The SmartUp Way

SmartUp Foundations Course - Lecture 10

Given November 3rd, 2024 by Yonatan Stern

So, first of all, thanks to everybody who came here. We have a full house today, so thank you. And this is the 10th lecture, which surprises me how much we covered. And I wanted touch on something very basic, which is why startups fail. So we all say, you know, nine out of ten startups fail and we take it kind of, yeah, that's what happens. It's difficult, blah, blah. But what I would like to do this time is dive into the details of why so many companies fail along the way. And is it law of nature or maybe something can be done about it and increasing the chances of success. So, as usual, we introduce ourselves. Ayala and Libby sit over there. For those of you who don't know who they are, Ruthie is hiding. Here is Ruthie. And we're going.

And as I always say, what we have in here is basically teaching the profession of building successful companies. It is a profession. I keep insisting on it. It can be taught, it can be practiced, a methodology. And as you will see today, I'm taking what happens if you don't follow the methodology and what happens when you do follow the methodology? The foundation course talks about successful companies. So we define what is a successful company and we have three parameters for a successful company. First and foremost, profitable. If it's not profitable, it's going to die. Second, it's fast growing. So just being profitable like a small store and going from day to day, that's not very interesting. It has to be fast growing. And the last one is grow fast from internal resources, which means modest investment. We have. We're planning to do workshops.

That was my daughter. And where we're going to cover specific subjects. And the plan we're doing in here is a residency program because very much like teaching any other profession, you need to practice it. So if you study to be a civil engineer or mechanical engineer or electronic engineers or whatever it is, you finish the technion or mit, doesn't matter. And you kind of know nothing. That's the reality. So you go to work for a company for four, five, six years. You specialize usually in something, and that's when you become a professional. The only exception is startups. You have a great idea and you have an algorithm in your head, and it's phenomenal. And you have no clue about how to build a company yet you get to $20 million and you say, oh, go build a company.

And you really have no idea what you're doing. So that's what we're trying to change in here, is to teach you how to do that and work with you on a daily and weekly basis. So as somebody taught me, when you give a lecture, tell them what they're going to hear. Then tell them, then tell them what you told them. Right? So you will have tolerate me. So what we're going to do is really follow the life of a typical first time entrepreneur. Okay? So there's nothing easier and simpler than that. Let's just go and look at what's going on. And those of you who built the company, I'm sure will recognize many of the things I'm going to say. And those of you who didn't, it's going to be interesting.

So we're going to follow the process of fundraising from angel investors to venture capital firms, explain the whole ecosystem of venture capital and its impact on companies. We touched on that in the first lecture when we talked about how venture capital firms are built and so forth. I'm not going to repeat that. I'm going to talk about different aspects of the venture capital ecosystem. So those of you who want to get the other one, go back to our website, look at the first lecture and you will see how venture capital firms work. We are going to talk a lot about the mathematics of fundraising and dilutions and how it all works. It's going to be a little bit of mathematics. Those of you who are afraid about it, of it, just go to sleep, you won't miss anything.

But those of you who really want to understand how fundraising works and how you get diluted or not diluted and what is participating preferred and what is common stock, I'm going to talk a little bit about it so that you have that education as well. And then we'll talk about the tightrope walk. You don't have a profitable company, which means you need to raise money all the time. And what happens when you walk on that tightrope. You need to raise money while building a company. And very much when we think about tightrope, you're standing in there and I don't know, I've never done it because I'm afraid of falling. And I'm sure that all of you are afraid of falling. So this is it.

And we're going to analyze later on, after we look at the case study that I'm going to bring, we will analyze it and then we'll talk about what we recommend doing. So we will kind of compare and contrast, show how a typical startup is working and then show what we recommend on doing and why founders who follow this Startup methodology have two things working for them. First and foremost, they have a much higher probability

of being successful. Means building a company that is sustainable, is growing and is doing well. And second, that they're going to make more money out of it as well because they're going to own a much bigger share of the company than with a VC model. And anything that is written in red is a question.

So since this is a fairly complex subject and many of you live through it, feel free to ask questions. I will try to stop every 15 minutes or so and ask people if they have questions. But if you have a question, just raise your hand and I think it will make the lecture a little bit more interesting. Okay, so Mitch, I hope you recognize this guy. There is a website called this is not a Real Person. So this is one of those this is not a Real Person. But I liked him. He looks so smart and he's a top notch engineer with a great disruptive idea. He has a solution, complicated online mental health services, which means matching providers, psychologists, social workers and others with people who need help but doing it online.

The reason I chose this is A, we played with it a little bit and you will see it at the end and B, Russ Glass, who used to be the VP marketing at ZoomInfo, later built Beezo. We sold Beezo to LinkedIn and then he went and became the CEO of a company called Ginger I.O. And that's what they were doing. So I have kind of information from both sides. Sounds like a series in Netflix. Sounds like, yeah, almost. So he did the first thing, Joe, he quit his job. So that's it. He committed. He is committed and he has enough savings to live for six months without a salary and he has a little bit of savings and friends and family said, okay, we can support you a little bit.

So he thinks he has another 20 to $50,000 to invest in building his dream. That's where he is, okay, left his job, can live for six months, have a little bit of money and he wants to build a company. Who here was in that situation? So his first time. And what would he do, what he's going to do now? So the reality of it is he's lost like many first time people who do something. He left his company, he has his dream, but he doesn't know what to do. He has a very clear vision of the application. He has all the buttons and exactly how it's going to work and how people are going to sign up for it, all of that.

He knows he's an engineer, but he has no idea how to raise money, how to hire a team, how to develop a product. He needs help. That's the situation of most first time founders. So he looks for a co founder. Why do you want a co founder? You see it's red. So it's a question that I'm expecting answer. Why do you, why do people take co founders? Do you know? Right. Okay, good. What else? Share the risk. That's it. You don't have any co founders here. Yeah, that's correct. What else? Okay, so I did the work for you first. Exactly. When I ask people, and I ask a lot of people who came with co founders, why did you go with the co founder? The answer many times is the first one.

I was lost, you know, I was sitting alone at home and I didn't know what I'm doing and it just was very difficult. So I wanted somebody to be.

To get lost with me.

Exactly. Be with me. Okay, so we can do it together. And since I didn't have money, I couldn't hire them. That's what I did. Second is what you said, you know, complement my skills. I'm an engineer, so probably I should take a business person. Maybe you have more experience. And the other thing which is very critical, when you go to a venture capital firm to raise money and it's only you, they say no, especially first time, you know, they don't like it. Right. You know, if I went to a vc, I'm sure they would give me money, but I don't need their money. So you know, like a bank, they give you a loan if you don't need the loan. So it's that kind of a thing. But if you do need the loan and you don't have money, then it's a problem.

So you need a team in order to raise money. From their perspective, if you didn't bring another co founder with you, so you might not be able to bring the team. Right. So here are all the reasons why people bring co founders. Maybe there are more, but some of the reasons. Okay, so how to choose a co founder? How do you choose a co founder person that you trust? Okay, define what you want with your co founder. Okay, I'll tell you the truth. There are two ways of choosing co founders. One is you know the person for a long time. You were in another company with him for 10 years and you guys were very, you know, working together. You went to kindergarten with him or her, all of these things. That's one kind.

