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Abstract of bachelor's thesis

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MARKETING BUSINESS PLAN TO VENTURE CAPITAL INVESTORS: ABC FOR EXECUTIVE TEAMS BEFORE GETTING STARTED.

Bacheelor's Degree

Department of Marketing

Thesis advisor(s) Blakaj Hedon, Mikkola Ilona

Year of approval **2020** Number of pages **23** Language **English**

Keywords Pitching, Business plan, First-round, Venture capital, Financing, Startup

Only a few start-ups looking for growth manage to acquire a first-round venture capital investment for their business idea. This is often due to the fact that the entrepreneurial team may not be able to sell their business idea through to venture capitalists whose selection criteria for new investments are very strict.

Central to this selection process from a venture capitalist's perspective is the business opportunity of the start-up company and the competence of the entrepreneurial team. In addition to a good business plan, the entrepreneurial team has many other important things to consider before starting to use their resources and market a new business idea to venture capitalists or business angels. The credibility of the entrepreneurial team is also enhanced by the fact that they have also looked at their business idea through a scientific framework in order to see and identify the weak points of the business plan before starting to market the business plan.

The purpose of this thesis is to uncover the factors that influence the venture capitalist's selection process when looking for a new investment target.

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“MARKETING BUSINESS PLAN TO VENTURE CAPITAL INVESTORS: ABC FOR EXECUTIVE TEAMS BEFORE GETTING STARTED.”

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Fall 2020

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1 Introduction

Only a few start-ups looking for growth manage to acquire a first-round venture capital investment for their business idea. Often the reason is that the entrepreneurial team does not know how to sell their business idea through to venture capitalists, whose selection criteria for new investments are very strict; after all, it's about their money.

The purpose of this study is to uncover the factors that influence the venture capitalist selection process in the search of a new investment target and to help new entrepreneurs understand what factors are relevant when presenting a business idea to venture capitalists.

I also seek to open up investors perspectives on the basis on which they make investment decisions and what helps executives and entrepreneurial teams focus on making business plan that attracts venture capital investors and also fits in company's culture. Sathe (1985) defines company´s culture as set of important assumption that members of a community share in common. Company organizations accomplish these targets and objectives which the culture in organization sanctions. Company organizations often find they can form new strategies that make sense from a marketing or financial point of view. Often tho organizations have problems in implementing their strategies because they require:

- values
- assumptions
- ways of working that are too far out of line with the organization's prior assumptions. (Sathe 1985; Frankwick 1994.)

In most cases investors want to see how the entrepreneurial team sees the company's strategy and how they are implementing or intending to implement it. Above all investors are interested in whether the company's strategy is clear, truthful and replicable.

Research questions should be determined:

- *How to promote a business plan to venture capital investors*
- *What are the key factors that contribute to a successful promotion of a marketing business plan to venture capital investors?*

1.1 Venture capital investments

In most cases venture capital and angel-investors invest their money on early-stage companies. At these early stages high information asymmetry exists between the investor and the entrepreneurial team and even greater uncertainty exists about the entrepreneur: the product, service, the market or any combination of these factors. (Rasmussen & Sorheim 2012.)

The money received from private equity investors is risk money, so the return requirement for a private equity investment is considerably higher than other company financing models. This is why venture capital is especially suitable for companies seeking aggressive growth. For many start-ups, collateral and cash flow are not big enough to get a bank loan, so venture capital can be the only source of capital for many. (Gompers & Lerner 2001.)

For new ventures acquiring capital is a spectacularly difficult process. To succeed an entrepreneurial team must overthrow investor fears about the quality of their product or service or idea and market as well as their own capability to execute. (Williams 2013.)

There are many ways in which a venture capitalist monitors and directs an investment target:

- comprehensive company analysis before making an investment decision
- syndication of investments, i.e. bringing other private equity investors into the investment to share risk and to bring know-how to the company

- capital investment in several rounds so that the previous round set goals must be achieved before the next round is organized
- management reward systems that align management and investor goals e)covenants and restrictions that prevent management from doing harm to the company decisions
- monitoring the company by bringing investors to the board. Because the money received from private equity investors is unsecured the private equity investor must otherwise make sure that the investment object is sound and that the company does not lose money. (Gompers & Lerner 2001.)

