAL MODEL (IN PRACTICE)



MANY RISK AREAS

- Founders
- Employees
- **Technology risk**
- **Market risk**
- IP risk
- Legal risk
- etc. etc.

	Low Market Risk	High Market Risk
High Technology Risk		
Low Technology Risk		

	Low Market Risk	High Market Risk
High Technology Risk		Crazy
Low Technology Risk		

	Low Market Risk	High Market Risk
High Technology Risk	Crazy (but "Swiss crazy")	Crazy
Low Technology Risk		

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Low Technology Risk	Impossible (you're crazy if you think that you're here)	

	Low Market Risk	High Market Risk
High Technology Risk	Crazy (but "Swiss crazy")	Crazy
Low Technology Risk	Impossible (you're crazy if you think that you're here)	Crazy (hyper competitive)

EXPECTED RETURN

- Friends, Family, Fools
- **Angel Investors**
- Seed VCs
- Crowd funding
- Incubators

ANGEL RETURNS

- Kaufmann.org 2007 analysis of 538 angels, 1130 exits, 86 groups
- **26% IRR**
- Positive factors:
  - Increased time on due diligence (55% success)
  - Related industry expertise (2x returns)
  - Active participation (significant)

ANGEL RETURNS

- Kaufman 2007
  - 39% of the 538 Angels had negative returns
  - 52% of investments were less than 1x
  - The top 10% of exits was 75% of the total returns

ANGEL RETURNS

- ACA, EBAN and LINC data
  - IRRs 22% to 27%
  - 55% of all investments are total or partial loss
  - 10x return from 7% in the USA, 9% in the UK

Siding With The Angels, Robert E Wiltbank, NESTA 2009 – data based on 406 exits, 36 were 10x – small sample.
"Returns to Angel Investors in Groups, Robert Wiltbank, Kauffman Foundation, 2007

Does it look like an asset class?

- Very very little data
- Mostly US
- Many indicators are negative
- relies on *black swans* 10x returns

SMART MONEY

SMART OR LUCKY?

- Ian McGlynn in Body Shop: £5000 into £130 million
- Peter Thiel in Facebook: $500k into $1B
- Ram Shriram in Google: $200k into $2B
- Swiss Angels in Xing: 30x return

SV ANGEL (RON CONWAY)

- Ask Jeeves
- Digg
- Facebook
- Foursquare
- Google
- Mint.com
- Napster
- Paypal
- Square
- Twitter
- + 640 others

- Massive Information Asymmetry

- Massive Network Asymmetry

SOME SUCCESSFUL INVESTORS SAY …

- “if you can’t get into the best startups or the best funds, you shouldn’t be investing”
  -- “Mike Maples, Silicon Valley investor”

SOME SUCCESSFUL INVESTORS SAY ...

- “almost all of the investment performance of business angels is accounted for by a small handful of investors, and 40 percent of investors simply lose money”
-- “Fool’s Gold? The Truth Behind Angel Investing in America” (Oxford University Press, 2009), Scott Shane

SOME SUCCESSFUL INVESTORS SAY ...

- Many Angel groups started in the mid-2000s with the expectation that it would take around five years to reach an exit event. Many groups have now passed that point and find that they are still without a positive exit experience
-- Source unknown.

SMART ANGELS BUILD FOR THE EXIT

- Financial Exit: 10x EBITDA, 2x revenue
- Strategic Exit: 100x EBITDA, 20x revenue
  - win-win
  - Medtech to Roche, Novatis
  - Software to Google, AOL
- a Financial Exit involves more **risk** to create the same value

BEING SMART CAN BE A DISADVANTAGE TOO

- Some of the best ideas looked like stupid ideas
- “it can’t be done”

PORTFOLIO EFFECT

- spreading the risk
- could be increasing the risk
- how do you know? how to measure the Beta?
- diversifying: random vs. synergies
- difficult if you’re not smart money

PORTFOLIO STRATEGIES

- Spray and Pray
- Seek out lower risk sectors (later stage?)
- Have detailed sector knowledge
- Find emerging sectors
- gut feel
- follow others (eg. join an angel group)
- focus on the team
- focus on the idea
- focus on the exit

