As an early stage investor, Serra Ventures will review approximately 500 deals a year from a variety of sources. It's essential, therefore, to establish strict criteria for deal evaluation – so that the truly superior deals can be separated from the “very good.” What makes a deal truly “right” for our fund? What are the high level evaluation criteria we use when making our investment decisions? Like other early stage funds, Serra Ventures has created a set of criteria to guide our team through this challenging process. We call it the Bill of Rights.

There's an old proverb that says, “If you really want to understand someone, walk a mile in their shoes.” Our goal in publishing this white paper is to help teams from start-ups (who are seeking to become a Serra portfolio company) understand where the Serra team is coming from as it evaluates your particular deal.
RIGHT TEAM

Selecting a company with the right team is perhaps the most important criteria in the Bill of Rights. Without the right mix of people to execute the plan, most great technologies will fail to find market traction and sustained success will not be achieved. As investors, we’re making a critical judgment call not only on the competence and skill of the team, but whether or not the team is one that we can work well with. From the very initial interactions, does the team appear teachable and flexible? Do they exhibit core strengths, yet display a sense of humility?

Meeting the team in person and spending some meaningful time interacting is a must before making an investment decision. This allows for the close observation of the team’s interaction with one another – and with us. Through multiple touch points, we’ll typically be able to discern the quality of the team’s chemistry and the degree to which they respect one another.

One of the basic elements we evaluate is the mix of technical and business talent. Does the team have both? On one side of the equation, is there a strong business lead, with requisite experience in the industry? Someone who has “been there and done that”? On the other side, what’s the composition of the technical team – its scientists, developers and engineers? A strong team is a diverse and well balanced team.

Finally, do we believe that the team has the ability to be resilient in the face of challenges and failures? Nearly all of our 60 portfolio companies have met with setbacks -- from timetables shifting, new competitors entering the market, difficulties in fundraising and departures of key team members, among other problems. It isn’t a matter of “if” there will be challenges, but when. Resilience will be essential in weathering the inevitable storms of start-up land. And while there isn’t a crystal ball in making this evaluation, one of the key predictors of resilience is the prior track record of the individuals involved. Have they demonstrated success in previously challenging situations? Have they persevered and how have they done so?

RIGHT THING

So – assuming we have the right team -- does the team have the right thing? At the heart of every company is a particular solution for a particular problem in a particular marketplace. We call this the company’s reason for being – and it needs to be compelling.

Our investment team is apt to focus on companies that have a novel, market-disrupting technology that is solving major problems or “points of pain” in the marketplace. Another way to look at this is that the company’s offering to customers should have a strong “value proposition” – a powerful collection of specific reasons why customers should embrace this particular solution over others.

And we’d also like to know – is the product or service offering founded on protectable intellectual property (otherwise known as the secret sauce)? Have patents been filed, prosecuted and granted – or are they in process? Are additional developments in IP contemplated, and over what period of time? Has an “IP strategy” been conceived to optimize the competitive positioning of your technology? These are all important questions as we survey the landscape of competing solutions in the marketplace.
An Early Stage Investor’s Bill of Rights

September 2016

SERRA VENTURES

RIGHT MARKET

Every business idea needs the right addressable market in order to have a chance at becoming a success story. And while this might seem obvious, it’s one of the key items that prospective portfolio companies often get wrong when pitching investors. First, the market must be easily identifiable and must be specific (no, we aren’t impressed by so-called platform technologies that are targeting ten markets). Second, the company’s addressable portion of that market must be well understood. Is it really quantifiable, using bottoms-up math as opposed to sweeping generalizations along the lines of “…if we just penetrate 2% of the overall market, we’ll see X millions in revenue.”? And, of course, the target market must be large (for Serra, we like to see markets in the hundreds of millions if not billions) and growing at a respectable rate.

A survey of the company’s target market will often reveal other competitive players. That’s not a negative – rather, the right mix of competitive players can be a validation that indeed a real market exists. But the corollary to this is that the company’s offering must be differentiated in a meaningful way from the other offerings. Is it much easier to use? Is there lower friction to customer to adopt the solution initially? Does it deliver better results or cost less? Is it more feature rich? Is the customer incentivized to engage more robustly on an ongoing basis? A well differentiated solution that is showing real evidence of market uptake is what we’re really looking for.