Not everyone can be a winner; on average only one in ten of companies that have received a first-round venture capital investment brings a large return to the investor. Two or three out of ten investments survive as operating companies until the exit, two go bankrupt and the rest of the companies end up as "living dead" meaning they survive but growth stops. (Campbell 2003.)

1.2 Business opportunity

Investors are looking for markets with rapid growth potential whose evolution is still in its infancy. Most private equity investors will not invest in companies that do not have a realistic chance of achieving a turnover of more than € 50 million within the next 5 years. (Sahlman 1997.)

Financially profitable customer acquisition is a stumbling block to the success of many business ideas. No matter how great a product is, it doesn't matter if production and marketing costs can't be covered. Especially in the case of technological innovations it is often a false assumption that when a great enough product is built customers automatically follow. (Sahlman 1997.)

Sahlman (1997) lists some of business opportunity characteristics that the business plan should meet:

- Who is the customer?
- How the customer selection process works for a product?
- Which makes the product an attractive purchase for the customer?
- How a product or service is priced?
- How the company reaches the target groups it has identified?
- What it costs to acquire a new customer and how long it takes?
- What does the production and distribution of the product cost?
- What it costs to keep a customer and?
- How easy it is to engage customers?

Investors also prefer products whose price can be based on the benefit experienced by the customer as margins are better when pricing is not based on competition or margins. Production costs can then be very small in relation to production costs. (Sahlman 1997.)

1.3 About Business Plan

A business plan that expects the company to have no competitors in a fast-growing market gives entrepreneurs a childish image. Therefore future potential competitors should also be analyzed and a plan developed for how competitive advantage can be maintained against the pressure of large brands. (Korpela & Tolvanen 2008.)

According to Sahlman (1997) mapping the competitive field is one of the most important parts of a business plan. Considering the whole field also

requires an analysis of the suppliers of replacement products, as well as an analysis of potential entrants to the new product market. With regard to competition the many questions need to be answered:

- Who are the company's current competitors?
- What key resources do competitors have at their disposal?
- What are the weaknesses and strengths of the competitors?
- What will be the response of competitors to our new company?
- How can our company respond to competitors response?
- Who else could spot and take advantage of the business opportunity?
- Is it possible to form alliances with existing or potential competitors with?

1.4 Pitching - Marketing And Selling The Business Plan

Many studies reveal that venture investors may take only a couple of minutes to reject a business idea (Hofer & Hall 1993). This is indicating that venture investors must have some decision-making process through which they select businesses for potential investments.

When it comes to selling a business idea the entrepreneurial pitch has become an important part of an entrepreneur's toolkit. The purpose of the pitch is to reduce information asymmetry and convince potential investors of the attractive risk/reward profile associated with the product or market or team. Studies show that there are actually a few different types of pitches - ranging from an elevator or rocket pitch which may last from one to five minutes and more typical 'pitch'. Pitch for a larger network of angels or venture capitalists

are always longer which may last from 15-30 minutes. (Clark 2008.) Ekhardt (2006) describes that a credible entrepreneurial pitches often include:

- A summing up of the problems is trying to clarify how the business provides a unique solution
- a description of the business model
- the competitive advantages of this approach
- the associated financial projections
- cvs and biographies of the entrepreneurial team.

2 Venture capitalist point of view

2.1 Venture capitalist requirements

Investors look for the following features in a business plan (Mullins, 2003):

- large and fast-growing markets supported by favorable macro trends
- attractive and competitively easy industries
- an innovation whose competitive advantage can be defended by patents, contracts or organizational processes and at the same time financially viable business model
- an entrepreneurial team whose mission, goals and risk profile fit the investor's own profile
- an entrepreneurial team that identifies and is able to implement critical factors in the industry
- an entrepreneurial team with good relationships up, down and across the value chain

According to Sahlman (1997) an investor looks for information in a business plan in the following four independent areas:

- The people who run the business, as well as outside groups that provide key services or resources. The team is the most important aspect, because without a viable team, other areas of the business plan are irrelevant. A prudent investor will start reading the business plan from the team presentation, and will only read the other sections if the team seems qualified.
- A business opportunity and its details: what and to whom, how fast growth is possible and what are the drivers of growth, what are the factors that stand in the way of success and how to overcome them, who are the current and potential competitors.
- Context and big picture: regulatory environment, demographic trends, technological development, ie a changing environment that affects the company but cannot be controlled by the entrepreneur.
- Risk and return, ie an analysis of everything that can go well or badly, and how situations should be reacted to.

