

What Entrepreneurs and Angels Should Do *Before They (You?) Dance*

John Mullins

London Business School

Let's Face an Uncomfortable Fact

- Fred Wilson: Union Square Ventures
 - “The amount of money that start-ups raise in their Seed and Series A rounds is *inversely correlated* with success.”

Why Might This Be So?

- Talk with your neighbor
 - 2 minutes
 - 3 top reasons, please

Why Might This Be So?

- My take on it:
 - Too much money makes you sloppy, stupid
 - Plan A rarely works. But your funder wants you to (flawlessly) implement it anyway!
- Question for angels: Might it be wiser to wait and fund customer traction, instead of a plan?

So, What Should Entrepreneurs and Angels *Do*?

- Here's what you probably should *not* do...



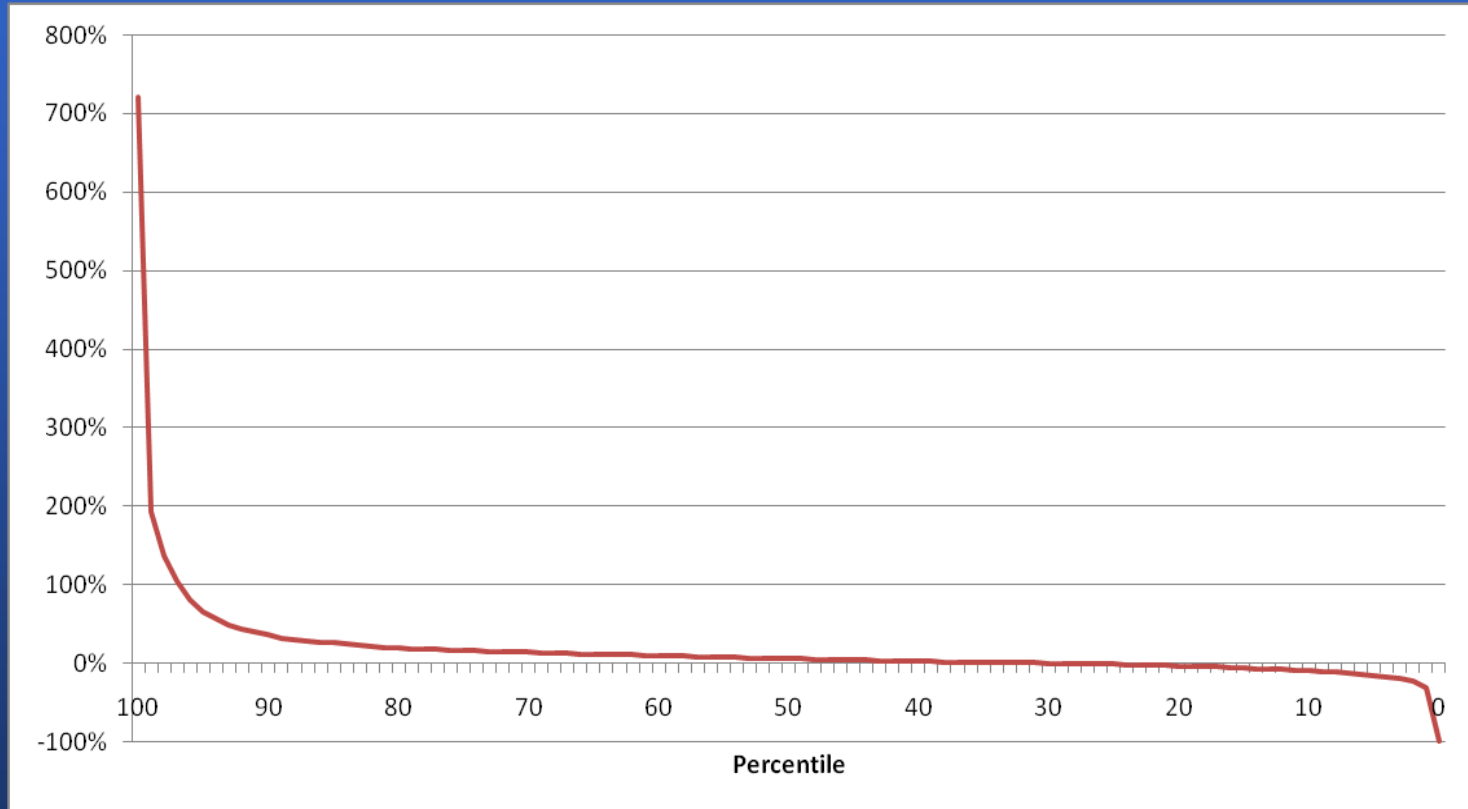
So, Would You Invest in Ali G?

