Angel Education Day
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Siding with the Angels
Business angel investing – promising outcomes and effective strategies

Returns to Angel Investors in Groups

Montlake Capital

The Catalyst
How YOU Can Become an Extraordinary Growth Leader

Effectual Entrepreneurship
Distribution of Returns by Venture Investment

UK: Overall Multiple: 2.2X
Holding Period: 3.6 years
Approx 22% IRR

US: Overall Multiple: 2.6X
Holding Period: 3.5 years
Approx 27% IRR

Exit Multiple

- <1X
- 1X to 5X
- 5X to 10X
- 10X to 30X
- >30X

Percent of Exits

Red Bars: U.K. % of exits in that Category
Blue bars: U.S. % of exits in that Category

Hold: 3.0 yrs.
Hold: 3.3 yrs.
Hold: 4.6 yrs.
Hold: 4.9 yrs.
Hold: 6.0+ yrs.
Outcomes Split by Industry Expertise

60% better multiple for deals related to industry expertise

Percent of Exits

Multiple Category

<1X 1X to 5X 5X to 10X 10X to 30X >30X

No Industry Expertise
Some Industry Expertise
Outcomes Split by Due Diligence

2X better multiple for 20+ due diligence

Percent of Exits

Multiple Category

Less Than 20 Hours 20+ Hours

<1X 1X to 5X 5X to 10X 10X to 30X >30X
Details in Due Diligence

• **Transaction Economics vs. Macro Economics**
  
<table>
<thead>
<tr>
<th>Price</th>
<th>Cost</th>
<th>T.A.M.</th>
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<tbody>
<tr>
<td>Contribution Margin</td>
<td></td>
<td>Predicted Market shares</td>
</tr>
<tr>
<td>Cost of Customer Acq</td>
<td></td>
<td>Historical Data</td>
</tr>
<tr>
<td>Customer ROI</td>
<td></td>
<td>Comparables</td>
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<tr>
<td>Key Target List</td>
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• **Cash to Cash cycles & Capital Intensity**
  
  | Longest lead time supply | Production cycle   |
  | Sales Cycle              | Order/Shipment gap |
  | Days in AP               |                   |
Early stage investing perspectives

- Select ventures that appear most capable of influencing critical market elements.
  
  Create and influence localized markets OR
  Compete in large growing markets

- Emphasize the current means and capabilities of the venture rather than on plans for acquiring the “best” means to reach their original goals.
  
  Adjust goals to use current means OR
  Acquire means critical to insightful goals

- Encourage the venture to make smaller investments that get to cash flow positive rather than investing in the resources suggested by market research to “hit plan.”
  
  Overhead trails growth OR
  Pre-position assets to time great opportunity

- Avoid prediction as the basis for investment decisions.
  
  Emphasize affordable loss OR
  Maximize expected values
Effectual vs. Predictive Logic

**Distinguishing Characteristic Of Predictive Logic:**
Selecting various means to achieve pre-determined goals

New means may be generated over time
Effectual vs. Predictive Logic

**Distinguishing Characteristic of Effectuation:**

Imagining & Selecting various goals using a given set of means

What CAN we do, rather than what SHOULD we do.
Effectuation

Market Definition

Segmentation
(through strategic partnerships & “selling”)

Segment Definition
(through relevant variables such as age, income, etc.)

Targeting
(based on evaluation criteria)

Positioning
(through mktg strategies)

THE CUSTOMER

Customer Identification
(through Who am I? What do I know? Whom do I know?)

Adding Segments/Strategic Partners
Definition of one of several possible markets

Effectuation as Used by Expert Entrepreneurs

Causation Model from Expert managers
Prediction vs. Control

Prediction: To the extent that I can predict the future, I can control my outcomes.

- Efforts to insightfully position for success based on expectations/forecasts for the development of important market elements. This often includes modeling event spaces, estimating probabilities and consequences, and forming sophisticated portfolio strategies with multiple options. Assumes that market elements are predominantly independent of the organization.

Control: To the extent that I can control the future, I do not need to predict it.

- Efforts to deliberately construct/create market elements, such as defined products, articulated demand preferences, and market structures (i.e. channels, technical standards, common practices). Assumes either the non-existence of some key elements, or the organization’s ability to significantly affect the evolution of those elements.

Prediction is uniquely difficult with new ventures,

while efforts to directly construct markets may be particularly effective.
## Non-Predictive Control: Effectuation