From the perspective of a private equity investor, the business opportunity of a start-up company and the competence of the entrepreneurial team are at the heart of the new investment target selection process. The credibility of the entrepreneurial team is enhanced by the fact that the business idea has been examined through a scientific framework in order to see and identify the weaknesses of the business plan. (Korpela & Tolvanen 2008).

2.2 Marketing the Entrepreneur Team to investors: What information is relevant?

Not all information is significant from the perspective of private equity investors. However Sahlman (1997) has listed things to consider that entrepreneurial teams should consider when presenting themselves in the eyes of venture capitalists. The description of the team should include at least the following sections:

- What and who entrepreneurs know and how well they are known?
- The know-how, knowledge and contacts of each entrepreneur in the product, market, production processes, competitors and customers are relevant.
- How well the team members know each other and whether they have worked previously successfully together?
- Evidence of the ability to implement critical success factors should be included.
- It is benefitial to list the qualities of people in the management/entrepreneurial team that the business plan should meet .

For example what is their educational background, where are they from and where have they worked. It is good to consider what is the reputation in the business world and what experience relevant to business success has been accumulated. It is good to also list the skills, qualities and knowledge that the entrepreneur team has. It should be evalueted how realistic is it that the team will be able to implement the plan and how the team can meet the challenges ahead along the way. It is important to consider who else there should be in the

team so that the skills are enough to implement the plan. It is necessary to evaluate the team`s capability of recruiting top level professionals and does the team have the ability to make the difficult decisions required in business. It is crucial to take into account how committed they are to the business and what are their motivators .

In start-ups, investors emphasize the credibility of the entrepreneurial team. Even if a business idea is very attractive, but the entrepreneurial team is not credible enough to implement the business idea, investors often back down. Investors are more interested in entrepreneurial pitches that often include a summit-up of the problems that a business is trying to solve or how the business provides a unique solution to its customers. (Ekhardt 2006.)

2.3 The importance of the company’s strategy

A good strategy has three features: focus, difference, and motto. These set the company apart from other competitors with its value curve. A company must have certain characteristics on which to focus and differentiate itself from competitors by creating something new instead of comparing itself to competitors. Motto on the other hand guides the way of thinking to elevate the value curve. (Kim & Mauborgne 2014.)

The focus of the strategy should be clearly reflected in the company's strategic profile. If a company emphasizes different things than its competitors, it will be able to meet the needs of its customers better than its competitors and save on costs. In pursuit of a unique strategy, the strategy cannot be determined in response to the actions of competitors. If competitors behave in the same way in relation to each other, they have a similar value curve. It does not serve as a basis for the pursuit of the Blue Sea. (Kim & Mauborgne 2014.)

3 Example of tools that investors use during their decision making process: What should executives consider before start making efforts to market the business plan to venture capital investors?

3.1 Seven domains analysis model

John Mullins (2003) summarizes the requirements of venture capitalists for the content of a business plan. A successful investor bases a superficial analysis of a potential investment on certain conditions of success in which case a quick analysis can discard the investment or continue its analysis further.

According to Mullins (2003) The aim of the seven domains analysis is to analyze the industry, the market and the management team so that an overall picture of the company's opportunities is outlined. A total of seven characteristics are scored separately in the review, three of which relate to the management team, two to the market and two to the industry. The levels of analysis are as follows:

- Macro-level market analysis: The attractiveness of the overall market, i.e. how large the market is and how fast it is growing, whether the trend is positive or whether there is an opportunity to create one.

- Micro-level market analysis: The attractiveness of the target segments, ie whether there is a clear customer need, whether the need can be clearly better met with current solutions, how fast the segment grows and whether it opens access to other markets.

- Macro-level industry analysis: The attractiveness of the industry, i.e. Porter's 5 strengths; threat of entrants, power of buyers, power of producers, threat of substitute products and power of competitors.

- Micro-level industry analysis: Permanent competitive advantage, ie. how well a company can protect itself against imitators after achieving market leadership and what are the barriers to entry and opportunities to protect the business model from copying. In addition, this includes the attractiveness of the business's earnings model.

