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Growing Your Own (Deals) Pre-Investment Investor Value-Add Part II: From Good Idea to Good Deal

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In Part I of this series on “growing your own deals” outside of the established venture capital hubs, the focus was on spotting diamond-in-the-rough entrepreneurs. Today, the subject is seeing how an investor can help raw entrepreneurs morph their ideas into investable business opportunities. It can be a fun process, if stressful and not always financially rewarding. And it harkens back to the modus operandi of the venture investors that built Silicon Valley, way back when.

One thing about diamond-in-the-rough entrepreneurs is that their ideas are often less than fully formed. Some good ingredients, but a flawed recipe, perhaps only partially cooked. They often reflect the better mousetrap conceit: that is, the “if you build it, they will come” business model. Even those that go beyond that conceit usually travel neither very far, nor in the right direction.

And thus the first, in time and probably significance, pre-investment value add: helping the raw entrepreneur flesh out a plausible business model. It’s a process that requires a deep dive – by the investor and the entrepreneur – into relevant emerging, existing, and anticipated markets, and how those markets work. Who plays where in the value chain, and what are the economics of the various players. Where is the most value captured? Who will likely most benefit from your product/service, and where are they in the chain? And, as importantly, who will be most hurt by your product/service, and where are they in the chain – and what power might they have to thwart you?

Here, a brief digression. The business model search, as much of the entire pre-investment cutting and polishing process, is good place to find out something important about your entrepreneur: are they educable. Are they stubborn (defensive or evasive) when confronted with new information or hard questions, or tenacious (thoughtful and equanimous)? Shrewd (adroit in seeing their ideas from different perspectives) or dense (unable to think from outside their preferred box). Are they, finally, decisive (sees, evaluates and acts crisply when confronted with new ideas) or tentative (chases after new ideas indiscriminately or into the analysis-paralysis swamp)? (Click Here for a deeper discussion of the Educable Entrepreneur; for thoughts on the Educable Investor, Click Here).

As important as the business model value-add is the investment model value-add. Rough diamond entrepreneurs typically come to the table lacking an appreciation for how risk capital investors think about their investments. Their business plans speak too much to the business opportunity and how it will be captured, and too little to the investment opportunity and how it will be captured. Their thinking usually reflects a distinct lack of appreciation for the role of risk reduction in determining the size, timing, and price of financing rounds. That can present a novel pre-investment value-add, one that can be put in a positive perspective for the rough entrepreneur: minimizing dilution via a smart investment model. Click Here for a deeper discussion of this value-add opportunity.

Team enhancement is another area proactive investors can inject a mission critical value-add even before investment. Prototypically, first-time entrepreneurs present with an incomplete startup team. Many come to the table missing even a needed co-founder. I've seen dozens of tech-strong entrepreneurs pitch deals that cried out for a co-founder of a business mind, and vice versa. I've made a bunch of those connections myself over the years. Sometimes, as well, you see teams where the various founders are poorly deployed, most often in terms of who has the "buck stops here" role – or in fact where no one is in that critical role. Addressing these key team issues is, again, another good way to get a handle on the grit, integrity, and educability of the entrepreneur(s) in front of you.

Team development is a related area of pre-investment value add. Entrepreneurs in Silicon Valley and other venture capital hubs usually absorb a lot of high-impact entrepreneurship and investing savvy from the dense community of experienced players around them. Outside of those hubs, though, not only is that unlikely but, in fact, newer entrepreneurs are more likely to have been offered bad advice, and to have absorbed faulty ideas and entrepreneurial thinking.

A critical pre-investment value add is simply connecting promising but raw entrepreneurs with more experienced entrepreneurs and others players in the eco-system. Not so much for specific, deal-related purposes, but simply to expose the less experienced entrepreneur to more folks who have "been there, done that" and can offer realistic perspectives on the high-risk/reward culture, from the startup and investment perspectives. The kind of perspectives that entrepreneurs in Silicon Valley get just by being in Silicon Valley, where they are immersed in the high-risk/reward entrepreneurship culture. This process can payoff for the entrepreneur, of course, but can also be a key due diligence exercise for the prospective investor.

<u>A few closing thoughts</u>.

First, an occupational hazard: creating deals for someone else. Now and again good deeds are punished. After a lot of cutting and polishing the now ready-for-market gem of an entrepreneur might look elsewhere for an investment partner. When that happens, consider whether maybe you were wrong about the quality of the entrepreneur - and move on. Life is too short to spend it crying in your own beer.

Second, there's a school of thought out there that entrepreneurs won't take advice. Many in fact won't. That said, I've never met a successful entrepreneur who didn't seriously consider sound thinking from pretty much any source, and at least consider incorporating it into their own thinking. Sharing credit is a nice touch, but most investors will gladly settle for a good exit, credit or not. In any event, entrepreneurs who won't listen carefully to wise counsel are usually best avoided.

Third, never confuse cutting and polishing the rough diamond entrepreneur with standing in for them. Venture investors, before and after making an investment, are entrepreneur coaches, not entrepreneurs as such. Maintaining the coaching perspective – very interested but dispassionate – is critical for any investor. Besides, one sign that an entrepreneur is fatally flawed is a willingness to let an investor step into her shoes.

The bottom line is that mining for entrepreneurs in places where the good ones are hard to spot among the detritus is a special talent. Ditto shaping and polishing those rougher entrepreneurs and their ideas into investable deals. But beyond the financial payoffs, there are few things as rewarding for a risk capital investor than finding and refining a raw entrepreneurial talent into a valuable entrepreneurial gem. Even if now and again one slips through your fingers.

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