

URL: <https://stvp.stanford.edu/blog/videos/what-investors-want-entire-talk>

It's understandable that, amid a flurry of pitch meetings and rejections, founders might find themselves mystified about what venture capital investors want. However, according to Bessemer Venture Partners operating partner Jeff Epstein, it's actually very simple: They want to see a business that has the potential to grow exponentially, some evidence of traction, and a concrete plan for further de-risking the enterprise. As you de-risk the enterprise, he explains, you create opportunities for larger fundraising rounds



## Transcript

Narrator Who you are defines how you build.. 00:00:06,000 (electronic pulsating music) Robbie Today, we are thrilled 00:00:10,580 to welcome Jeff Epstein to ETL.. Jeff went to Yale before getting his MBA from Stanford here at the GSB.. Earlier in his career, he was an investment banker at The First Boston Corporation.. He then held CFO positions at several companies, including DoubleClick and Nielsen.. And later became the Executive Vice President and CFO of Oracle, one of the world's largest and most profitable technology companies with a market cap of over \$200 billion.. Jeff is now an Operating Partner at Bessemer Venture Partners where he leads Bessemer's CFO Advisory Board, and helps portfolio company CEOs and CFOs share best practices.. He serves on a huge number of boards, and an impressive list of board of director spots, including Couchbase, Kaiser Permanente, Okta, Twilio, Poshmark, and others.. And if that weren't enough, we're also really blessed to have Jeff as a lecturer with us in Stanford's Department of Management Science & Engineering where he co-teaches the Lean LaunchPad class, which is an immersive and experiential deep dive into the entrepreneurial process.. Today, Jeff is here to talk to us about what investors want..

And I should say that, as all of you know in the Bay Area, we recently had a storm and so we are having some internet connectivity issues, just FYI.. But like all good entrepreneurship, we are gonna be adaptive to the situation, but we ask for your patience, just FYI, in the process in case there is some internet latency as we present.. But with that, we're honored to have Jeff.. And I'm gonna turn the floor over to Jeff Epstein.. - Well, Ravi thank you.. 00:01:54,690 And thanks to STBP and Basis for sponsoring this today.. It's great to be here.. This presentation came because many entrepreneurs come to me and say, "I'd like to raise capital "and here's my pitch of why I'm so great." And my advice, typically, as I think many of the best venture investors are, is instead of thinking about what you're doing, think about what the investor wants.. And if you can understand what the investor wants and you can tailor your presentation to what they're looking for, you are now in the seat of the entrepreneur, CEO, founder, you're thinking of pitching a venture capitalist, you're trying to understand what do they want.. And this, the title comes from the old Mel Gibson movie, "What Women Want." It's a great movie..

If you haven't seen it, I recommend it.. He wakes up one morning and he's in the advertising business, and he, all of a sudden, thinks like a woman, and he can understand what his women, the customers of a product that he's trying to sell want.. So that's the theme here.. Ravi already went over some of this.. My background as chief financial officer for 25 years, Stanford alumni, and serving on a number of boards, which are pretty exciting.. We can talk about that in the Q&A session..

Okay, so the first thing to understand is that venture capitalists specialize, and they specialize by risk stage, meaning early stage, pre-product, pre-revenue, or series A and B, or late stage.. They specialize by market sector, healthcare, software within software, security, or enterprise software, things like that.. And then by geography, either the United States or even just the West Coast, or Europe, Asia, whatever geographic region.. And if you look at the investments any venture capitalist has made in the past, and they made 10 or 20 investments, and there's a theme there, if you are a part of that theme, you're highly likely to get a good audience..