You know, the person the other is you don't know the person and you start asking. Remember, you are not a company. You don't have money, you don't hire a recruiting firm. So what do you do? You ask a small random circle of acquaintances. So Joe met Julie. She's his neighbor's college roommate. Okay? So he asked his neighbor.

She doesn't exist.

Anyway, she doesn't. But I liked her too, so I put here. Okay? So now we have Julie. But she does have something working for her. She has an MBA from Harvard. Okay? So if you want to raise money, that tells you something. And hopefully she's really smart and she knows what she's doing. She has an MBA from Harvard and she was a VP of sales because remember, he's an engineer. He wanted somebody with a business experience and a sales experience. So she worked as a VP sales at the company that nine out of 10 failed. Okay? And as a co founder, she gets 50% of the company, right? You know, he doesn't know what he's doing, she doesn't know what she's doing. So 50, I'm just anybody who thinks I'm saying stupid things, please stop me.

But all of you laughing because you know that it's the truth. It's the truth, right? So let's just be realistic. That's what happens. Okay? So he picked his neighbor's college roommate, remember that? And he gave her 50% of the company. So now Joe owns 50% of the company and they start a company. They got a good name, Theriva. And look at the logo. So those of you who are can see that there's a little thing in here called Namelix. I strongly recommend this site. It gives you. It's very creative about inventing company names and giving you logos. So if you want to start a company in five minutes, you will have a great name and a logo. So anyway, we just now started the Riva and we have a logo and we are very happy.

Okay, so let's talk about the typical order of activities. Now that we have a team, we have a name, we have a logo, it's time to raise money. Okay, so we need to prepare a pitch deck. What is a pitch deck? Pitch deck is the story we tell investors of why they will do the best thing in their lives putting money with us. So we're going to go step by step. Julie knows because she was at Harvard, she knows how to write a pitch book a pitch deck. And it looks like that the problem the company targets mental health care. It's a disruptive solution. I've never seen a pitch deck that doesn't talk. Has the word disruptive, at least on every other page. Because it's online service. It's much more accessible, right?

You can be anywhere in the world and get the help you need. And it's more affordable. That's what they claim it is. Because they believe that delivering this service through online help will be much more affordable. Potential market size. Jokingly, I said it must be at least a billion dollar, right? Probably bigger. And you always put some market research in there. She's in Harvard, mba. She knows how to get the market research, and she prov. The market is probably $10 billion. They put the competition, the team, which is themselves, and the logo, and they put financial models. I'm going to show you three examples of financial models. They don't relate to Ceriva because I didn't have patience anymore. But they all look the same. They have this shape at the beginning. It goes hard and then boom. All right, so we'll see the boom.

Here it is. Okay. Financial plan. Here's another one. I just copied them from the web. Not necessarily interesting. They all look the same, by the way. Doesn't matter. They all look the same. Okay, so went to raise money and success because they look good. They know what they're talking about. And they were able to raise $1 million in a seed round. And they only had to give 20% of the company of the equity for this seed round. Okay, $1 million, 20% of the company. Until now, we are thriving with the Riva. Okay, so what do we do now? We hire a team, right? That's what you do. You have a clear idea of the product you want to do. Now it's time to start delivering. So they hire a team. Two founders, Joe and Julie.

Now they want to get the salary, five engineers to write the code. They also hired two licensed psychologists because they're developing a platform for psychologists. So they wanted to have them in house to help them with the design. A product manager, obviously, an office manager, and they rented an office. Where's the money? Billion dollar. Oh, no. You serious? Right? $100,000 a month goes like that, but that's what is expected. And money in the bank will last less than a year. Because you take a million divided by 100,000, you get about 10 months. So you need to start going after round A. Who here had a startup? Raise your hands. Okay. How often do you go and raise money? Right? So you start getting into this trap. Okay, but this time they said we raised seed financing.

We're going to go and raise money from venture capital. Okay, Good times to raise money. So now I'm going to give you a little bit of understanding of how the venture capital ecosystem works. Remember the first lecture we talked about their internal finance? You know, they get 2% management fees and all of that stuff. This time I'm going to talk about the ecosystem altogether. So when are the good times to raise money? So in the life of a company, there are points in time where it's easy to raise money and there are points in time where it's very hard to raise money. So what are the times when it's easy to raise money? Easy, kind of. So the concept stage, right, like at the beginning when they went to the seed round, you have a concept, okay.

You have a good team, Harvard MBA and a good engineer, and you have an interesting disruptive idea. You go after an interesting market and you have this hockey stick. You look interesting. And there's not no measurement to measure how much you really are worth because the market is $10 billion. You look great. You know, I specifically chose good looking people. You know, they look good, they look professional. How much do they worth? I don't know. So you go with them, right? $5 million, whatever. Close you will see that you are wrong. Proof of concept accomplished. So that was the first time you can raise money. Can you raise money when you're working on development? Not really, because you're in the midst of something and there's nothing to show for.

So the next point in time where you can raise money is when you have a working prototype or a product. You have something to show for the money you raised the previous time. So you have to understand that raising money has very specific milestones. You can't raise money anytime you want. There are milestones. If you meet that milestone, you can raise money. You don't, people will look at you, talk to you, but don't do anything. They want a proof of the pudding. Okay, so that's the second milestone. Third milestone is early traction. You have a few beta users, they use it, they give you good feedback and the investors can talk to them. That's the most important thing. Okay. Until now they had nobody to talk to. Now they can call the beta users and say, what do you think about this product?

Would you use it? Would you recommend it? So there is a milestone there? Yes. Why?

It's not the same stage.

Because even if you have it without a beta, and let's Say it's a complicated algorithm or something. You have something to show for. Okay, so many times there is a product development. Think about recycling, okay, so you want to show them that you can recycle that plastic or something. So you don't have any customer, you don't have any beta users, but you can prove that the process is working. Okay, early traction, you have these and then the product launch. Okay, so you went from the beta and now you sell the product. You have a few customers to show for again. They can now call the investors can call this thing and say, what made you pay them $20,000 for it? And get answer. And they say, oh, it helps me here. It saves me money.

Remember, these milestones are milestone of validation for the investors to say, yep, the risk is lower because they have done another milestone. And then the last one is you have a proven selling process. Okay, so that means you know how to sell one after the other. It's not like you have five early customers that you scrape from something. It's the other roommate of your neighbor or whatever. This is much more like a process that you can work on. Okay. Yes.

The previous slide, the fourth point, and has several customers. How many settle, how you measure it.

You don't really. No, no, I explain. I explain. Okay. Remember, you're trying to raise money. Okay? So you really follow what the VCs ask you to do. If, you know, you finish beta and you have not a single customer that pays you money, they will say, why? Nobody is paying money. You have two. And they ask why not three? You will see in a moment the problem. Why? There is a little funny video I brought up. Okay, so why not? Why 2 or not 5? My point is it's never enough. It's never. You will see it. You will see it. You just. You probably watched when I was playing with it, right? Okay, so. Oh, but what happens between the milestones? What happens between the milestones is what's called death zone, which means you can try to raise money.