PORTFOLIO BUILDING

- takes a long time - years
- opportunistic approach
- can't learn by watching - need to jump in
- need enough "skin in the game" in an investment to make it worthwhile to take an active interest

SWITZERLAND IS DIFFERENT

SWITZERLAND VS. US

- Is it different in Switzerland? Or Europe?
- screening & support. eg.
  - CTI, CTI label
  - Venturekick
  - startup.ch “top 100”
- no “fail fast” culture

SWITZERLAND VS. US

- “high market risk” startups are difficult here
  - Housetrip -> London
  - GetYourGuide -> Berlin
- Silicon Valley has a network advantage, then London/Berlin has.

SWITZERLAND VS. US

- Less smart money
- more access to the *best deals*
- how to spot the *best deals*?

SWITZERLAND VS. US

- ETH, EPFL spinouts
  - reported 20-25% IRR (ETH)
  - Oskarsson, Schlapfer,
  - http://www.vpf.ethz.ch/transfer/ETH_Zurich_spin-offs.pdf

SWITZERLAND VS. US

- Is there a Swiss startup asset class?
  - all ETH/EPFL spinout
  - all CTI label
  - all Venturekick supported
- If it's so simple why is no fund doing this?

SWITZERLAND VS. US

- the number of *best deals*?
- Are there more? We don't know if its limited by:
  - lack of business/technology ideas
  - lack of smart money
  - lack of available money
  - lack of ambitious entrepreneurs
  - incomplete ecosystem
  - limitations of a small local market

SWITZERLAND VS. US

- incomplete ecosystem
  - supply of smart investors
  - tax
  - legal
- Swiss business/legal framework not designed for startups
  - loss making companies
  - who want to be agile
  - who want to issue share options

SUPPORTIVE MONEY

SUPPORTIVE INVESTORS

- Go Beyond, others & I see from experience:
- (most) startups need massive support at critical stages:
  - strategy
  - on-going financing
  - restructuring
  - key hires

SUPPORTIVE INVESTORS

- making the right high-level intros at the right time

SUPPORTIVE INVESTORS

- Smart problem solvers
- Sector knowledge
- Strong entrepreneurial experience
- Experienced investors: deal terms, strategy, negotiating
- Backing new rounds $$
- restructuring

SUPPORTIVE INVESTORS

- being critical (at the right time)
- being angry (at the right time)
- and still being supportive
- being quick (at the right time)

SUPPORTIVE INVESTORS

- The Swiss ecosystem doesn't reward supportive, hands-on investors/mentors
  - little recognition - free as in *CTI free*, no high-profile accelerators
  - Tax uncertainty - *passive investor* vs. *professional investor*?
  - Co investing is focused on the investment, not on-going support

CONNECTING WITH SMART/SUPPORTIVE MONEY

PROFESSIONAL INVESTOR (VC)

- sign-up fee (2%)
- 2.5% fees per year (entire committed amount)
- share of the profit (20% after hurdle)

CO-INVESTING WITH SMART ANGELS

- zero, or Angel club fee
- share options for the investor on the board (issued by the company)
- “supply and demand”

CO-INVESTING

- It is possible for anyone to get to (a lot of) the *best deals* in Switzerland
- Post deal: more investors = more management
- new funds are changing the landscape eg. Debiopharm, Swisscom, FIT, ZKB, and crowdfunding