| 1. Where to Start | **Assess Your Means.** Take action based on what you have available:  
* Who I am  
* What I know  
* Whom I know  
Example: I have person A, I can achieve X, Y, or Z | **Set a Goal.** Goals determine actions. For example, the goal of achieving X, will dictate I need person A with skills matched to X. |
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<tr>
<td>2. Risk, Return and Resources</td>
<td><strong>Set Affordable Loss.</strong> Pursue interesting opportunities without investing more resources than you can afford to lose. Set a limit on downside potential.</td>
<td><strong>Calculate Expected Return.</strong> Pursue the (risk adjusted) largest opportunity and accumulate required resources. Maximize upside potential.</td>
</tr>
<tr>
<td>3. Attitude Toward Outsiders</td>
<td><strong>Form Partnerships.</strong> Grow. Strategy is created jointly through partnerships to create new opportunities.</td>
<td><strong>Perform Competitive Analysis.</strong> Protect. Strategy is driven by potential competitive threats.</td>
</tr>
<tr>
<td>4. Contingency</td>
<td><strong>Leverage Contingencies.</strong> Surprises are good. New developments encourage imaginative re-thinking of possibilities and continual transformations of targets.</td>
<td><strong>Avoid Contingencies.</strong> Surprises are bad. Contingencies are managed by careful planning and focus on targets.</td>
</tr>
<tr>
<td>5. Approach</td>
<td><strong>Transformative.</strong> The future as shaped (at least partially) by actions of all players. Prediction is neither easy nor useful.</td>
<td><strong>Predictive.</strong> The future is a reliable continuation of the past. Accurate prediction is possible and useful.</td>
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Selecting ventures for investment

Investors prefer opportunities:
  in large and fast growing markets
  with customers lined up waiting to repeatedly buy a high margin product
  where no powerful competitors exist
  with the potential to ‘keep others out’ of the market
  led by experts in the field who have prior entrepreneurial success

The problem is the sequence; prioritization
  i.e. insightful market research to demonstrate market potential,
      or win a great beta customer?
  i.e. win a new great team member
      or finish the prototype to demonstrate claims?
Staged Decisions in Angel Investing

- Angels use predictive information more than they think
  - Especially early in the process

- This shifts as we approach actual investment decisions

- Investors with more Entre Experience Prefer Non-Predictive Info.
Cognitive Matching between VC’s and Entre’s

Conjoint analysis of VC investment evaluation.

Simultaneous manipulation of preferences

Economics: Hi Potential vs. Moderate
Social Capital: Strong rep and Referrals vs. Moderate
Entre Mindset: Effectual vs. Causal

1. The match between VC’s and Entre’s significantly increased funding

2. Social Capital and Match were jointly as ‘powerful’ as the economics
Returns to Invested Capital

- Smaller venture deals do get to exits
- The returns to those deals are quite attractive

Accumulations of Private Ventures by Public Corporations

<table>
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<tr>
<th>Paid In Capital Range</th>
<th>Deal Count</th>
<th>Median Price</th>
<th>Median Paid in Capital</th>
<th>Median Multiple</th>
<th>Sum of Price</th>
<th>Sum Paid in Capital</th>
<th>Aggregate Multiple</th>
<th>Aggregate Profit</th>
<th>Profit $'s per deal</th>
<th>Hypothetical ROI</th>
</tr>
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<tbody>
<tr>
<td>$5M-$100M</td>
<td>322</td>
<td>60.2</td>
<td>14.0</td>
<td>3.5</td>
<td>34,914</td>
<td>8,260</td>
<td>4.2</td>
<td>26,654</td>
<td>82.8</td>
<td>20%</td>
</tr>
<tr>
<td>under $5M</td>
<td>1,359</td>
<td>10.3</td>
<td>0.2</td>
<td>53.6</td>
<td>35,741</td>
<td>931</td>
<td>38.4</td>
<td>34,810</td>
<td>25.6</td>
<td>48%</td>
</tr>
<tr>
<td>Whole Sample</td>
<td>1,530</td>
<td>14.8</td>
<td>0.5</td>
<td>24.5</td>
<td>70,655</td>
<td>9,192</td>
<td>7.7</td>
<td>61,463</td>
<td>40.2</td>
<td>29%</td>
</tr>
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Includes ONLY deals with a MULTIPLE OF AT LEAST 1
Includes ONLY deals with complete data (70% of transactions)

ROI equates if 3 and 7 year holding periods
ROI equates if smaller deals fail 91% of the time
VERY Active Angels

• Interviewed 30 “Super” Angels

• Average of about 30 angel investments.

• Min $8M invested (max of $100M)

• Amgen, Autocad, Google, Intel, Apple, Twitter, National Semiconductor, Sun Micro, Plaxo, Guidant, Silicon Valley Bank, Teledyne
Searching For Something

• What role does their network play in their investing?

• What is their approach to angel investing?  
  Criteria, Strategy, Process, “Rules” etc.

• How do they manage investments after the fact?

• What have they learned along the way?
3 key findings to date

• **From experience:** Better at reading people
  – No quitters, no liars, no jerks, big passion
  – real FIT between the person and the opportunity.
  – Some love “coachability” but not all.

• **Major Sector Focus**
  – Med Devices is not Bio Tech
  – Consumer Internet is not Network Technology
  – Software is not hardware.
  – Software isn’t even software

• **Strategies:** Equifinality
Equifinality: Many paths ➔ same end

• **Broad and Thin**, support in “key moments,” team interaction is critical, no follow unless “no-brainer”

• **Co-Founder**: start with 100% ownership, use it to build team and opportunity

• **Wealthy Sector Expert**: go deep on funding as needed, forget co-investors, work with experts you know

**Strategic Coherence, Yes** (though not always consistent)
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