VCs will be very polite to you, they will drag you. But basically they say, before you bring me five paying customers. You know, it's interesting. It's really interesting. So basically it's in between. So the development phase, from concept stage to working proof of concept, from working proof of concept to product beta users, from beta users to early paying, from first customers to working sales process. And the last one is when you really want to get very high valuations, you have to prove that you have a growth engine so that you really figure it out how the thing is going to grow like crazy. The reason you're still raising money is many times that this growth engine is very expensive. Okay, so it's not necessarily that a growth engine really means you're making money. I'll give you an example.

If you are giving access to your application for free, like Facebook or LinkedIn, right? So you're measured by the number of users because everybody understands that your money is going to come from advertising. But you have to prove that you're going to have 100 million users or 500 million users. So growth trajectory is different than making money and being profitable on the spot. On that, I tend to believe that you have to be profitable all

the time. But. Okay, so I want to show you the thing that I promised. Our hosting fees could become a challenge.

As we scale, right?

But we can offset a lot of that once we get a few customers and start a subscription revenue model.

No, no, no, no. No revenue. I'll call you back.

What?

Why would you go after revenue?

Because. To make money.

No, if you show revenue, people will ask how much? And it will never be enough. The company that was the hundred x or the thousand x or becomes the two x dog. But if you have no revenue, you can say you're pre revenue. You're a potential pure play. It's not about how much you earn, it's about what you're worth. And who's worth the most? Companies that lose money. Pinterest, Snapchat. No revenue. Amazon has lost money every quarter for the last 20 years. And that Bezos is the king.

The king.

There's no revenue. No one wants to see revenue go.

I just thought that mainly the goal of companies is to make money.

Yeah, no, that's not how it works. I don't want to make a little bit of money every day. I want to make a ton of money all at once. Roi. Roi. You know what that stands for?

Return on. Return on investment? Nope.

Radio on Internet.

Thanks to Ruti who found that video and I think it explains it much better than I can ever do. All right, so go back to the boring stuff. So that was one side, right? The other is the venture capital market goes through cycles like everything else in business. So there are hot periods and cold periods. Obviously in the cold periods, it's hard to raise money, and in the hot periods it's easy. So 2000 to 2024, I looked at 24 years to give you the sense. So 2000 to 2003, I had two startups at the time, in that period of time and the year 2000 came about, bomb the dot com. And I was pretty worried about the inability to raise any money at the time.

So I was running Cartskin and we laid off a third of the people right there at the beginning of 2000 because I was so scared that we're going to run out of money and there is no way of raising money at that period of time. And literally it was a desert. You couldn't raise a penny at that time. 2008, you're not that young. So many of you do remember 2008 at least, right? So 2008, the financial crisis around the world can't raise money. 2016-17 there was a brief cooling period and now. Right. So all of you know that now is not a good time to raise money. So if you look at this 24 year period, half the year were cold years, half the year.

So if you are going to raise money randomly, there is a good chance you will be in the cold period, not the hot period. So let's look at the hot period. So not surprising is the other years. 2004 to 2007, the web 2.0 boom. Remember that? 2000, the Internet.comb bomb. Then it comes again, just cycles always 2011 to 2015. So after this 3G iPhone, Android, suddenly the whole communication area becomes really interesting. 2018 to 2021, huge boom. Huge boom. I liked especially the unicorns. Companies that do nothing and worth a billion dollar and up. So those mythological horses were roaming the streets in here. I looked out the window, saw them many times going down the street. But whenever I tried to catch one, I couldn't. So this is the cycle and let's take another look at what do they invest in.

So remember when you're trying to raise money, you have to be attractive to venture capital firms, right? So it's not enough that you are nice and have an MBA from Harvard, but are you doing something that is of interest to us? VC in general? Going hoards. If they all decided that something is interesting, they will all go after that

thing. And if it's not in that category, they wouldn't touch it. So in 2000-2010 enterprise software was very big. I remember that cleantech, Nobody in today talks about cleantech. Early social media started and mobile infrastructure again. I described why 2011-2020 consumer mobile apps, iPhone, Android, SaaS, cloud services, fintech AI starts to show up, especially after 2016 when people realize it really works. So that's when it started taking off. Remember, we are now eight years later.

So just think about the time it takes for things to really scale up. Digital helps in E commerce and remote desktop. You can read, but this is more.

Interesting for the Corona. The Corona was.

Yeah, it's not here. I'll tell you. I took it from ChatGPT. I verified that it has a good source, but I'm not responsible beyond that. Okay, at least there is a source that I trust. Okay. Consistently challenging sectors. Remember those, because if you want to raise money and you are in one of those sectors, you're going to have a hard time raising money even if you have a good idea. So hardware nowadays, AI chips obviously is very hot. Okay? So even though hardware in general is cold, this is hot capital intensive manufacturing. Nobody wants to manufacture anything anymore. Traditional retail, non tech enabled services, deep tech. So deep Tech used to be the darling of many venture capital. Nowadays they say no, it takes too long, too risky, we don't want to invest in it. Next week it might change.

So this is all what they decided at that moment. But here's the challenge. So the company is not profitable as you said, you know, they keep spending money, so they need to continually raise money. So it depends raising money on four things. The company stage. Remember we talked about the death film? This is something I haven't brought up yet. So when investors, potential investors look at a company, one of the things they look at is the team. And at the beginning it's enough that they have a Harvard MBA and all of that good stuff. But later on they start looking deeper. How do they work together? They ask the board, how is it to work with these people? Usually the board is heavily involved in raising the money because investor to investor. So having good relationship with the board is critical.

Having good relationship with the previous investor is critical. Having good relationship in the company, all of that becomes suddenly very critical. Remember the little movie, you know, once you can measure something, everybody looks at it. So now they can measure how the team works and they look at it. The industry, market cycle. You know, if you come at a cold moment, you know the year 2008, nobody's going to put money, even if you are really exciting because they have, remember what they do have, they have the companies they already invested in that they need to keep supporting because otherwise they will lose them and they don't make new investments. That's the way it works. And the last is what is the focus of the market at the time. So you might have started with cleantech. That was Very hot.

And by the time you develop the product and you have the process, nobody's interested in it anymore. Why? Because. Okay, so what you start seeing is what I'm calling these tightrope that we discussed before. So you really have to time what you do. And if you don't time the time, you are in trouble. And the conclusion is, if you are able to raise money, take as much as you can. You don't. It doesn't matter if they are willing to give it to you. Take it. Take it. Money in your bank is much better than money in their bank. So if you ever. What?

Depends for whom.

For you. For you. Okay, so if you are in the process of raising money, you came to raise $2 million and you have oversubscription, it's called, right? And you can raise $10 million. Take the $10 million. Yes, you're going to be diluted. But when times are bad and you need the money, you're going to be diluted much more. But then you get to the point.

