Pitch evaluation – what are deal killers?

Purpose:
This article has a two-fold purpose

1) Encourage startup founders to research the deal-killer evaluation criteria used by investors to quickly determine whether to devote further time to learn about a startup. Given the massive number of startups looking for funding, time constraints force investors to be able to say "no" as quickly as possible.
2) Encourage board of directors and CEOs of established companies to also develop their own deal-killer criteria as a filter for the many proposals and recommendations made to them.

This article:

1) Reflects my personal point of view. Investors, board of directors, and CEOs will have their own deal-killer criteria.
2) Is not intended to score a pitch or enable a relative ranking of pitches.

My deal-killer criteria are based on 3rd party research regarding the 3 greatest contributors to startup failure?[1]
This research study analyzed 101 startup failures and identified the most frequently cited reasons for failure. Usually there were several reasons for failure.

1) 42% of the time built a solution looking for a problem i.e. no market need.
2) 29% of the time running out of cash.
3) 23% of the time, not the right team.

Deal-killer criterion #1 What is the size of the market need?
How many customers believe they have an urgent enough problem or need that they

1) Are willing to spend money to address;
2) Have the money to address;
3) Have put a value, including what would pay, on addressing the problem or need.

<u>Has the pitch described the customers' value-proposition?</u>
This is the customers perception of value. What are all the financial and non-financial benefits achieved? e.g. time savings, convenience, status, reducing negative emotions or risks, benefits achieved (financial and non-financial) achieved by the customers? What are all the financial costs incurred by the customer (purchase costs, costs to switch to your company, other adoption costs, ongoing costs and non-financial costs (e.g. time, social status, existing relationships, etc.)

To understand the customers perception of value requires direct input from potential customers, by a combination of interviews and surveys. Most of the pitch I hear reflect the either the founders opinions/hopes of the startup or a one-page slide showing market size in the $10s of billions, based on a consulting/research study. These startups are taking the "build it and they will come approach" of first creating the solution and then hoping that there are customers.

<u>What is TAM (Total Addressable Market)?</u>

1) What would be the startup's revenues with their future solution if 100% of the global customers demanding a solution to their problem bought the startup's solution? TAM is the case with no competitors.
2) The solution built in the first 12 months is only a subset of the solution which in 5 years time will address TAM i.e. TAM depends upon the specific nature of the solution at a point in time. Note the phrase "demanding a solution". You must not include in TAM ghost customers who are not demanding a solution. If customers don't know they have a problem and are not demanding a solution, the startup is planning to fail.
3) There is a critical difference between customer needs and customer demands. Customers have a large number of needs. Demand is customers deciding that they will spend time, effort, and money to get a solution for what they believe is an urgent need. Often this means that customers will spend less money to meet other needs.
4) Is the startup's TAM large enough to launch and grow the company? For example, the global smart phone TAM is huge, but the global TAM for smart phones that have a keyboard is tiny.
5) The best way to calculate TAM is with a bottom up calculation, starting with a clear description of the target customer segment, its needs, and then considering the subset of customers who will actually provide revenue, and the revenue per customer. Recognize not everyone in every country will be able to afford the solution.

What is SAM (Serviceable Addressable Market)?

1) This is the portion of the TAM that is within the reach the startup's distribution channels and partners, and your ability to deliver and support your solution. Geography may be a constraint. This still assumes 100% market share of those customers demanding a solution. SAM will change over time, as growth occurs in geography, the number of distribution channels and partners, and the volumes from each distribution channel and partner.
2) How will customers connect with the startup? If they are seeking a solution, how will they find the startup? How will the startup make customers aware of the solution?

What is SOM (Serviceable Attainable Market or Share of Market)?

SOM will be lower than SAM for two reasons: the startup may have competitors, and every customer who is demanding a solution may not actually buy a solution.

Deal-killer criterion #2 When will the startup run out of cash?

This is rarely presented in the pitch. If there is time, follow-on questions can provide insight:

1) How many months out does the monthly cash flow forecast go (many startups lack this)?
2) Given current customer income and costs plus existing cash in the bank, how many months until cash is gone?
3) Assuming that there are three future forecasts, how many months until the cash is gone in the most conservative forecast?
4) How many weeks have they assumed that it will take to close the current financing round?
5) How many weeks have they assumed from the end of the current financing round until the next financing round?
6) The average seed stage round takes 12 ½ weeks. 20% of the startup require 20 weeks or longer. 20% of the startups require 6 weeks or less.[2]
7) A fund-raising round can take a long time. This research study examined 13,916 financing events.[3] The average time between fundraising rounds was 20.6 months. The time between rounds ranged from 6 months, to 35 months, 68% of the time. i.e. 16% of the time less than 6 months and 16% of the time longer than 35 months
8) The above fact-based research was done prior to COVID-19.

Deal-killer criterion #3 Does the team have relevant experience?

1) Assess the skills and experience requirements implied by: the target customers, the value proposition, the nature of the solution to be built, the needed partners and suppliers, etc. Have the founders demonstrated that the team (which includes investors and advisors) has the relevant experience, skills, and network.
2) Most founding teams have gaps. Have the founders identified the gaps and milestones to close the gaps.

How do I use the deal-killer criteria?

I focus on whether the founders are doing the right thing, that they have the right approach and mindset. I don't expect the perfect research and perfect analysis.

Deal-killer criterion #1 What is the size of the market need?

1) If the founders do not believe they need direct input from customers, the deal is dead. Most of the startups I meet fall into this category.
2) If the founders market size slide shows a massive number and at the same time does not reflect understanding of TAM, SAM, and SOM the deal is dead. I cannot tell from a pitch if the founders don't understand the concept or are being deliberately deceitful. Unfortunately, many founders are not coachable on these concepts. I've also met deceitful founders.

Deal-killer criterion #2 When will the startup run out of cash?

Founders rarely give enough information in a pitch to assess this. There's rarely enough time in a pitch Q&A session to ask the detailed questions regarding cash flow. The questions can be a follow-up action for the founders after the presentation. This is a deal-deal killer if:

1) The monthly cash flow forecast does not exist.
2) The founders have an extremely optimistic view of how quickly funds can be raised.
3) The founders are already almost out of cash.

Deal-killer criterion #3 Does the team have relevant talent and experience?

1) I don't expect the team have had a long history of experience in the target marketplace, target technology, etc. Historical knowledge often becomes obsolete. What's key is current knowledge and the mindset to keep that knowledge up-to-date.
2) I expect that the team has learned about the customers, the customer perception of value, competitors, partners, technology etc.
3) The team includes: founders and key leaders, advisors, board directors, and major investors.

Your next steps

1) Define you own deal-killer criteria.
2) Define in detail the criteria and process for evaluating the team's relevant talent and experience.
3) Pitches for major change to an established company (e.g. transformation) will require a third party to assess the board of directors and key advisors and consultants for their relevant talent, skills, experience, and personal networks.