If you look at your company and you're nothing like all the other companies that person has ever invested in, the odds are pretty low they're gonna invest in you.. So you want to focus on what the venture capitalists that you're talking to have specialized in.. At every funding stage, the risk goes down and the valuation goes up as you continue to improve, and investors specialize this way.. So some investors are eager to take on high risk at a very low valuation.. And others say, "No, I want to have lower risk, "but I'm willing to pay more." And it's important to understand where the investor is in that transition.. And then you want to position yourself to what they're looking for, and you wanna think about how can I, at whatever stage I'm at, how can I reduce the risk for the investor? How can I come up with proof points that say, "This actually is not very risky because I've accomplished "a lot and I'll demonstrate it to you and prove it to you." Well, let's start by looking at these different stages.. You can see that there's over 12,000 venture investors a year, 100 venture investments a year, \$150 billion a year just in the United States, with 5,000 of those being Angel and Seed rounds, several thousand being Series A and B, and later stage Series C.. So there's a lot of deals.. There's plenty of opportunity, lot of activity, and of course, this is the best of times in venture capital.. Now on the next slide, it's interesting to point out what's not venture capital, and I'll pick on this company Quibi because they were rich and famous and pretty high profile..

They raised a billion dollars in their first round in 2018 without a product, and then two years later, they raised another round of 750 million still without a product, without launching.. Their first revenue they launched the product in early 2020, and within six months they went out of business.. And so they raised \$1.75 billion.. They probably lost almost all of it.. This is the opposite of venture capital, and it's a very high risk way to go.. Now, sometimes companies like Tesla have done this and have succeeded, so it's not impossible to succeed this way, but this is not the venture capital way.. Now on the next slide, it shows you what a typical venture capital structure is, where you have a series of investments over time, typically a financing round every year or two.. And the idea is that you raise a little bit of money and you prove something with that money.. So DoorDash is an example, raised \$120,000 at a 2 million pre-money valuation in 2013.. They then raised another 2.4 million the following year, and the next year they raised 17 million at a 54 million valuation..

And every year or so they raised another round.. Over time, they're worth, as of the IPO, \$64 billion, so they've been enormously successful, but they had over 10 financing rounds, and in each round they had to reduce the risk and prove what they were accomplishing in order to raise the next round.. And so if we go to the next slide, the concept here what DoorDash was demonstrating was that venture capital is gated capital, meaning there's a gate and you have to go through the gate to get to the next round.. So the venture investors would give the founders one to two years worth of capital, just enough to get to the next gate.. Now this footnote here says, "Except in 2021." What's happening right now is investors are giving venture capital backed companies, enormous amounts of money, tens of millions, hundreds of millions of dollars that they're not going to spend for the next year or two.. And so we're in something that's very unusual.. We'll have to see how the industry responds.. But I would say for the last 20 years, this idea of gated capital has been the normal paradigm, where the company only has enough capital for a year or two, and has to make a lot of progress during that year or two.. We'll come back to this in the Q&A about what the 2021 market environment is like.. So why does this system work? Well, it's worked in the natural world for a long time..

It's Charles Darwin came up with the idea of natural selection.. And fundamentally that happens with venture backed companies.. You have 12,000 venture capital companies funded every year.. They're not all gonna make it.. Some of them are gonna go out of business.. Some will merge with others.. Some will just return some amount of, you know, 50 cents to the dollar or 100 cents to the dollar, after only a couple of years.. And so this concept of natural selection, it works very well in the world of biology, it also works very well in the venture capital world.. So what happens if you don't make the progress? You raise your first round of venture capital or your second round, you're not doing very well.. You're not growing..

You're not reducing the risk for the next round of investors.. What happens?; you can't raise any more money.. What do you do then? Well, you're losing money.. You can't raise more, and you only have one of three choices: cut costs, if you have some revenue to get to break even, sell the business for whatever you can get, or shut the business down.. And this discipline of having to prove something within a year or two until your cash runs out is an important reason why the venture capital process works well.. So let's turn now to: How do you raise money? Now that we've laid the outline of how the venture capital ecosystem works.. And let's start with the DoorDash example again.. You have no money.. You have this great idea to deliver food from restaurants to consumers.. Well, what you do is you build a minimum viable product..