Of profitability after a lot of time comparing.

If you take only the $2 billion, if you're smart alone, what you said, no, if you're smart, you put it in the bank and you don't touch it. Profitability has nothing to do with it. It's a loan or an investment has nothing to do with it anyway, so remember, they are first time founders and they raise $1 million. They have a small team in their product development stage and the expenses are about 100,000amonth. So they need to raise money. And the times worked. Okay, so it was really phenomenal timing and boom. They raised $5 million from a venture capital firm called High Flying Ventures. You know, I was very creative last night. High Flying Ventures and a

pre money valuation of $10 million. Okay, so the pre money valuation went up 50%. They took. Wait, so the round dilutes the founders by 33%.

I will explain later on. I'll give you all the formulas. Don't worry. So don't believe me. That's what it is. Okay. And Joe now owns, remember he's the founder of the company. He owns about a quarter of the company. Okay. And High Flying Ventures want to accelerate the company growth. So they say, hey, you know, I gave you $5 million. Do something with it. Those of you who ever raise money know the story. Stop laughing. Yeah, I know. I took you as an example. You're not embarrassed. That's what everybody is doing. Literally everybody is doing the same thing. Okay, so what do they do. The team grows to 20 people, expenses grow to $350,000 and within a year they're successful. They have a product in beta, so they're really good. They're doing what they said they're going to do.

20 person team is not that big. Life looks good, they're moving. But 350,000amonth in a year, that's close to $5 million. So they now need to go and raise money. Okay, and if you think I'm joking, then I'm not. Anybody here with a little bit experience know that's what VC backed companies do. The CEO is doing one thing, he is or she is raising money continually. That's what they do, continually raise money. And they hope that all the stars will align, that the market, the cycle of VCs will be aligned. Point in their company life will be aligned. And when it's aligned, they raise as much as possible, then they spend it and then they start all over again. Okay, good. Time to raise money. Product is ready, it demos well. It's in the beta with 10 providers, 10 healthcare providers who like it.

Good inflection point. Remember you have to time all of the activities. The VC market is hot. Bingo. They raised $15 million in round B from three new venture funds at a pre money value of 15 million. So they're doing well. It's great. By the way, if anybody here wants to invest in them, he's welcome. I take subscriptions later on. But the round dilutes the founders by 50% and Joe now owns 13% of the company because what can you do? You know, people buy portions of your company, okay, so they have a product in beta, they get good comments. So it's time to start selling. So Julie, who is in charge of sales, right, she has VP sales, she has the Harvard mba. I hope there's no Harvard MBA here in the room because you might notice my opinion about it.

So she's in charge of sales, marketing, customer success, operations and all of that good stuff. And she starts hiring people and the team grows to about 50 people. Why? Because they have $15 million in the bank and the VC said grow, grow. And everyone is busy because you have to move from 20 people to 50 people. Just that is a huge task. So they are hiring, they interview, they have meetings, getting to know one another because for every person you know, there are two and a half people you don't know. Okay, so you're really busy. You are running from meeting to meeting. That's what you do because 20 people turned out to be 50 people. So the office is in a buzz of activity. Tons of stuff going on. Expenses grow to $750,000 a month because 50 people is more expensive than 20 people.

But Joe started to notice something. Tremendous amount of activity running from meeting to meeting. Everybody is busy, but no results coming out. What's going on here? So he argues with Julie. He says, you know, we told the board that we're going to have a thousand service providers online by the end of the quarter, and we have 100. And I have a board meeting next week. What am I going to tell them? She said, don't worry, I'll tell them. He said, what are you going to tell them? You know, we said, we're going to have 1,000. You spend all of that effort and we don't have the results to show for. So they also have a hard time finding people who will pay for the service. So remember, we have two sides to it. We have the service providers, the psychologists and social workers.

But to make money, they need to get people who need the service, pay for the service, and they take a cut off it, Right? So tension starts to grow. Very typical in a company like that is this, you know, how come you don't. You didn't do that. Well, it's not my fault. You know, you had to build this platform. It doesn't work. You know, blah, blah. And Julie launches an expensive campaign to sign up mental health providers and paying clients. You know, that's what you do. You need to get customers. You spend a lot of money, you put a lot of campaigns, but the results are not sufficient and the tensions grow. The board gets involved and Julie is asked to leave. Look at all the companies, you know, and you see, they all had co founders that disappeared. Why?

Something like that, okay, that as the company gets into the real stuff, it turns out that some people deliver, some people don't deliver. If they're just employees, they are fired. If they are co founders, they are asked to leave. That's what happened in here.

What do you mean? What's the difference between us to live and fire?

The politeness. We're all civilized, polite people, Democrats and Republicans, something like that. Okay? But the reality of it, at the end of the day, she didn't deliver. She's out. Happens in virtually every other company that I met. Okay, so what happens now? Linda, the director of marketing, is asked to take over sales and marketing because he didn't want to go and hire another person. And she's Asked to reduce expenses because they don't have revenues. So you need to start cutting expenses. And she lets go of 15 people from the team, okay? So she's doing her job, she starts cutting the team. So expenses do go down from 750 to 600,000amonth. And there's still $5 million in the bank. But that's about nine months of operation, right? Nine times 600 is 5.4. They only have 5 million in the bank. But there's side effects also.

When you go and you start slashing the team, morale goes down. I remember in the year 2000, the famous year 2000, people say, what do we do about morale? There's only one thing you can do about morale. Be successful. If the company is not doing well. What? Yeah, if you're not doing well, you can, you know, take them out for lunch. You can have company day, you can do whatever you want. But morale, you know, people are smart. They look at it and they say, they just fired 15 people. When am I next? So what happens is key. People leave, because think about it, you start laying off people. So everybody says, am I the next one? So the people are divided into two camps. Those who say, I can find a job in two minutes.

Why do I need to take all of this crap? And they're the good people. Usually they have self confidence, they have proven themselves and they just go. Then there are the people who say, well, I will never find another job. So they sit there and they stay there. And usually they are not the stars of the company. So what happens when you start doing these layoffs? You lose a lot of the good talent and the quality of your team goes down. In addition to obviously the morale, the other thing that companies do as a mistake is they say, well, things are going to better tomorrow or next month or whatever, so I shouldn't fire so many people. Let's just let go of five people. Then the following months they let go of another five people.

Then the following month they let go of 10 people. Now it's a pattern. Now everybody leaves. So if you need to make cuts and you say, I need to cut 15 people, cut 25. Why? Because you want to make sure that it's one time event. That's it, one time event. You can't have it as a pattern that you lay off people all the time. When I needed to lay off people, what we did, I asked all the managers to come to my room. We had five managers. And I said, I want you to make a list of people in the Company. The first one on the list is the person you just couldn't wait to let go. But there was no real excuse why to fire that person. So that's the person number one. Okay, this is the opportunity.