- Management Team Analysis: mission, passion, and risk-taking, i.e., whether the industry matches personal interest, and whether the entrepreneur wants to grow to create a growth company or a personal source of income.

- Management team analysis: Perception and implementation of critical success factors, ie the ability to implement the developed plan.

- Management team analysis: Contacts up, down and across the value chain, ie contacts to the customer interface, producers and important gatekeepers.

Seven domains analysis should not be interpreted in the form of a scoreboard alone by adding points. Instead the more important criteria are certain domain pairs that support each other. After scoring individual domains it is recommended to look at each domain from the perspective of the business model as well as other domains. Niche business is subject to different rules than broad market targeting, and some domains are more valuable than others. The analysis should be performed as follows:

- The attractiveness of the overall market - Highlights alone are not enough to make a business a success, and in a niche market, high points

can even be dangerous if it is difficult for the industry to gain a lasting competitive advantage. Micro-market analysis must also be accurate in order to gain a competitive advantage in an attractive market. Bad scores are not necessarily a problem if segmentation can provide a clear added advantage over competitors. In this case, the team's ability to implement critical success factors also becomes very valuable.

- Attractiveness of the target market and customer benefits - In the case of a niche market, a certain identifying and meeting the needs of the segment alone will make starting a business profitable. In the wider market, the combination of a clear customer benefit, a strong team and the permanence of a very attractive industry / competitive advantage are very good conditions for the interest of private equity investors. Poor customer satisfaction or lack of differentiation almost invariably leads to business idea failure. If the business model does not in some way provide a superior benefit to customers compared to competing products, it is worth rethinking or rejecting at an early stage.

- Attractiveness of the industry - In the case of a niche business in a highly attractive industry, the business model will work even if the sustainability of the competitive advantage or the entrepreneurial team is weak. Wider scaled market not only an attractive industry is enough, but a clear competitive advantage is needed concept and a strong entrepreneurial team. Weak industry attractiveness does not necessarily lead to a business model rejection, as a well-differentiated and clearly value-added product or business concept has the potential to compensate for a weak industry.

- Lasting competitive advantage - A strong lasting competitive advantage is not enough in itself if there is no competitive advantage originally big enough to compete successfully, so the product is be sufficiently differentiated to stand out. Weak persistence of competitive advantage

does not necessarily lead to a business model rejection, but raises the bar for success. In this case, it is crucial to achieve and maintain the interest of the first player through a brand name and a good reputation (eg eBay).

- Mission, Passion, and Risk-Taking Capability - Determines how well the team's mission fits into investors 'goals. If the mission is in a different industry than the investor, no investment can arise. The entrepreneur should look for investors with a normal investment amount the entrepreneur's need for money. If an entrepreneur is looking for an investment of € 200,000, he or she should look for business angels rather than private equity firms with investments starting at € 500,000.

- Perception and viability of critical success factors - Without evidence of the viability of success factors, funding is difficult get. The ability to implement the critical factors required for business success is the most important characteristic of a management team. In addition to the micro-market, this is the single most important factor influencing the financing decision.

- Contacts up, down and across the value chain - The number of contacts is easy to compensate with the contacts of venture capitalists, so the weakness of this domain will not result in a negative funding decision if the other domains are in order.

3.2 An analysis of Porter's five competitive forces as an investor tool

Porter's (1985)analysis of the five competitive forces examines the business idea from five different industry-related factors, namely: the threat of a substitute product, the threat of a new competitor, the intensity of competition, the bargaining power of customers and suppliers.

- Threat of a substitute product looks at the existence of the nearest existing substitute product / service and threatens to crowd out innovation.
- The threat of a new competitor looks at the barriers to entering the industry or how much money to invest when entering the industry.
- Intensity of competition is the most important point for most of the sectors. Here we look at e.g. the number of competitors.
- Customers' bargaining power consider, for example, customers' purchasing power, volume, leverage, customer loyalty or, for example, the customers´ reactions to price changes. The intention is to delve deeper into subcontractors, such as suppliers of raw materials, to provide a service, or to what unexpected costs may arise if a raw material or factor of production is depleted or its price has risen.

3.3 Pest analysis as a tool for investors

The PEST analysis examines factors at the micro and macro levels that cannot be influenced by an entrepreneur or company through their own actions. Several factors related to the operating environment make the market an attractive.

