IntelliVen, L.L.C.
Intelligent Strategies...Successful Ventures

Intelligent Venture Evolution

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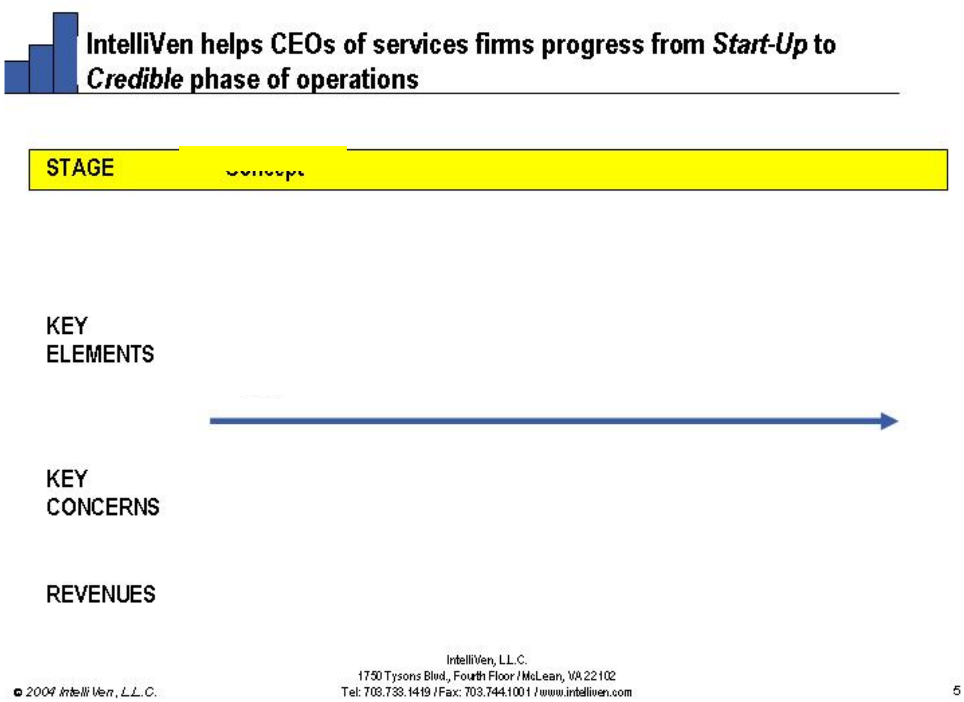
Summary

Ventures almost always progress through five growth phases:

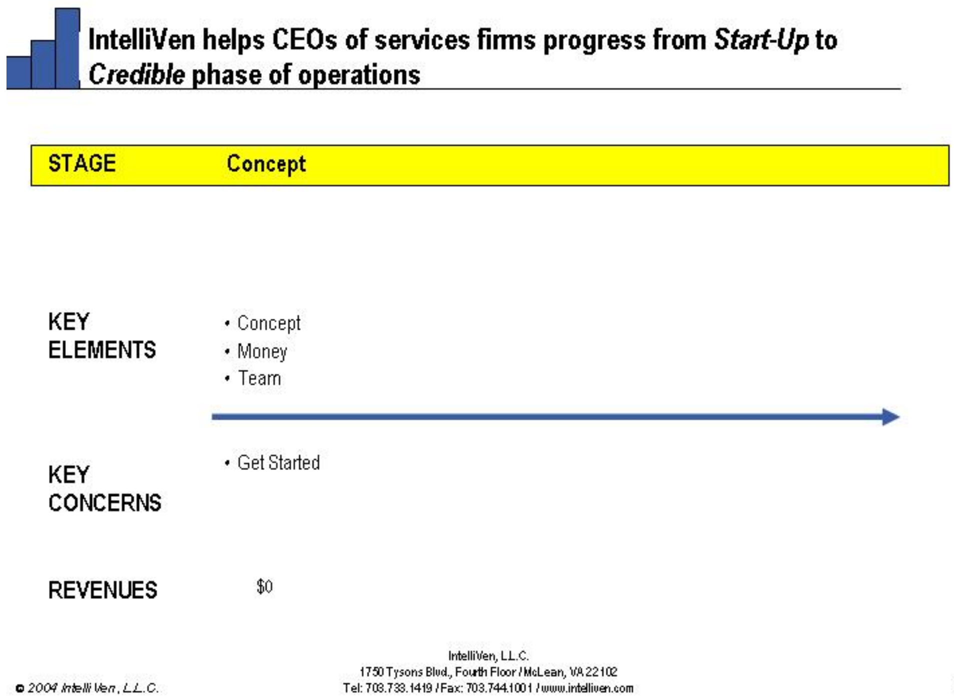
- Concept,
- Start-up,
- Credible,
- Sustainable, and
- Mature.