THE EXIT

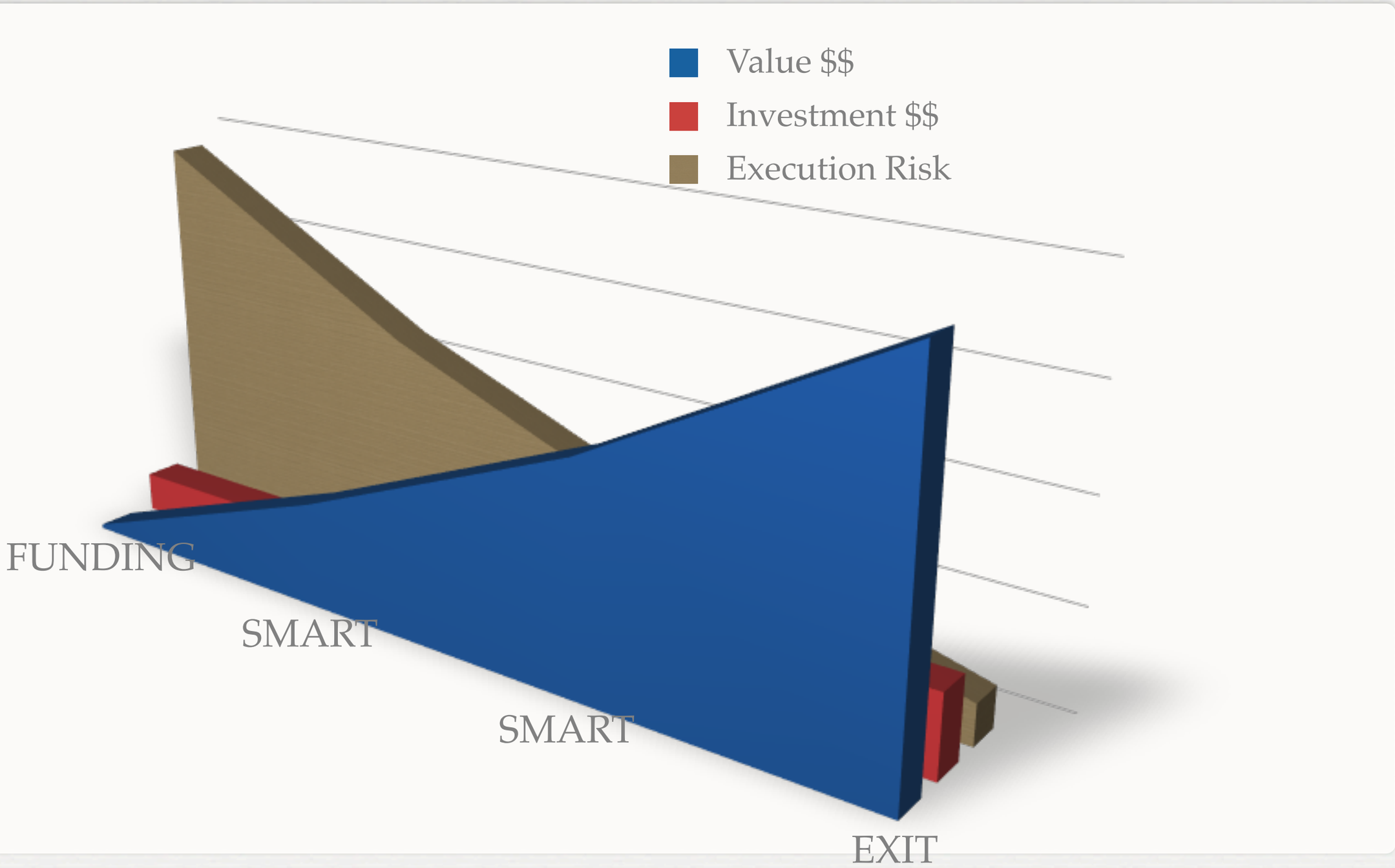
10 YEARS OF VC FUNDING

- $600 billion of US exits
- $6 billion of European exits

LIQUIDITY

- getting to exit takes a long time from seed investment (6 years +). More complex if VCs are involved
- US:
  - secondmarket.com - mainly high profile US startups
  - GSV capital corp (NASDAQ: GSVC)
- Go Beyond - wants to offer liquidity for small investors via fiduciary investing
- Crowdfunding initiatives
- liquidity is complex: needs to be **sold** (packaged up)

FOCUS IS ON THE FUNDING, NOT THE GROWTH & EXIT



HighTechFondue

GETTING TO THE BOTTOM OF TECHNOLOGY INNOVATION IN SWITZERLAND

About

There's a lot of innovation in Switzerland, and yet, just like every other region in the world, it wants to create a better technology/innovation/startup ecosystem.

This blog tries to get to the heart of the amazing innovation happening in Switzerland, to understand how well the innovation is

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