Get rid of him or her and then go down. As you go down the list of people that it really painful for us to let go, but we have no choice and just rank them like that. And each one of you, were five people, please prepare a list of your own and we will compare it in 10 minutes. That's what we did. We compared the lists and it was pretty amazing to see that the lists were more or less overlapping. Number one, by the way, was number one by everybody. That was very funny.

Someone is annoying, he's annoying everybody.

Yeah, she was annoying. She was really annoying. And we knew she's going to sue us. So we just waited for an excuse. So. But you know, we had to cut. We had to do it. We did it on Monday morning, did it in an hour, and then called everybody else and said, okay, this is it. Everybody who is here in this room now is going to stay with us forever. And that's what happened. Okay, so the river is getting ready to raise another round, but they have a problem. They don't have a working business model. And it's a VC called period. It's getting very hard to raise money. So if before that we raise money at up, we're now in a down period. So a new VC investor. This one has a wonderful name called Way of Hope Ventures.

Okay, the other one was flying high. This one is a ray of hope. But he had terms that he wants for the deal. So he wants Thoriva to raise $10 million. And the reason he wants raise $10 million is he wants to have enough cash in the bank to really overcome all the hurdles. So again, one of the mistakes people do is they raise small amounts of money and they constantly have to prove themselves. So this guy is smart, ray of hope, and he says, yeah, we're going to raise $10 million, but I will put $5 million and you, which points to the other investor, will put the other 5 million. Why is that? Because I'm not a sucker. If you are not, if you guys are not willing to risk your own money, then why would I go in? So half.

I'll put half 5 million. Show me you believe the company. It happens all the time. Existing investors are always asked to participate in new runs. Always remember what I said before. You need to be in good terms with your

investors. And your board. That's exactly it. Because if you go to raise money and your existing investors say no, I'm not going to put money in here, there's nothing to talk about anymore. That's like saying don't even get close. Okay, the pre money valuation will be 10 million down round and I explain it, whatever. So post money valuation, last round was 30 million. So the company was valued at 30 million. He now says no, no, no, it's not worth 30 million. Excuse me, you guys have done a lousy job.

So I'm going to put the money at 10 million and it will be done in participating preferred. Those who not know what it is, all the others don't know what I'm talking about. So I will explain it in the next slide. Okay, and, but as you might have guessed, if it's already in the list of, well if I'm the ray of hope, I'm going to take, you know, good care of myself. Then you will see it and surprise, the company will hire a new CEO to lead a turnaround or a pivot. Why? Because the existing Tim didn't deliver. So Julie is already out. Joe is an engineer. So they kind of say, okay fine.

Joe was the CEO.

Joe was the CEO? Yes. Sorry, I didn't say that. Yeah, he is the founder. He's the CEO. Or used to be. He's no longer the CEO. Yes. Tough luck. You know things happen in life.

The free money CEO.

Okay, I'll ask the question.

A new CEO is a new investment.

A new guys. If you haven't gone through that in your own life, you probably heard the story from 10 others, right? This is the typical cycle of venture backed startup. They all look the same. Okay. Except for a few that somehow miss the turning point or whatever and they get to be the 1 out of 10. They all look the same. Okay, but I just wanted to go to the details so that you understand why companies fail. They fail for really good reasons. And we'll see it in a moment. So the round now dilutes Joe by 50% and he now owns less than 7% of the company. So he started with 100% 50 to his co founder and from there it's downhill to 7%. Okay, let's talk a little bit about what do we mean by a lot of words.

And as I said before, now we're going into the difficult mathematical data and I think it's important that you will understand what people talk about. So an up round, did the rider succeed? Eventually.

What we don't know what happened.

I know. That's why, that's why I put this here. So you have no way, you have no excuse. You have to listen. So an upround, when the new financing round is done at a pre money valuation, it is higher than the previous round. It's measured by the price per share. Okay? So if the price per share goes up, and you will see later on when I show you the spreadsheet, when the price per share goes up, that means the valuation of the company goes up. And that's an up round. If there is an up round, then there is a down round. A down round is when the price per share goes down from one round to the other. Common stock is the type of stock that the commoners like us are getting.

And so if there is a common stock, there is also a preferred stock or preferred shares. So what's the difference usually between common and preferred? Well, there are some standards and then there's tremendous variety. The standards are usually that they contain all kinds of protections because people who put money in want to have protections both for the down and the up. Give you examples for the protections. So there is around, you know, the company is sold and there's not enough money. Do they all share or do they take the money out first? Most preferred shares take the money first before the common shares. Okay. And I made a mistake, by the way. You will see it in the. I forgot that they had preferred shares. So excuse me, you will see the mistake later on. Okay?

What do you mean take the money? Take the money based on the amount of share they have in the region.

No, in preferred. Yeah. If they put in $10 million and the company sold for $7 million, they take the 7 million and the founders get zero. Why? Because they put 10 million, they want 10 million out. If there isn't 10 million, they take whatever it is. So that's preferred. Preferred usually have the first right to take the money. Now the question is round A, preferred. Round B preferred. Round C preferred. Who is first to take the money? C. Why?

C. Because invested the most.

But why?

Because it's the last one.

They resigned all of the contracts because he can. Exactly. You want my money, I'm first. You don't want to give me first. Always take. Because they can he put in a term if you don't have money. And I said it about, I think twice at least in every one of my lectures. If you don't make money, you don't have the power to say no to anything. Right. So the new Investor always say way of hope, you want me, I'm the first. No, I'm the first. I'm before the B shares, I'm before the A shares. I am the first.

And if you want my turn, pay to.

That's how it works. So that's number one preferred choice. That's on the downside. On the upside, they also have some preferences. For example, if one of the shareholders, let's say the CEO found the buyer for his shares who are willing to pay $100 per share, then the pre purchaser says, no, not so fast. Okay, I'm before you, participating with you in the sale. Why? Because the shares are worth a lot of money. So I need the right also to sell my shares. Okay? So that's called tag along. Tag along says if somebody's selling shares, I have the right to tag along there. Okay. If the company is being sold, you have to take my shares as well. And la la. So there are about 10 different things that prefer shares usually have and then there are by the deal.

So each VC has their own little shtick that they want to insert, which is why when you get the contract, it's about 40 pages written in Old Greek with some Latin words in it. Participating Preferred. What is Participating Preferred? Participating Preferred is something that comes in and out of the agreements, depending if it's a hot period and money is chasing deals, it's out. If it's cold period and companies chase money, it's in. What is participating? Participating says, wait a minute, I put $10 million here. First of all, I want my $10 million out. I took my $10 million out. Now I convert. So if I own 30% of the company, I take the 10 million out and now I share 30% with everybody else. It's called the ratchet, right? Yes, yes. Okay, so that's Participating Preferred.

As I said, sometimes when I was in the market and talking to people, it was a hot market.

They say, oh, $10 million. You take the money out and now you want to sell your share.