- Fact: the vast majority of fast-growing businesses *never* raise venture capital (nor write business plans, either)
- Nor should they, at the outset, I argue: why?
- Raising capital too early – whether from angels or VCs – is a dangerous practice, on both sides of the table

The Killer Drawbacks of Raising Capital Too Early

- Distraction: takes the entrepreneur's eye off the ball, now, and later, too
- Higher risk = lower stake for the founder
- And the baggage that comes with it in the shareholders' agreement
- Is this good news for the investor in such a deal?

Let's Consider Some Evidence: US Venture Fund Returns



So, Is There an Alternative? The Customer-Funded Business



Is Anything New Here?

- Pay-in-advance models: Consultants, architects, Dell. Nearly all services, too.
- Matchmaker models: eBay, Expedia
- Subscription models: Periodicals, Netflix
- Scarcity models: Zara
- Service-to-product models: Microsoft
- But let's look at some savvy 21st century entrepreneurs putting them to use

Vinay Gupta 2006: A Pay-in-Advance Model



Brian Chesky & Joe Gebbia 2007: A Matchmaker Model



Krishnan Ganesh 2005: A Subscription Model



Krishnan Ganesh 2005: A Subscription Model



Jacques-Antoine Granjon 2001: A Scarcity Model



Balder Olrik, Claus Moseholm 2003: A Service-to-Product Model



These Examples Share Three Attributes in Common

- Negative working capital – love thy float!
- They required essentially *no* external capital to get started
- When they did raise capital *to grow* once the concept was proven, there was an eager queue of angels or VCs lined up at their doors

Not Just for Start-Ups



Not Just for Pioneers, Either



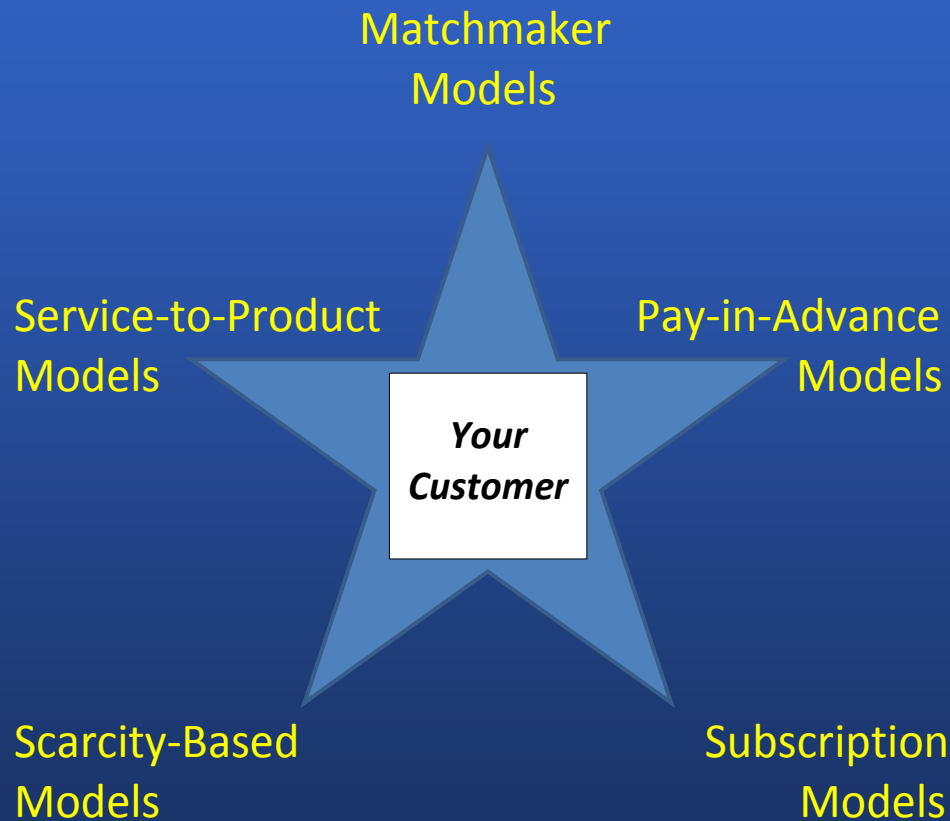
So, What About *You*?