Each phase is defined in terms of its key elements, business agenda, economics, and key concerns:



This note describes these phases and their implications for managers and investors.

Concept



A venture commonly starts with at least a rough outline of what it will do for whom and how, some seed money, and a team to get things going.

- There are plenty to choose from with a million new U.S. businesses started each year and a large number of initiatives at going concerns that could each be the start of something big,

- Funding at this stage is most likely provided by the one who came up with the concept and their "family, friends, and fools (which, some say, are by definition, all fools!)".

- People who are both qualified and interested in leading the concept venture are scarce. More than likely, it will be run by someone who has no business being the leader. Most will fail. But those with determination, energy, intelligence, wits, sense of humor, and thirst to learn from those with more experience can nonetheless do very well.

Objectives at this stage are to:

- Produce some evidence that the venture concept is viable

- Get everything done that can be done with little or no money

- Form a leadership team of two to seven people with relevant and complementary strengths who get along well with each other. While no one ever is able to go it alone, it is mandatory that it be clear who among the top team fills the role of leader. The leader and his or her team need to have the energy and drive to take action and make things happen. The team is more important than their offering because, after the first round has played out, the team that learns from experience to get it right next time is the one that wins.

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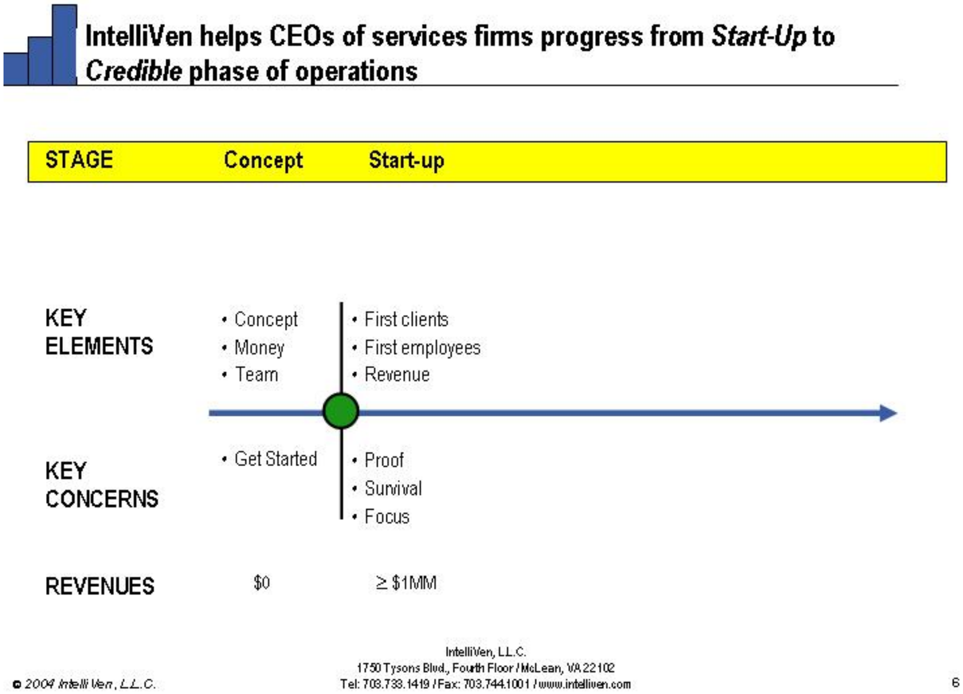
Start-up



The Start-up venture probably has:

- A few clients and up to a few dozen employees who are gaining confidence that what they do fills a real need in a market where no other player dominates. On the other hand, survival is far from guaranteed.

- A few angel investors may have kicked-in less than a million dollars to fuel the company as it develops its product, sales, delivery, and operating methods.

