The Executive Summary + what investors look for

This short note is an informal shot from the hip about the Executive Summary – the 2 pager used to introduce most investment opportunities to investors.

General point No 1: it's a good principle to hold in your mind that the world is about stories. John Hendricks was a university administrator who started the Discovery channel when he noticed that students learned best when they were told stories. Discovery tells stories. Good ones can be held in the head and told to someone else. It's easier to tell someone a joke than a sonnet. I think it's good advice to try and make something fundamental to your success simple to pick up and pass on.

Examples:

1. 'You know how so many business models which are about taking content online need big marketing spend to bring the viewers to their sites? Basically that is speculative spending, what do you do when your first pile of chips has been gambled away? The basis of this model is to take its very low cost content and place it on sites where the demographic target is already gathered. The model is to have no marketing spend because it rides on the back of everyone else's.'

You respond to that nugget well. It's simple. It works with the grain of what's going on. It says that the web is a pennies medium and this is a pennies model. It's discontinuous – I mean it's not about the commissions and controlled margin of production in the old pounds world of television. It raises questions, but the next paragraph is going to answer those, of course.

2. 'You know that all video has a basic problem: you can't search for it. This business has the answer to that, it tags individual frames with metadata to make them searchable. This is one of the holy grails of digital.'

You respond to that nugget well too. This brings a solution to a problem that everyone recognises. That means it has a big upside if it can be made to work. And it'll probably have a bit of software or IP at its heart that has underlying value; it'll probably have a really high quality of earnings made from long term contracts with big customers. On the other hand it'll not be so easy to bring this off as some propositions. These are the first thoughts that are bound to arise, so the Executive Summary will move on smoothly and deal with them.

These 2 examples introduce 3 more general points.

No 2: remember that everything is something else. Meaning that potential investors will always try to relate what you are saying to something that they know already to give them some points of reference. Can you help them get orientated?

No 3: make yours a wobbly man. Meaning if you push it, will it fall over or spring back upright? Does it have internal integrity? Make it self-contained. Don't jar. Never assume. Don't make it difficult. Don't mis-spell because the reader will judge your general intelligence by you use of language including your ability to check for detail and your proofreading and use of language are going to have to do proxy for that. Are your sentences short? Make it self-contained: do you sensibly signpost the reader away to other parts of the document for detail or do you make a horrible bulge in your Summary, unbalance it, lose momentum and lose control of the reader as you guide him or her towards the thin business end of the funnel - ‘so how much will this make, what multiple will that get, how much does it need, what’ll my money get me, what sort of return does it offer...?’

No 4: say as high up the piece as you can how the business will make its money.

In an exam I would say this is easily the commonest failing of the Executive Summary. With Creative Capital Fund, I should say that half the first fifty plans that I was asked to review failed to do this clearly. You don’t want your reader to have to get to page 26 and to have had to work hard before she or he has pieced together a working idea of how the profit will be made.

No 5: remember there are 6 things your reader has to believe before breakfast if his or her first response is going to be positive. Not exactly 6, but the point is there. Make sure that you feed this point. So...is there a market for this and is the implied market share instinctively believable? Are you proposing a comedy growth curve with an improbable margin – so from a loss of £150,000 in the first full year through plus £1m to £2.9m of profit in year 3 with a 32% margin and the promise of exit through a stock market listing? Well, a high upside is good, but if this is your conservative forecast, make sure you let on in your Summary that you know you really need to work hard to defend it.

Among the 6 things will also be permed: will it need more money; who am I backing; who might buy it and why; is there underlying value; is the quality of earnings good?

Moving away from these few general points, I would say it is good to indicate to the reader that you know how they will be absorbing the Summary. I said ‘funnel’ because it is a politeness to acknowledge that they can’t not be doing an idiot-check as they nip through your points. They are funnelling down from how does it make its money through the 6 things they need to believe in order to share your view of this down to the back of the envelope calculation that they have to do at the end which will give them an idea of how commercial and how practicable you might be to back.

I will move on in a minute to the back of the envelope. First a quick sweep into a pile of other universal points and questions.

i) Exit: it really helps, I think, if your comments about exit aren’t forced. Saying we’ll list it is pretty hopeless – will you have the half a million pounds this costs? Will the price you pay for the benefits of being on the market be worth paying for your business? Far better to sound a bit doubtful and say that you are pretty sure that the quality of your earnings and the growth potential you will have are going to make this a pretty desirable business and that you are sure a realisation will be possible for your investors as a result; you though want to live happily for some time after carrying on building the business because you doubt you are ever going to have a better one under your thumb. Or to point out that you will have a robust future-facing business, that to get into the future all the big boys have the problem that they need to do something discontinuous and at a scale that is noticeable to them, so you expect they’ll be round at your door soon enough. Your reader only needs to feel that your business will be a desirable buy to want to read on at this point.

Incidentally, on this, I was told by David Gregson of Phoenix Private Equity once that apart from realising that it was their simple niceness and the network that brought that distinguished them, the biggest point of difference their research gopher had unearthed was that in the ten years previously 87% of the private equity investments he had managed to track – and these things are quite well documented and there were a lot of them – were un-exited, but Phoenix had managed to exit 67% of theirs. The 87% is a striking figure – and it related to a good period for private equity.

ii) Who: a lot of new media business models, being like any model a bunch of guesses, will need adjustment as they go along. Is the team the investor is backing going to manage that? Do you have the energy and drive, the authority of having done it before perhaps, great connections, enough incentive, a good board – there is a whole list of this type of question being asked as the Summary is being read. Is what you propose capable of being delivered by you?

iii) Will it need more money? If so will your investor be in good company? Can the shareholders you are seeking produce the next round between them if all is going well? Or will you the management be distracted raising the next round rather than running the business?

iv) Are the earnings high quality? I started working life as a City investment analyst for 10 years. This is probably what makes me fond of this question. To illustrate: I like the second story I tell above because if it works at all, the business will have the ingredients of very high quality earnings: IP that it owns and can defend; long contracts which are others will find hard to supplant; low dependence on the entrepreneur when you come to realise the value of your investment; a big upside – actually a very big upside – good news if you want to raise new money later. Good earnings quality at exit means a high multiple – very good news for everyone concerned. With content businesses, the questions will be about whether they will control their distribution, whether they will own their customers, whether they will own their rights…

v) Is your valuation the work of a person from Mars?: in the next section I am going to explain quickly how you can work back from the end of your Summary to see if you will be considered a Martian or not. But I would like to end here by saying that for a start-up, my Creative Capital Fund experience says that a man and a plan is worth between roughly £400,000 and £600,000. Under £350,000 and there is no room to get the investors' money in, I mean it leaves not enough upside for the founders. Above £700,000 and you start to smell some adviser in the background who is only experienced in exit multiples and whose mother hasn't taught him to respect the work that has gone into earning the money that is going to be invested and so to value the money properly. Or you need to have some distinctive features to justify the premium value. Or you need to hear that the founder is aware there is going to be a gap between his and your valuation and willing to have deal that is structured to cover the difference of opinions at the starting gate. That's common enough and being aware of its commonness should be a useful part of your armoury. Last advice here: one always say to the founders 'Think of the exit.' It's a useful point to have in mind and reflection on it by both sides can help deals to be struck.