Yes, yes. You know why? Because you want my money. If you want my money, these are the terms. If you don't want my money, find somebody else who will give you money. Guys, when your alternatives are to shut down the company or agree to Participating Preferred, who wants to shut down the company, raise your hands. I don't see a lot of volunteers. Okay, so shut up. Sign, get the $10 million in the bank and try to make the company worth a billion dollar. And who cares about participating? Because it's in your hands. Not in my hands. Isn't it fair? You are the founder. You are the CEO. It is your idea. Show me the money. Shut up guys. That's life.

Sad, but that's life.

Okay, so let's talk a little bit about the equations. So pre 1 evaluation is the value of the company before the investment. Okay. So I give an example with numbers so you can see the formulas later. So $10 million was the pre money valuation. And we invested let's say 5 million. Okay, so 10 million pre money put in 5 million. So post money valuation, not surprisingly is it was worth 5 million. 10 million, I put in another 5 million. Now it's worth 15 million. Right. Okay. So post money is basically how much it was worth a minute before you put the money in. Plus now were in a bank account. More money. That's how much it's worth. Okay, so that means that the dilution is basically the percent the new investor now owns which is the investment divided by post money.

So if he put 5 million at a pre money of 10 million, now it's worth 15 million. So 5 divided by 15 is a third. Okay? Not what you said. So our founder raised 1 million seed round and was diluted by 20%. What was the pre money? 4, of course. 4 plus 1 is 5. 1 over 5 is 20%. Okay. By the way, there is a test afterwards. And those who failed the test will not be able to raise money. So you better know these numbers. Okay?

And those who pass the test will be.

They will stand in line and then you will hoof to and then they will have to show shut up and start delivering.

Okay? Okay. So here's the dilution impact. So I'm taking you now step by step as it goes. I told you that there are numbers. So what do we see in here? And I will have to start walking in here. So the seed round was pre money 4 million. We put a million. Okay. Joe came in with 50%. Number of shares where there are a million shares to start with. So you can see the numbers. Okay, so we issue 250,000 more shares. That's the number of shares. That's the price per share. Post money value 5%. The dilution is 20%. So he owns 40% of the company. Okay. That's the seed round. A pre money just went up. Why?

Because the company was performing. Everybody's excited. So the pre money now reflects what people think the company is worth. It has nothing to do with how much money was put in. Okay. And he started 40%, we raised 5 million. So altogether post money is 15 million and we diluted by 33% and now he owns 26%. Then come round B. Round B is the same price per share notice in here. So the price per share here was 4, it's 8 and stays 8. So round B is not an upround, is not an up round. Why? Because they're doing their job, but they haven't blown the top. So they get the same price, but they raised $15 million. He's now diluted and then comes round C with Ray of Hope and he gets it down to 10 million. Why? Because he says you screwed up.

Sorry, that's what I'm giving you. And he puts 10 million. Okay, so he diluted everybody by 50% and now Joe owns 6%, 7%. And as I said, I made a mistake. So you will see later on that this makes no difference. As you recall, I left you in the middle of the drama Way of Hope put $10 million, 5 and had some conditions. So the new CEO is an experienced entrepreneur, should be successful, something. And it fell off like 2 o'clock in the morning. And he figured out that the way it's working now, it's not going to work. So he made a pivot. And the pivot is from signing up individual clients to selling mental health services to large companies. Now this is based on a true story.

As I told you, when Russ took over Ginger, he realized that going after one client at a time, paying client at a time will not work. He came up with the idea of going. I think his first customer was Netflix that they have, as you may recall, they have a very brutal culture in the company of being brutally honest and things like that. So people needed help and he gave them that. And the company is very successful. So this is Russ making a thing. And in about two years he was able to do an MIA transaction and sell the company for 25 million. Right? And what you're going to see is there is a press release in the press saying success Ma. The company was acquired and this is put a big checkmark. We are successful, we sold the company.

Therefore, this is not one of the ten. This is not nine of the ten. This is one out of the ten. This is the successful company. How many years from beginning to end. Choose a number. Whatever you want, okay? Choose a number. Meanwhile, they burned $30 million or something. Now the question is, was it really a success? Yes or no. So since I know all of you are geniuses in math, I Did the work for you? How much money did Joe make? For the last investor, it was success.

Joe didn't make money.

Joe didn't make money. Right. Why he didn't make money? Unfortunately, you're right. So Joe started the company, went through hell and made zero. How much money did Ray of Hope make? Don't try to calculate. Zero was easy. And did the agile investor make money? And the other investor, did they make money? So the answer is here. And I can assure you that you will not be able to find the formula, because I just invented it. And the reason is the following. All of this is true. Here's the cap table, okay? This is the money invested. $31 million. This is, remember, they take $10 million because it's participating preferred. So the 25 million becomes now 15 million, okay? So the 15 million has to be shared by all the people who have preferred share. But the question is, what did they negotiate? Not negotiate.

So I decided to just put numbers. Doesn't matter really. Just to show you what's going to happen. Okay, so as you can see in here, the round C was also round B. So $5 million they take out in participating because that's what they write off this round. And the $15 million that they put before. Right. Gave them 5 million. I just put a number, okay? I don't remember what it is. Altogether they took 25 million out. But here is the percent of the original investment. So the seed investor got 50% of his money. The high flying ventures was low flying ventures and made only 40% of their money. I gave the round C, which is round B. Okay? They did it twice. They did about 68, 69% of their money. And the only one who made money was Raofol and the new CEO.

Again, I forgot, I didn't put the new CEO because just to simplify life, what I'm trying to show you here, and this is really important, what you read in the news and what you hear, stories have very little to do with reality because the reality is extremely complicated to calculate. Once you start looking at all of these cap tables and the agreements and who gets first and who gets what, no way you can get out of it. So unless the company is

really high flying, you know, sold for $2 billion and invested 10 million in it, which is great, in most cases they look like this. So you don't really know who made money and who didn't make money. Even.

So when you see a press release announcing a great exit, that doesn't mean that everybody made money in this case, only the last round made money. Way of hope and not a lot of money. Okay, well in two years he did nice, 75%. So you have to bear in mind that when people say 1 out of 10 succeeds, the 1 out of 10 that succeed, which is like that might not be a success at all. Which is what I wanted to convey in here. Here's a success that really is masquerading a disaster. So those of you who want to start a company should come in here, look at it again and think twice about whether they want to do it yes or no. So why companies fail? So I went to ChatGPT and I asked why do companies fail? Venture backed companies.

And I got this table of 20 reasons. And you can see that they kind of first of all don't add up to 100 and second, they seem to be overlapping. No market need. 42% ran out of cash. 29% not the right team. 23% get out competed. 19% and so forth and so on. So I helped you consolidate. Ran out of cash. No, 100% failed because they ran out of cash. Nobody that has money in the bank closes the company. Okay? It's that simple. Very, very rarely companies with cash go out of business. So what they really mean in this table is that, yeah, why they didn't get why they ran out of cash? Because not the right team, get out competed and bullshit like that. Okay? They ran out of money. Can I repeat it again? They ran out of money. Why?