- Issues tend to revolve around managing scarce resources to:

    - Deliver on commitments to clients,

    - Find the next client, and

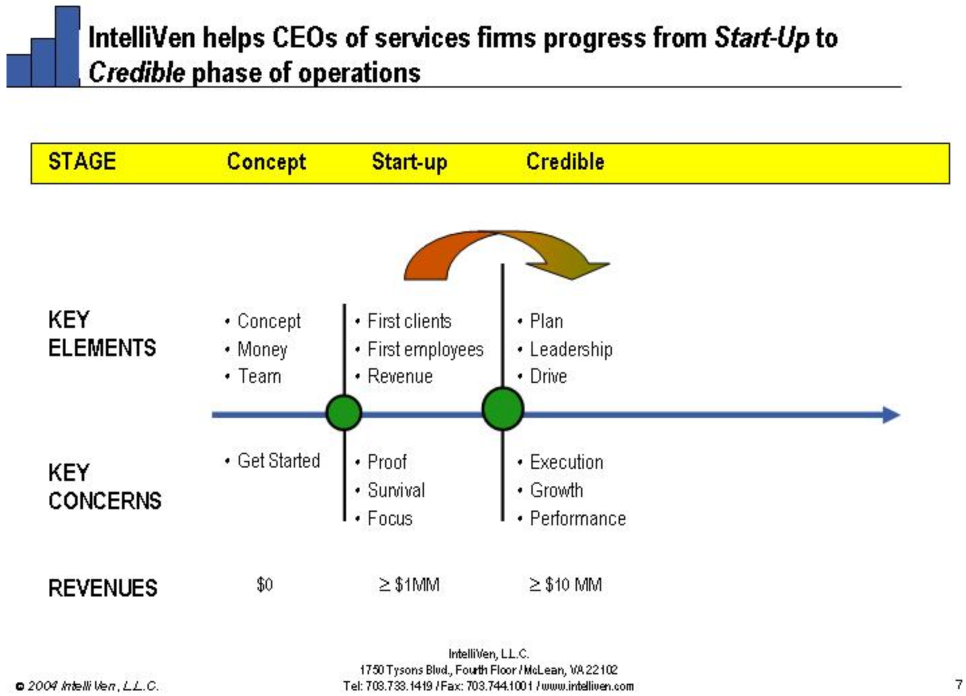
    - Secure the resources needed to find the next client and to deliver on commitments.

- Too few people who know what they are doing usually end up spread precariously thin across sales and delivery responsibilities, and there never seems to be any time or energy left at the end of each day to set up for the long haul.

- Whether, and how, the business evolves to systematically address these challenges will determine its attractiveness to current and future employees, clients and prospects, banks, investors, the market, and future suitors.

- To stabilize operations sufficient to attract clients, employees, board members, financing, and partners, this is the time for the venture to develop a strategic and operating plan that includes:
    - Mission, vision, and values
    - A target financial model,
    - Dashboard (scorecard) to track progress,
    - Short term initiatives and success criteria (e.g., number of new clients generating significant revenue within so many months, profit as a percent of net revenue, etc.),
    - Key players, roles, responsibilities, initiatives and accountabilities associated with a pattern of achieving stated objectives
    - Sales, delivery, governance, human resource, and financial processes
- A funded venture at this stage might have:
    - No more than one serious institutional investor, with more waiting in the wings, who has invested $1-2M in return for about 40% of the equity
    - A board of outside directors to provide consistent accountability, input on strategy and focus, and access to resources such as money, people, prospective clients, and partners
- At this time, management:
    - Executes the strategy and operating plan
    - Tracks and reports on progress to establish a pattern of success against plan.
- Stakeholders (owners, founders, management, board, employees) are anxious for the venture to achieve results that make it clear that things are on a solid and predictable track to fulfill the mission and to generate returns on their financial and personal investments.
- Ways of working take shape and harden.

Credible



- A firm's long-term growth and profitability is primarily determined by how closely it holds to one of five business models (see examples at the end of this note):

  - services,
  - product,
  - operations,
  - reseller, and
  - exchange

  and how well it executes its primary delivery functions, sells its offerings, and develops its capacity in the face of increasing scale.

