Think You Know What Venture Capitalists Look For In New Start-Ups? Think Again

By Patrick Hanlon

Everyone talks about how entrepreneurs and innovators get their famous “aha!” moments.

But no one really talks about when the VCs who fund them get their big idea to finance fledgling entrepreneurs with the capital that turns ideas into industry and headlines.

Silicon Valley venture capitalist Chi-Hua Chien has had a long career investing in Silicon Valley companies including Spotify, Twitter, and Facebook. When his firm Goodwater Capital was looking at a new investment in the Imoji app, all their financial research was boiled down into a human moment.

“My 5-year old daughter wanted to play with Imoji rather than have her bedtime story,” laughs Chien.

Not every investment is so close to home.

Eurie Kim is a principal at Forerunner Ventures, the company that has helped bring us Warby Parker, Bonobos and Birchbox.

"Often, we see several similar ideas come to us all around the same time. Sometimes it's two or three of the same general concept, sometimes even five or six," says Kim.

"We are always doing our own research to explore categories and themes we think are interesting and have pain points that, if addressed, could open up big new market opportunities. But the 'aha!' moment happens when a founder comes in to pitch and every aspect of their approach seems to addresses all question marks in our minds.

"Every time we invest, it's a 'zing' moment," Kim continues. "The stars seem to align with a stellar team that has great chemistry and relevant experience, a unique brand that has potential to inspire consumers, a differentiated product that stands to disrupt existing options—and that unmistakable connection we feel when we just have to be in business with someone."

"I think back to 1994," says Stuart Rudick of Mindfull Investors. "When Sky Dayton had the idea of creating an Internet service provider. (I didn't know what an ISP was at that moment.) I said 'no' during the first round of investment.

"My 'aha!' moment was when he came back three months later and showed me the growth of the business—which was 3X what he showed me the first time," says Rudick. "He was getting traction, the number of users, and he had beat what his projections were."

The company back in 1994, of course, was called Earthlink.

Rudick's latest pick is Atheer Labs. Atheer has technology imbedded in glasswear for augmented reality. The Atheer software development kit allows developers to create fully immersive and interactive 3D enterprise apps on the Android platform.

"When I saw the power and ability to do it in real life and real applications in medical, entertainment, auto industry," says Rudick, "it really made me think this is something that will truly change our lives."

What venture partners look for is part economics, part science, and part gut instinct. Generally, every firm begins with a robust decision framework that includes key ingredients.

The founder is passionate about their idea.

They have past experience that makes them credible.

The world is dying for their idea, even if they don't know it yet.

The founder has an unfair advantage.

FOMO. The investor has a fear of missing out on something big.

And finally, what will the exit be? When does the investor get their money back—hopefully several times the size of their original investment.

It is the purpose of all brands—especially those in the fledgling, start-up stage—to surround themselves with a community of fans. At first, that community lives on the inside, the nucleus of founder(s) and Employee #2. Over time, the tenets of community expand, spread, and embrace the world at large. In order for the brand to survive and become a Brand (capital B), the essentials of community must be communicated, differentiated, and spread across a diverse set of media from packaging, point of purchase, out-of-home, experience, home page, social media and (yes) the pitch deck.

The beliefs of the Brand must seep into the world of venture capitalism where, hopefully, the idea is transformed from another meaningless pitch, into a product enriched with enough purpose and meaning for someone to click the "Like" button.

Mark Goldstein of Camiolog has funded dozens of Silicon Valley ventures. He admits that while the business fundamentals must be in place, sometimes that “aha!” moment is already staring you in the face.

An instance. A few years ago, Goldstein found himself sitting in a bar. The bar was full, but he noticed something peculiar. “I looked up,” he says, “and no one was talking. Instead, everyone was on their cell phone. So I dove in and funded only mobile-first companies!”

In the end, it boils down to basics. “We assess the potential opportunity,” says Eric Kim of Goodwater. “And the rate of return for investors.”

And sometimes, the VCs just don’t get it. Example. Neil Young’s high resolution music ecosystem Pono was turned down by VCs, so Young turned to his millions of fans. His subsequent crowdfunding campaign raised $20 million on a $50 million valuation.

Effectively giving VCs an entirely different kind of “aha!” moment.

About the Author

Patrick Hanlon is ceo and founder of THINKTOPIA® and one of the leading branding practitioners in the world. His book *Primal Branding: Create Zealots For Your Brand, Your Company And Your Future* (Simon & Schuster, 2006), is recommended by YouTube, the largest social engagement platform on the planet. His new book *The Social Code* helps startup (and grown up) entrepreneurs and companies of all sizes understand how to create a community of fans who are so passionate about your success, they are willing to create it themselves.

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