Because you saw how difficult it was to raise money and how complicated the whole thing is. No sales, basically they failed in sales. You say no market need. Get out competed. Basically couldn't sell. Okay, 61% and I think it's much higher than that even. Okay, so companies fail because they cannot generate revenues. They run out of money. Run out of money, Shut down the business. Not the right team. This harmony of the team, 43%. Basically half the companies that I meet have dysfunctional management. There is one reason which is missing here. No luck.

I think luck is crucial. It's important to know.

I cannot really build a theory about luck, but I can build a theory that will show you that. What they doing here? Here's a problem and I will explain in a moment the problem. Okay, so there is a typical order of activities. Sorry, this line shouldn't be there. Forget about it. Okay, so typical order sequence that companies go through is usually the same. They have an idea. There is. They find a co founder as I described. They try to build a prototype, a proof of concept. They write a pitch book, they raise money, usually at least a few hundred thousand dollars. They hire a team, proceed with building the product, and suddenly there is something highlighted. Team is a rigid monthly expense. Rigid means that on the 29th of the month, you need to transfer money from your bank account to their bank account.

Otherwise you break the law. Literally break the law. There's nothing you can do about it. So the moment you hire a person, you could dig a big hole for yourself. You have to pay them salaries or you fire them. You fire them. That's not that easy. You know, you have shimua and this. And that takes time. So when companies build a team, they build a rigid expense line. Rigid means months after months. After months, this money goes out the door. Everybody heard it. Think about it, okay? If they're sophisticated, they use a methodology called the lean startup. I'll show you the book. Here's the book. There is the book in Hebrew. They look almost identical. Those of you who read English can read it in English. Those of you who read Hebrew can find it in the conference room. This is the book.

Those of you who want to flip through later on is welcome to do so, but leave it here. I think it's an interesting book. I think it covers some of the areas that companies need to pay attention to. I will talk about it in a moment, but not a lot. We will have a lecture about this as well. Okay, Then there is the vicious spiraling cycle. So what happens is you raise money. With the new money come expectation that you would accelerate. You will do something with the money. Because otherwise, why give you the money? Usually what you do with the money is hire people. You hire people, you increase your monthly burn rate. So you are in a vicious circle. The more money you raise, the higher your expenses. And the expenses are rigid.

Most startup companies, their biggest expense by far is salaries. So when you ask yourself why companies fail, they run out of money. Why do they run out of money? Because they have people and people want a salary. It's that simple. I know it sounds stupid, but when you boil down why they fail, it's not luck. It's because they have people and they have to pay them salaries. And these people don't produce. That's why they fail. And we'll see what to do about it. Okay? The critical transition in life of a company is from product development to sustainably growing sales. So how do you get out of this vicious circle? The only way to get out of the vicious

circle is to get money. Not from investors. Right? Remember the movie no revenues. If you do revenues, you're going to be measured on revenues.

God forbid. You know, you can't make money, but you have to make money from customers. That's the only way to get out of it. Before you make money, you protect every penny in your bank like crazy because you don't have it. Okay? So the business model is the product. What is the business model? The business model is the entire shebang of who you sell to at what money you sell to. How do you reach to these people? We'll talk about it in a moment. But really, what you sell is not your product is the business model is what you sell. Okay? And that's very critical to understand before you have a working business model, you cannot spend more than a penny, maybe two pennies. That's about it. Every. Let's look at the standard way or the typical way companies work, right?

So every month of delay in sales, remember this is the critical transition. So you have a product, you have beta, blah, blah, all the good things. But you don't yet have this process that generates new customers and new revenues every month, and it's growing. Every month of delay in getting that accomplished cost you hundreds of thousands of dollars. Time is literally money. There is a reason I'm shouting. It is that simple and that much people don't look at. Before you make money, you lose hundreds of thousands of dollars every month. Okay, can this go engine be like.

A person that cold calls or something?

Whatever works, but it has to be proven to work. Okay? You need to bring money in at an accelerating rate or else you're going to get out of business. Sometimes you are lucky, you raise more money. Ray of hope, all of that crap. Okay, but even then he did a pivot. You have to find your business model that generates more money than you spend. The problem is that sales are complex and unpredictable. So every market looks different. B2B is even more complicated. B2C has its own problems. But B2B, you know, you sell. There's a whole committee there. There are many people involved in the decision. It's very complex. So what do you do? I'm here to tell you the secret. So you spent 10 lectures, you waited patiently for a half a year for this one liner. You inverted the order.

You start selling before you have anything. I know it sounds very bizarre, but that's the only way of increasing the probability that your company will be successful. As you said, there is luck. I don't argue with that. But if you increase your luck by a Significant factor. The only way of doing it is to invert the order. You start with sales. So let's look at it. We're going to go and this time we have our friend Joe.

Another Joe?

No, same Joe. But this time you will see what happened to him. Okay, He's a top knob engineer, has the same idea, left his job, everything is the same. He's still lost, very confused, but he doesn't look for a co founder. He joins Smart Op. That was a gimme, you have to admit, right? It's a gimme. Okay, so what? That's okay, you know, you didn't pay anything I'm allowed to do. So he joins SmartApp and we asked Joe the engineer, remember he's an engineer, to sell his concept, to see for himself if and how he can make money. This is almost like, you know, asking him to convert to Christianity or something like that, you know, it's really horrible. But yes, engineers can sell. I've tested it, some of them can do it. And you will see what happens to the ones who cannot.

You're an example.

Yeah, exactly. I'm an engineer through and through. So he needs to talk to two groups. Remember he has two audiences. He needs to talk to service providers. This is the mental health professionals and clients, people who want help. So he start talking to them. And what does he do? Because remember I told him, you won't get a penny from me. Roll up your sleeves, Joe, and start working. And what is the working? Tell me what the market tells you. Go and talk to the people you try to sell to. Just go. And those of you who already work with me know that we are ruthless about it. Go and talk to the market. So he has some friends and get intros and just cold calls and talks to some psychologists and social workers and it seems the following.

Many of them don't like this remote. The whole thing is about emotions. They want face to face. This, by the way, has changed since the Corona. I can attest firsthand, my wife, she wouldn't even consider doing it by zoom and now she's doing it by zoom. She doesn't like it, but she does. So has changed. They are also worried about the online platform where they look like they're selling themselves. Remember, these are professionals in the

healthcare business. They are not used to advertising or selling their services online. And you're not doing your shopping on the cheapest dentist or whatever. So it's just kind of not in the profession to have it there. And so they don't like it and they're also worried about, you know, what are they going to charge. So they say, I don't understand. An hour is an hour.

I want to charge the same thing whether I do it online or face to face. So the whole idea of price advantage disappears. Okay? So you start seeing what happens when you really roll up your sleeves. Don't think about the platform and all the buttons and whatever you're going to do, but just start talking to the market. You find things that you didn't expect. What happens with clients. So they prefer to meet a provider who is recommended. They don't go to a psychologist or a social worker just like that. They want somebody to recommend them. And they like the concept, but only if there is a significantly lower price than going face to face with a psychologist. Because otherwise they say, I prefer to go to somebody that is highly recommended. Yeah, I'll pay $300 an hour.