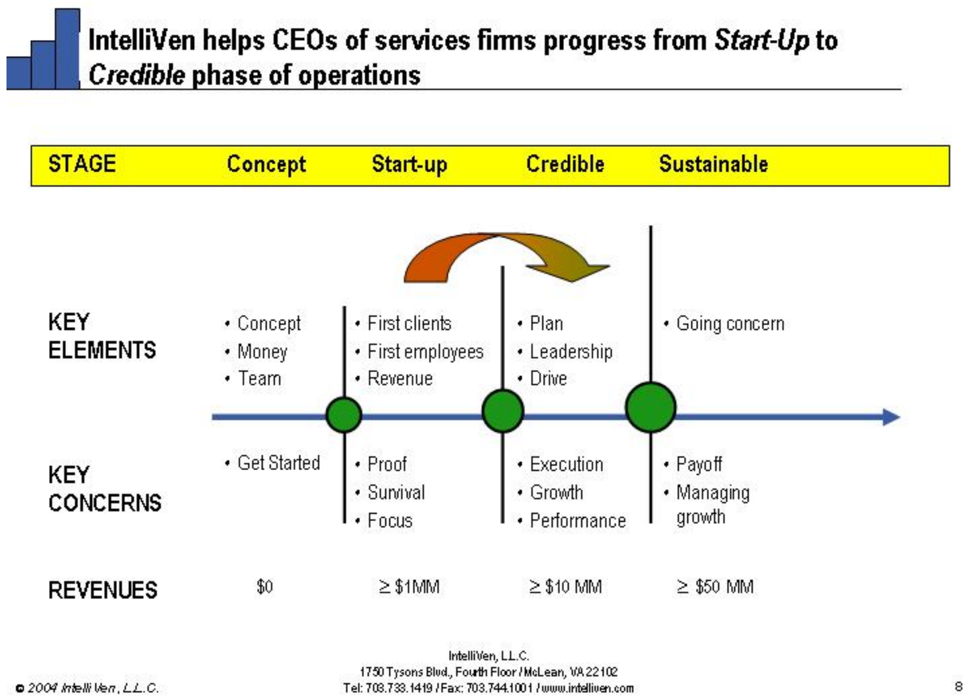
- More specifically, a firm's business model determines:

  - The way its finances work
  - Its sales and delivery processes
  - The competencies it needs to develop
  - Its competitive landscape
  - Its target valuation as a function of operating income
  - Exit alternatives, potential buyers, and timing
  - Growth prospects and targets
  - The degree of risk and difficulty

- It is critical to determine the key source of revenue around which to build the business. While it may be possible to build around multiple revenue sources, it is a hard enough to do around just one revenue source. It is therefore best to pursue multiple sources only after at least one is on a solid track for success.

- To be credible a business needs an operating plan with key players in place and on board about what parts of the firm is counting on them to cover and a track record of consistently achieving planned performance. The key players responsible for developing and delivering on the plan must also be highly charged up to achieve their plan usually assured by an incentive program that rewards success in so doing.

<u>Sustainable</u>



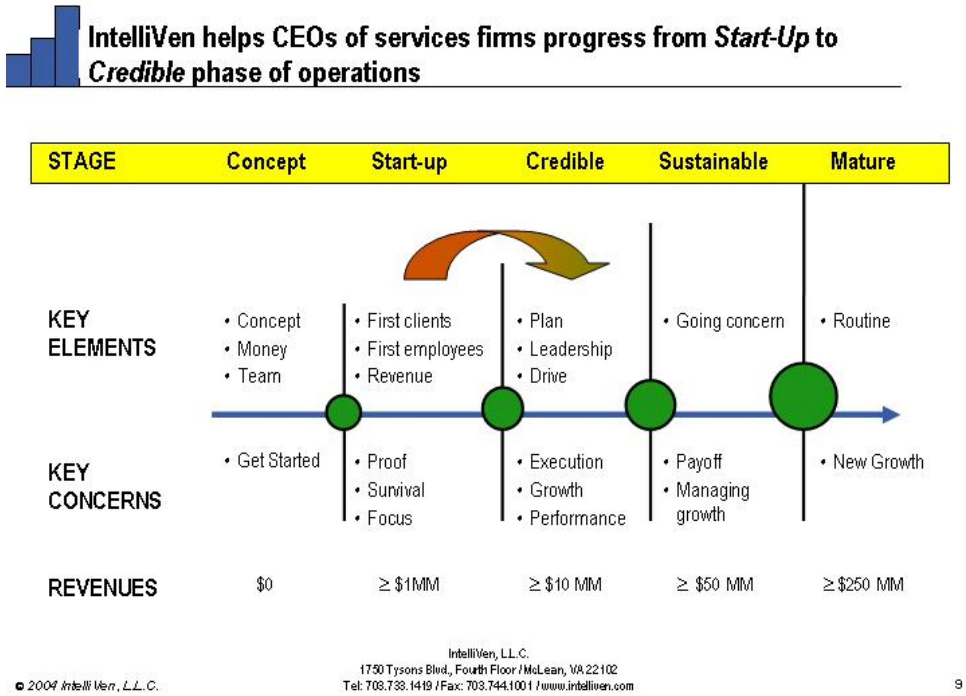
- If a business does a few things right in its early stages of development, it can markedly improve the odds of sustaining accelerated growth and outstanding performance.