- Which one of the five models might be put to work in *your* business now?
 - Pay-in-advance models
 - Matchmaker models
 - Subscription models
 - Scarcity models
 - Service-to-product models

Talk with your neighbor

- 2 minutes

So, Which Did You Choose?



OK, “So What?”

As an Entrepreneur or an Angel, What Should You *Do*?

- First, what NOT to do
- Prepare (or ask for)
 - Pages of prose
 - Reams of spreadsheets
 - All in support of the perfect Plan A (that probably won't get you where you'd like to go!)

OK, “So What?”

As an Entrepreneur or an Angel, What Should You *Do*?

- Mark Suster, Upfront Ventures
 - “I say ring the freaking cash register. I have said so for years!”
- If you’re an angel, tell your entrepreneur
 - “Come back when you’ve used one of the five customer-funded models to secure some *paying* customers – and I’ll then help you grow!”

So, Is Venture Capital – from Angels or VCs – Bad for You?

- Not necessarily. It's the timing that concerns me.
- And it concerns Mark Suster and Fred Wilson, too!
- If you've got a venture that's firing on all cylinders, perhaps *yours*, that's when to add fuel!

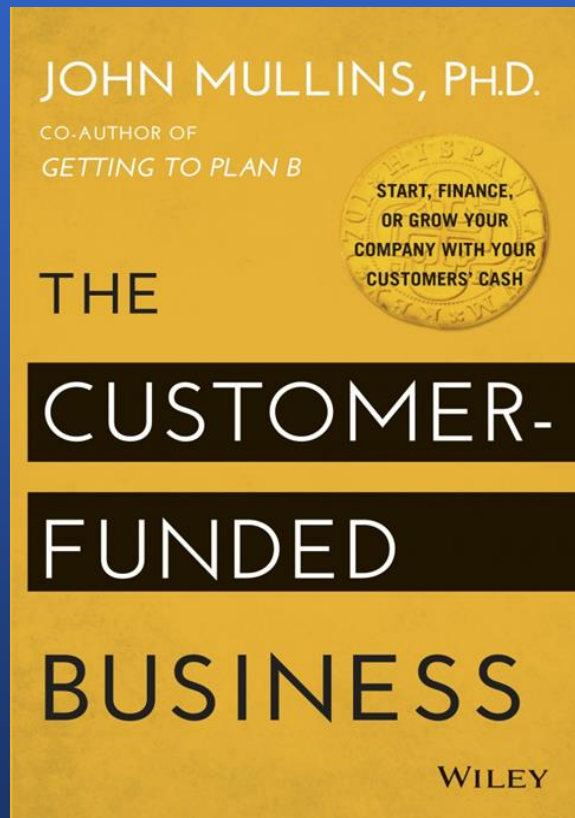
To Be Clear...

- Note that nothing I've said here is anti-angel or VC
- Angels and VCs have their time, place
- But consider the rejection rates
 - YCombinator 97.1%
 - Angel List 98.9%
 - Andreessen Horowitz 99.3%
- Is customer-funding a better way to go?

A Final Observation on the Business Plans You'll (Hopefully Not!) Get to Read

“We believe that...”

For the “When-to”, the “How-to” and the Pitfalls to Watch out for...



David Rose, NY Angels
“*The Customer-Funded Business* should be mandatory reading for every entrepreneur before *even thinking* about seeking angel or venture capital.”

In a Nutshell...

*“The customer is not just king.
He can be your VC, too!”*

Bernie Auyang
Angel Investor
Shanghai

Questions?

jmullins@london.edu

www.TheCustomerFundedBusiness.com
[@John_W_Mullins](https://twitter.com/John_W_Mullins)