What they did at DoorDash back in 2013, and the first six months of the company, you had four founders.. They did some email marketing.. They made flyers.. They tried to get on Google organic search.. They built a website with just menus.. It wasn't interactive.. You couldn't order on the menu, and they just was phone number.. And consumers found DoorDash somehow through these flyers or marketing, they called the founder's mobile phones or they text messages the founders and said, "I'd like to order this food." The founders then went to the restaurant, the restaurants were not part of the network.. The

founders just went to the restaurant and ordered the food take-out as if they were eating it themselves, but then they would drive it themselves to the customers.. So that's pretty basic minimum viable product..

All it is is a static website, a telephone, call us up or text us we'll order for you.. We'll go to the restaurant.. We'll order the food.. We'll bring you the food.. That was their business for six months with no money.. And they then raised a pre-seed round of \$150,000 to hire a few people and to try to build the business out.. They were already proving it was working.. They already proved customers a handful of customers wanted to order food this way.. So they hired 20 drivers as part-time drivers.. They hired two employees in customer support..

They expanded from Palo Alto to Menlo Park also.. And they were beginning to get a little traction.. This is in the second six months of the company, months 7 through 12.. And the goal of this round was to make a few people happy, a few customers, a few restaurants, a few drivers.. And they were very successful.. The restaurants who did use them, loved them and recommended them.. And some users were using DoorDash several times a week.. So what you're trying to do at this point is get to product-market fit.. There's a lot of definitions of product-market fit.. But one way of defining it is doing a user survey, which is, there's a website and the link here of how to do this user survey, and the question is, "How would you feel if you could no longer use DoorDash? "Very disappointed, somewhat disappointed, not disappointed, "or I no longer use DoorDash." Even with a very small sample size of a hundred, if 40% or more people answer "very disappointed", you probably have product-market fit..

It's a very good way of measuring.. So you now have reached product-market fit.. You've only raised a few hundred thousand dollars, and now you want to expand, so now you raise your series A.. And what do you do with your series A? Well, you're expanding to your second region, to San Jose, you're now up to 20 full-time employees and 300 drivers and continuing to expand.. So if you remember that slide before where every year you were raising more money at higher valuations and proving more, getting more traction, proving your customers love you, proving you can expand from Palo Alto to Menlo Park, and then from Menlo Park to San Jose, and then other other regions, that you can recruit more drivers.. At every level you're reducing the risk and increasing your value.. And that's what investors are looking for.. Now on the next slide, if you go to a large fund, which has a billion dollars or more under management, they're looking for home runs.. The venture capital business, is in a way, it's like playing baseball, where instead of getting four runs for grand slam, you can get a hundred runs for grand slam, or a thousand runs for grand slam.. So people in the venture capital business, on average, know that many of their investments are going to fail..

Often, a third of all investments in venture capital, investors lose all their money.. And a third of the time, they about make their money back.. And then the remaining third, the profitable third, they have to make a big return to get a good return overall on their entire portfolio.. And they're looking to make a 10X return or even a hundred times return.. And they're looking in many cases for a company that could be worth more than a billion dollars for a large fund.. So for the company to be worth more than a billion dollars, the revenue has to be over a hundred million dollars.. Let's say, I just ordered Magnitude, and to get there within a venture timeframe, meaning eight years, you have to have growth approximately triple, triple, double, double.. So let's say you're a company like DoorDash, and you get to 2 million of revenue by the third year.. And then, not just revenue but the profit margin; in our marketplace you'd have to look at not just revenue, but also what's the take of the marketplace.. So that number being 2 million by the third year, then you want to triple it..

You want to grow very fast.. You grow from 2 million to 6 million, meaning that the take rate for a marketplace were the revenue for a software company, and then triple again from 6 to 18, and then double, double, double, and then you get to over a hundred million dollars of revenue in the eighth year.. And let's give a real example of this.. Shutterstock, a company where I served on the board for nine years, was founded by Jon Oringer.. This is an image of Jon with a camera there.. He's the founder.. He started it in 2003.. It's a B2B marketplace for images.. And by Shutterstock's eighth year, they had 500,000 customers.. Customers were paying on average \$2 an image..