- Conversely, it is very difficult for a firm to make critical adjustments to its operating characteristics once it has achieved a certain level of scale and maturity.

- Designing the venture well in the start up stage improves attractiveness to all its stakeholders.

- A key concern at this point is to create liquidity for those who have helped get the venture this far.

Mature



Key concerns of a mature venture are:

- Continuing to perform well against plan.
- Holding the attention and interest of key leaders.
- Finding new sources of growth in the face of approaching market saturation, which may lead to spawning initiatives that then each progress through these same phases of evolution.

Overview of Alternative Business Models

High-Tech Business Model Characteristics

Business Model	Description	Payment	Example
Product	**Software, hardware, or information**	**Per copy Per unit**	**Hewlett Packard Microsoft**
Service	**Hourly or project consulting or service**	**Per hour Per deliverable**	**PWC Booz Allen & Hamilton**
Operation	**Outsourcing Facilities Management**	**Per unit of time Per unit processed**	**USInternetworking EDS outsourcing**
Channel	**Set up and administer connection between buyer and provider**	**Percentage of revenue**	**GTSI IDIQ contractors AOL**
Exchange	**Broker links between many buyers and many sellers**	**Subscription fee Transaction fee**	**NYSE Metals Exchange**

Business Model Operations

Business Model	Economics	Competencies	Metrics
Product	**EBIT=20% P/E=100X**	**Sales, Call Center, Development**	**No. of Salesmen, salesmen tenure, $/sale, sales/salesman**
Service	**EBIT=15% P/E=25X**	**Project Management Account Management**	**Staff utilization Average hourly rate**
Operation	**EBIT=10% P/E=10X**	**Efficiency of operation Driving to scale**	**Cost per unit Service levels**
Channel	**EBIT=3% P/E=5X**	**Contract management & administration Space, Inventory mgnt**	**Contract order backlog Commitment level**
Exchange	**EBIT<0 P/E=n.a.**	**Domain competence Efficiency of operation**	**Number subscribers Number of Transactions**

Product (e.g., Microsoft, Oracle, PeopleSoft)

- Each unit sold leads to revenue sufficient to cover its share of R&D, cost of sales, G&A and profit.

- Revenue can come in all at once (e.g., $1M/sale) or over time through recurring subscription fees or pull-through of other offerings at a very low incremental sales cost above and beyond fees that cover cost of maintenance and product development.

- Key is the number of fully productive salesmen generating $XM/yr (where X is in the range of 1.8) in an "infinite", or barely penetrated, market. For example, Hyperion, which was a niche market compared to Oracle or Microsoft, had over 100 salesmen. In the 15 preceding years, some 3,000 units had been sold into a market with about 50,000 prospective customers in it.

- Services are sold principally to drive unit sales. 50% of Hyperion's (and PeopleSoft's) revenue is services, but all they count and care about is software revenue. Too much services revenue means the product has played out, and the business is resorting to services to stay alive.

- Key skill sets: product developers, call center managers and workers, training developers and deliverers, sales managers, salesmen, market developers, product managers.

- Target margin: 15-20%

- Target multiple: 20-100X

- Time to exit: when market saturation is in sight

Services (e.g., Accenture, AMS)

- Each unit sold drives millions of dollars in services revenue

- Key is how many people can you keep how billable at what rate and how fast can you grow it

- In this business, a product is a distinguishing asset that separates your services from the pack and essentially lowers the cost of delivering value.

- At some point, others will build new and better offerings that are more self-contained and that do not require as many services. This signals a maturing market and that it is time for the services company to move on to other problem areas

- Key skill sets: strategic thinkers to find and solve the next problem and to provide consultative support to sales and market development, consultative account managers (vs. salesmen), project management, and system developers.

- Target margin: 10 – 15%

- Target multiple: 15-25X

- Time to exit: when out of interesting problem domains to pursue

<u>ASP (FDR, SalesForce.com, USI)</u>

- Each unit sold leads to fees for running the software.
- Key is to offer best-in-class functionality at minimum cost and then drive to scale as large as possible as fast as possible
- Be open to running products developed by others that are better than yours. Those in the ASP business cannot afford to do their own product R&D.
- Key skill sets: process engineers who can drive out costs of operation, customer call center
- Target margin: 5-10%
- Target multiple: 6-10X
- Time to exit: When someone else figures out how to offer the same functionality at much lower cost