Stanford eCorner

Attrition Rates for Potential Investors

Ron Conway, *Angel Investors LP*; Mike Maples Jr., *Floodgate*

January 23, 2008

Video URL: http://ecorner.stanford.edu/videos/1920/Attrition-Rates-for-Potential-Investors

The numbers are stacked against the inspired business owner-to-be. Seasoned angel investors Ron Conway and Mike Maples talk about how many ideas they receive, how many executive summaries they peruse, how many meetings they call, and the shockingly few ventures - roughly one out of 150 - that end up receiving their investment of time and money. Also, Conway points out that investing is a risky business, with an even split between those that fail, those that earn just enough to pay back their investors, and those that turn a profit.

Transcript

We read the executive summaries. See if we like that. Then we have a phone conversation. And then we have a meeting. So the face-to-face meeting is getting more and more rare because the amount of deal flow is so high. I see five new deals a day. You can imagine I have to reject three a day or there's no way of keeping up. So two a day go down the assembly line. And by the time we set-up a meeting with the company, we're pretty impressed already with what we see. So I'll just follow-up, what's the attrition rate? I want to hear the funnel.

How many do you get? How many do you read? How many do you see? How many do you fund? How many are successful? Ok! Common on! Inquiring mind coming up. So we see five a day. And I have another angel find like Mike's that helps me called Baseline. So please don't think that I do all these myself. Baseline has three people who basically rely and process all my deal flow because it's so massive because I've invested in 500 companies. Think about 500 companies. You have five people on the management team. Five people on the board of directors. That's 10 people per company times 500. There's 5,000 people in Silicon Valley who when they go start a company they go, "Oh why don't we go back to the guy that did our last one?" So that's why the deal flow is so massive.

My deal flow is actually very high quality. These are all people I know. I triage the deal source right away. When he sends me a deal which he does like once a month, that's a high quality deal. Because he's already passed his screen. He wants to see if I want to co-invest with him. So back to the question. Five a day are coming in. We try and get rid of two and half to three right at the get-go. And then the other two to three will go on this assembly line where myself and Baseline folks will evaluate the executive summary.

That's why you have to have a great executive summary with a great elevator pitch. If you can't communicate via writing exactly what this company's doing, you're not going to get through the system. So if we like the elevator pitch, we'll kind of vote on that. One of the folks from Baseline or myself will call the entrepreneur, chat about the company. We'll probably be doing a couple of back door references. I'm huge on back door references. So this guy came out of Yahoo!, I'm going to call some of my buddies at Yahoo! and see if this person's well respected. We do all that in the background. And then if it passes that stage then we'll take a meeting and then we'll invest. So let's say we do one investment a month.

So five times 30, we see 150 deals a month. One gets a check written. So that's kind of the funnel. Right now in the last two years I've invested in 125 companies. That will be two or three rock stars in there. Facebook's definitely going to be one.

Digg would be another one. That's one that Mike and I are in together. But basically a third, a third, a third. A third of the companies are going out of business.

When you start a company, understand a third of them go out business. I do not get upset when companies go out of business. I feel sorry for the entrepreneur. I hope they learn from their mistakes. But it is a fact to life. This is a risky business. And then a third of them usually return the money back. So I had an entrepreneur yesterday saying, "Oh this is awful! I'm going to sell my company. I'm only going to give the investors their money back." I said what are you talking about, you're already above the law of averages. You're in the second quartile of success.

And then about a third of the companies will return three to five to 10x your money back. That top third pays for the other two thirds. So lots of mistakes get made in venture. That's what it's all about. It's about taking risks. But in the end that top third, if you have one hit. It's definitely a hits business. If you have one hit per investment cycle and I've been very fortunate to have one hit per cycle. It pays for the entire rest of the portfolio. So you really are looking for the hits.