Thinking Like A Venture Capitalist by the Wolverine Fund

Have you ever watched an episode of Shark Tank and wondered what makes a Shark want to invest in a company? Although Mark Cuban and Kevin O'Leary make investing look easy, it's much harder that it looks! The Sharks are venture capitalists, meaning that they provide capital (money) to companies with the potential for growth in exchange for equity stake. Behind those million-dollar deals the Sharks have thought through all the elements that could get in the way of them making their money back. These elements include things like industry growth, strength of the company management team, and much more. How do the Sharks sort through all that information and determine the risks, you might be asking? Well, to help you understand, an example of a simple venture, one that you have likely done before as a child, is explained below. By the end of this document, you'll know exactly how to think like a venture capitalist.

To start, let's look at the two basic principles of venture capital:

1. Investing

2. Return on Investment

Now, let's review these principles in the example provided below:

The Parable of the Lemonade Stand

Lesson #1. The Idea and Creating the MVP (Minimum Viable Product)

As a child, it is likely that you ran a lemonade stand once or twice. That was a business venture, even if you didn't understand that at the time. Imagine now that you are the CEO of a lemonade stand. . In business terms, you would be considered an entrepreneur working on a start-up **venture**. You and your friends are brilliant entrepreneurs selling lemonade and solving the world's problem of quenching thirst on a hot summer day. To start the lemonade stand you'll need materials including:

- Lemonade powder (Cost of Goods Sold)
- Water (Cost of Goods Sold)
- A Pitcher (Cost of Goods Sold)
- Ice (Cost of Goods Sold)
- A mixing spoon (Cost of Goods Sold)
- Cups (Cost of Goods Sold)
- A table (Real Estate)
- A poster board and markers (Marketing Expense)
- Location to sell lemonade (Real Estate Lease)
- Friends to help you sell, maybe someone to dance with the lemonade sign (Employee)

All of those materials cost money. Now as a kid with little to no money you probably just took stuff out of your pantry that your parents bought. If you didn't have any of the needed supplies in the pantry you would need to find funding to buy the supplies. You ask your parents for $15 to get the supplies in exchange for a small stake in your business. In venture capital terms, your parents are the investors, the $15 is the investment, and your lemonade stand is the venture.

Lesson #2:inding Capital & Due Diligence

Because they are your parents, they probably give you the money, no questions asked. However, in the world of venture capital, your parents are savvy investors who want to get the most out of their money. They are going to invest in the best lemonade company that they can find, so they are going to do due diligence, more commonly known as research, on various lemonade stands. They will see what kids are doing on the other side of town, the ratio of lemonade powder to water they are using, how natural sugar vs. high fructose corn syrup is selling, who is offering the best deal on lemonade mix. All of this research just to see if your lemonade stand is the best investment for them. You understand this, because you did the same thing before you bought Costa Vida instead of Wendy's for lunch last week. You thought about what you wanted to put in your body and how much it would cost, and you decided that a salad at Costa Vida was a heathier option than the greasy hamburger and you bought it. .

After doing some research, your parents agree that you and your friends have the best product, but they want something in return. Remember venture is about two things, **investment** and **return on investment (ROI)**. Your parents expect ROI for the cash (capital) that they put into your venture.   they ask for their $15 back plus 25 percent of whatever else you make that day.

Lesson #3: Negotiation and Due Diligence

As the entrepreneur, you think to yourself, *"25 percent? Are you kidding me? I'm doing all the work, you money-hungry savages!"* As you might have guessed, that won't go over well, so instead you say, "Mom and dad, thank you for meeting with me. I want you to think of the life lessons I am learning with this venture. I'll learn hard work, integrity, and salesmanship, skills that will benefit me throughout the rest of my life. . Additionally if I become majorly successful, I will be able to take care of you in your old age. As my business grows, I'll be able to afford a ring, get married, and then provide you with grandchildren. I know you want grandchildren. Surely that is a worthwhile investment?Tell you what, I'll give you 15 percent now and a promise to give you lots of grandkids by the time I'm 40."

Your parents think on it and agree, but with the stipulation that they get to decide the rest home that you put them in. Your parents drive a hard bargain, but you agree

In venture terms, your parents are **Venture Capitalists.** They are investing money, or capital, in your lemonade stand so that you can acquire materials, start a business, make money, and hopefully provide them a return on their investment. Venture capital is aboutthe investment and the return on investment, which is something we do all the time. Let's list some other examples.

Other Every-day Examples of Venture Capital:

Education: If you **invest** money in a degree or certificate now, you expect some kind of **return** later. You do the research or diligence on what college you want to attend and what skills you want to learn in order to determine where you will spend your time and money. You'll look at things like the ranking of the school, majors provided, and perhaps the success stories of the school's alumni. You make an educated investment in order to gain a significant return on investment, in this case, by becoming a qualified job candidate.

Buying a Car: After years of saving, you have enough to buy that beautiful Tesla that has been on back order since 2018. But why buy a Tesla and not a Toyota, Ford, or Cadillac? Why buy the Model 3 and not the Model S? You have most likely thought long and hard about these questions and many others before laying down the $75,000 to get that work of art in your driveway. You do the research, make the investment, and end up with a beautiful car that will last a long time, which is the return on investment.

You can think of other examples, dating, marriage, kids, jobs, grocery shopping, etc. You are acting like a venture capitalist every day, probably without even knowing it! Just like the Sharks, you are looking to get "the most bang for your buck" with the hope of getting a significant return, be it money, experience, or other elements. To return to our previous analogy:

You don't always get to determine the return, but you do get to decide whether to invest. Ask yourself, is the lemonade worth the squeeze?

<u>Key Players:</u>

You and Your Friends = The Entrepreneurs

The Lemonade Stand = The Venture

Materials and Location = Cost of Goods Sold (COGS) and Real Estate

The Parents = The Investors (the Venture Capitalists)

Asking for Money/Materials = Negotiation on Terms