They were buying a hundred images per year each.. And if you just multiply that out, 500,000 times two times a hundred, that's a hundred million dollars of revenue in their eighth year.. And when they started, they thought this is what we could do, and they actually achieved it.. So that kind of growth is something which most large venture funds will say, "I don't know whether you can do it.. "I know some of the companies I invest in "won't be able to do it, "but my ambition is that every company I invest in has "the potential to do that." And then, on this next slide that shows some other examples, and you can see how, in recent years, some companies have been growing even faster.. Cornerstone, an HR software company took 12 years to get to a hundred million of revenue.. Coupa took eight years, Shopify, six years, and Twilio, Hashi Corp, Slack, and UIPath even faster.. So this is possible to get to a hundred million of revenue within this sort of two to eight year timeframe for the very best companies.. What are other ways of reducing risk? Well, if you're an investor, ideally, you'd like to see that your company has a technical advantage over all the other alternatives out there.. So for instance, when Google launched Google Search, there were half a dozen other search engines, but the Google page rank algorithm was a different and superior way of getting search results..

And the investors initially in Google felt that this was a much better way of doing search.. Another key thing to look for is network effects.. When you have a company like Uber, where if you have more drivers, you can deliver, the car can show up faster to the consumer.. If you have more consumers, you generate more rides per driver.. That's a classic flywheel network

effect business, and investors love to see network effects.. It's another way of reducing risks.. So if you think about all the different things that investors would like, they would like companies that can prove that they can get to product-market fit, prove that they can have a potential to have a business model that can get to a hundred million of revenue in some reasonable number of years, and then have these additional benefits, like a technological edge and, potentially, network effects.. Now, when you're thinking about how do you reach out to venture investors, there are better ways and less good ways to do it.. And the best way to do it is to think about, again, think what does a venture investor want? A venture investor wants their portfolio company CEOs to be happy, and they trust their portfolio company CEOs.. So if you can get a warm introduction to a venture capitalist from a portfolio company CEO, to an investor who specializes your stage, sector and geography, that's the best way to reach out to venture capital investors..

And then let's summarize what the key metrics are that venture investors look for.. We talked about net promoters.. We talked about having product-market fit.. One way of measuring that is through net promoter score above 50.. You'd like to have paying, referenceable customers as soon as you can.. For an early stage company, sort of a rule of thumb is getting over 10 B2B customers.. For B2C, you want to have over a hundred paid consumers, or over a hundred thousand monthly active users, if you have a free advertising supported company.. So you want to have key benchmark metrics for number of customers.. Your CAC Payback, your customer acquisition and cross payback, under two years.. If you have salespeople, you wanna have your salespeople achieving quota..

You wanna be growing fast.. You wanna have a higher net renewal rate, a good gross margin, an efficiency score, which is your growth rate plus your profit margin above 50.. You'd like to be capital efficient with a cash conversion score over a hundred, and have no customer being more than 1% of your business.. So we can get into this in the Q&A, but there's a whole series of these metrics, which if you have all of these, you're going to be very attractive to venture investors.. If you have several of them, you'll be somewhat attractive.. And these are all the kinds of things that you can try to achieve as you grow.. And each time you achieve one of these, you can reduce risks.. Let's turn now to a description of how Stanford participates in this system, and I'll talk about a number of courses that we're launching.. The Lean Launchpad is a course that's been around now 10 years at Stanford.. We have two different versions of this course..

There's a winter course and a spring course, and if you can learn more about it at [leanlaunchpad.stanford.edu](http://leanlaunchpad.stanford.edu).. You need to apply with a team to these courses, and the timetable is coming up very quickly for the winter course, so we'd encourage you to apply.. The winter, also, there's another version of the Lean Launchpad, Hacking for Climate and Sustainability, Earth Systems 213, and the spring is Hacking for Defense, which is MS&E 297.. So a lot of variations on the Lean Launchpad methodology that you can apply for.. And then I'm teaching a new course in the business school, Chief Financial Officer Leadership in the spring.. So if you're in the business school, we'd love to have you apply to that.. (electronic pulsating music)..