- Political perspectives: From a political perspective, the analysis looks at many different areas such as legislation, trade principles, the potential threat of war, corruption, taxation and political balance.
- Economic perspectives: When looking at economic aspects, it is necessary to take into account e.g. inflation and interest rate growth in each country, income levels, overall economic growth, interest rates, labor costs and financial market efficiency.
- Social perspectives: From a social perspective, we look at class differences, demographic factors, level of education, culture, the country's entrepreneurial spirit or, for example, the national attitude.
- Technological aspects: This section looks at the business idea from the perspective of new technological inventions. In other words, what is new and innovative has entered the market which makes it possible to reduce fixed/variable costs in the service/product chain, create more efficient production or create a completely new service / product need for people

4 Conclusion

In start-ups investors emphasize the credibility of the entrepreneurial team. Even if a business idea is very attractive but the entrepreneurial team is not credible enough to implement the business idea, investors often back down. When talking about a business opportunity investors often ask questions about the business plan and its content. If investors' questions have been answered successfully and investors feel they want to move forward with a start-up, the company's strategy will begin to be looked at more and more closely.

4.1 ABC for executives who market their business plan to investors

Entrepreneurs and executives should recognize both macro-level and micro-level time dimensions while marketing the business plan to venture capital investors. The macro-level comprises the venture's overall evolution from concept to exit, "living dead" or failure. The micro-level trails what ensue from the start-up's first contact with potential investors through the point at which an venture capital investor or "business angel" makes an investment decision about the business idea.

A typical venture investor will review on the order of thousands of potential investments annually and will usually make investments in less than five per year. On average only one in ten of companies that have received a first round of capital investment brings a large return to the investor. Two or three out of ten investments survive as operating companies until the exit,, two go bankrupt and the rest of the companies end up as "living dead" meaning they survive but growth stops. (Campbell 2003.)

Venture capital is a highly cyclical sector and companies ability to

access venture capital varies depending on market sentiment from very readily available resources to very tight cash taps. An extreme example of this was probably the IT bubble at the turn of the millennium, where almost every IT company with even some kind of business plan received risk money. Internet technology was believed to be the money spinner of the future but in reality hype and flawed earnings models led to the burning of billions.

According to my study the three main factors (ABC) that entrepreneurial team should be aware of before starting to make efforts to market business plan to venture capital investors (ABC) :

A) Importance of pitch

The entrepreneurial pitch has become an important part of an entrepreneur's marketing toolkit and the purpose of the pitch is to reduce information asymmetry and convince potential investors of the attractive risk/reward profile associated with the product or market or team. Pitch itself should be short, sharp and clear that investor can understand it easily.

B) Business opportunity & Entrepreneurial team

In the financing decision in investors mind the entrepreneurial team is considered more important at the early stages of the business' development when the business opportunity becomes increasingly more important as the business grows (Kaplan *1995).* Similarly as the business grows along the time the quality of its financials become more important when it comes to the investment decision- making process (Mason and Harrison 2003).

Whereas previous studies sought to understand whether venture

investors consider the entrepreneur or the opportunity to be most important in investors decision making process.

C) Company's strategy

A good and clear strategy has a memorable motto. It conveys the message and advertises the offer truthfully. If this is not the case, customer; in this case investor, confidence and interest will decline, weakening the strategy and decline investors interest towards to the business plan. Once the focus, difference, and motto are discovered and in place, the value received by the company as well as the customers increases. (Kim & Mauborgne, 2014.)

4.2 Final words

Because no one can really know which company will succeed private equity investors often follow each other's example in their investment decisions. Investors trust that if another professional is willing to invest, the investment is good enough.

The venture capital cycle then begins sensitively when the best venture capitalists make an investment decision in new and difficult-to-understand properties. Rapid increases in value are attracting other investors as well, and this oversupply of capital is rapidly raising the value of investment targets even further. As money is cheap and loose, more and more imitators are appearing in the industry, which further intensifies competition. Eventually, the bubble will burst as survival in the industry becomes increasingly difficult for companies due to fierce competition. During a downturn few private equity firms make

any investments at all but investors follow each other again:. (Campbell 2003.)

To conclude, be a winner in investors eyes you have to be in right place in right time and with right team and right business plan. It is not easy goal to achieve but it surely can be done, if the ABC is carefully considered.

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