RIGHT STRATEGY

Next item on the list? The business model for bringing the product/service to market must be well conceived – and of course, must be carefully executed. We’ve seen many examples of the right product targeting the right market, yet struggling due to a poor business model or poorly executing a decent business model. A well developed commercialization approach is often reliant on a management team with prior experience in the space, or deft ability to surround the company with seasoned advisors and partners.

But even the most well conceived strategies may encounter unforeseen problems. Business is an imprecise science, to say the least. Teams must be able to react to market conditions, particularly competitive forces and the changing dynamics of customer expectations, implementing pivots in strategy as necessary. Investors will often drill deeply to explore the team’s track record in previously making successful pivots in strategy. It’s a key predictor of how they’ll handle future situations.

And while we’re on the topic of strategy, we’d be remiss not to mention that said strategy must be fundable with a reasonable amount of capital. The funding being sought must ensure a reasonable “runway” of time (typically 18 to 24 months) for the strategy to play out. And the funding amount must be in alignment with what the capital markets will provide. We’ve seen numerous examples of companies seeking extraordinary amounts of capital – but the market appetite for providing the capital is for something more modest. At Serra, it is important for us to see achievement of strategic milestones using more modest amounts of capital – and deferring commitments of larger amounts of capital until a Series B or C round is warranted.
The meaning of “right timing” involved with any given investment is fairly straightforward. All of the previously discussed points need to come together in the right timing – for the company, for its customers, and for the investors. And while the concept of timing is simple enough to understand, getting it right can be quite difficult. That’s because there may be a variety of market factors in play that are essentially non-controllable. Our team has seen many examples of companies that were “too soon” or “too late” to the marketplace with their solution, perhaps through no real fault of their own.

Not only does the company need to be entering the market and serving customer needs at the right time, but the company’s request for capital needs to fit timing-wise with the availability of investor capital. This one is often difficult for teams to understand or respect. Investors manage a multiple-variable equation of raising capital from limited partners, evaluating numerous deals at any given time, deploying initial amounts of capital to selected deals and then reserving appropriate “dry powder” for potential future rounds. This is not an easy process to manage – and it comes with some unpredictability in its own right.

The timing involved with investment is fairly straightforward. All of the previously discussed points need to come together in the right timing. There are a lot of examples of companies that were “too soon” to the marketplace with their solution. Or on the flip side, there were several that were too late.

Right Economics

At Serra, we are committed to being disciplined to do deals that are at the “right pricing” and the “right terms.” Investing at the right economics increases the odds of a successful exit down the road. And while we see plenty of very attractive companies, we’ve turned down our fair share of high flyers due to economics that were outside of our acceptable parameters. It’s really, truly a matter of mathematics. To produce a target return of 10X for our limited partners, we need to be selective in identifying those deals that have a reasonable chance of returning the right exit values. And that, more often than not, means starting with the right economics out of the gate.

“Coloring outside the lines” on economics can get an investor into big trouble. So forgive us for being sticklers on this particular point – and understand that we’re shooting for a win-win-win solution for company founders, our investment team, and our limited partners.
Ah, yes. We have to admit it. Checking all of the above boxes is essential. Rigorous due diligence is a must. But when all is said and done, every deal we do must have a certain “it factor.” More specifically, this is a combination of intangibles that are present in a deal that make it particularly attractive – helping to elevate and separate the deal into a rare category. And while it’s hard to nail down a definition, it is some wonderful combination of a team that is seasoned, sharp and humble; a novel and powerful solution that is solving a big problem in a beautiful way; a vibrant chemistry that exists between the team members and the investors; a strategy that is bring the company’s offering to the market doorstep in just the right way and right timing. And, yes, we have to use an intuitive sense to discern which deals do indeed have the “it factor”.

We trust the guidelines outlined in this paper will be an encouragement and a help as you seek to build your high performance entrepreneurial organization. We wish you all the best in accomplishing just that!