But I feel that I'm getting the best service. So what do we do? We have two groups. One has to give service to the other. One doesn't want to lower the price. One says, we're not going to come in there unless the price is lower.

Actually, they should lower the price because they don't have to pay for the propriety.

Tell them. They just don't listen to you when you try to build. So you have a problem. You have two things. My wife using such a platform and she's not ready to load the price first hand proof. So let's go back. Hold on, let's go on. Let's go on. So I have a rule. Follow the money. Did you ever see the movie Deep Throat? You know what I'm talking about? Follow the money. At the end of the day, you will find the root in where the money comes from and what they want. So if there is demand, if people want something, there will be people who will deliver it. So my rule is always try to generate demand. You can always figure out the supply. So I told Joe, let's figure out if we can generate demand.

So his understanding what the client want and when talking to friends, he realized that some are connectors. What are connectors? So gradually he started hearing from people who say, yeah, I actually don't need help because I'm talking to Linda. She's a best friend of mine. I mean, everybody knows Linda. You know, everybody knows her. And I are you Linda? Everybody knows you. And it turns out, and I'm sure all of you know them because they know you. Okay? All of you know people like Libby where is Libby? Gone. So I go on a plane. I went on a plane 10 times a year. Tel Aviv, Boston, 11 hours flight. Got out of the plane, didn't know who was sitting next to me. Libby goes on a bus.

She comes out of the bus, she knows everybody on the bus, what they do and everything else. Okay, they are connectors. These are people that people open to them, they talk to them, they feel something about it. So he suddenly realized that there are these people they would love to be the people who provide advice or service. They would do it at a much lower price. And actually it will be a very pleasant experience because people are attracted to them, they have empathy, they listen, they're nice. And if we charge not 250 or $300, but $100 an hour, there might be a business in here. So a new direction to explore the venerable pivot. Why am I saying that? Whenever I hear that a company was pivoting, I think about the rigid expenses.

That means they were spending a half a million dollar a month. They were going very fast to the edge of the cliff. They were about to dive down. And then they said, okay, oh my God, we need to move to the side or this side and hope that they will do something, they will change the direction. They should have pivoted a long time before. And the time to pivot is before you spend any money. That's the time to pivot. So that's why you want to talk to customers very early on and understand it. So what do I suggest to do? We went through exactly this concept. We wanted to develop an application that used connectors and we called it with a name bbody. And we decided to check whether it's a good idea or a bad idea.

So we thought about who might want to have this kind of relationship of help. And we had some ideas about beachheads, for example, people who undergo the process of divorce, tremendously stressful, right? And a lot of people are in that stage. They probably want to have somebody they can talk to. Doesn't have to be a psychologist. They just need somebody to talk to. So this is a bitch head, okay? People in a certain situation, easy to recognize because they raised their hand that they are in that process. And we had a few ideas like that. And Libby tested this bitches ideas using Facebook ads and Facebook groups. So we told Facebook, if they are in group X, Y or Z, give this ad to them.

And we ran several campaigns and got about 100 people to fill out a survey and talk to about A few thousand of

them. And we spent the royal amount of money of $2,500. We started to see whether we can get to these people and get them to do something. And we did it before. We had a thread of an idea about how the platform is going to look and anything else, it's irrelevant. So where is bbody today? So everything you see in here is the work of two people, Libby and Ayalasso. She became very busy and I told her, yeah, I know B Buddy is great, we love it, but unfortunately I need you here. So that's where B Buddy is. Anybody who wants to pick the baton and keep running, please talk to me afterwards. We think it's a great idea. Okay.

And we'll give you another $2,500 to do the next round of. But you start seeing the idea in here. So I talked about the typical startup sequence of event or actions. Let's talk about the smart up way. What do we. When I said invert the process, here's what I mean by that. First and foremost, try to sell your product or your idea to potentially paying prospects. You come to me with a great idea. I don't want to listen to you. It's not interesting. I'm not your customers. You're wasting your time on me, totally wasting your time on me. Find your prospects and talk to them. The prospects are the people who are going to pay you money. So you talk to them about money. Second, I want you to reach those prospects through a systematic marketing process. Let me explain to you.

Talking to the roommate of your neighbor is not scalable. You only have so many neighbors and they have so many roommates who went to Harvard mba. It's not scalable. So the fact that you found somebody who is interested means that you found somebody who is interested. That's not a business model. A business model is. You define a process that can scale up. You put an ad in Facebook, you were willing to spend only $100 and you got five people to respond. If you spend $1,000, you will get 50 people to respond. Okay, that's scalable. So when you talk to prospects, I want you to talk to the prospects who came through that systematic marketing program. Because now you build the foundation to a scalable business, to a growth engine. Remember, what kills you is the rigid expenses.

You want to make sure when there is a product to sell, you already have the process figured out. You know how to turn it on. You have to do that before you start spending money. And you saw that's why I gave you the example of Bee Body. It doesn't take a lot of money to check that you have a scalable, fast growing growth engine. A CEO that is not focused on sales from day one is not a CEO. You don't want to find it after $30 million. Okay, it's really that simple. To me, if when we talk to a CEO and he's not focused on sales, I tell him you're an engineer, that's really nice. Go find a job. It's that simple. Go find a job. Because your job is to sell and you didn't even sell to me. Go find a job.

Invert the process. Okay, can I say it again? Invert the process. Start selling. Day one. Don't spend a penny before you convince yourself that there is a market. You know how to reach it and they're interested in what you do. Now, how do you do that? So you can use tools like figma or Generative AI, like I generated these two beautiful people to demonstrate the product that you have. People want to see what you're doing. Right. So you can talk, but not the same as showing them. Showing them is believing. Right. So you can look real without being real. You saw these two guys, Joe and Linda and Julie. Can I say something about it? Sure.

You can also reach out to video editors and they will be able to do like a video that fake the product, but it will be animated and it will look the same. Remember the one we saw with the small thermos? What was the name of it? Kimos. Right. So those of you who saw that lecture. Right. So yeah, you don't need to develop the product to sell the product because your customers will believe in what you say. And then you will start heeding the real roadblock. The roadblock is not, can you do it? The roadblock is, do I need it? How much is worth for me? What's the sales cycle? You know, I need to get the CEO to. I need to have a budget. Blah, blah, blah. These are the roadblocks.

So just showing them a Figma or a video or whatever is enough for them to start literally seriously thinking about purchasing it. And then you start discovering the real issues before that, you don't know. A word of warning. Americans are very polite.

Too polite.

Very polite. Not too very polite. You go and you show them something and you say, is it interesting? And they say, oh yeah, very interesting. Those who are not Americans didn't notice how I said they're very interesting in American English, the intonation of these two words make a whole world of a difference. When we moved to the U.S. A friend of mine told me, when you see somebody who you didn't see in a long time, they will reach out to you, hug you and say, we must get together sometime. Don't get confused. That means I never want to see

you again. If they want to see you, they say, when can we meet again? We must get together one time means get lost, please. So the same happens in business. They will tell you it's really interesting. They would think about it.

Yeah, it's a really nice accomplishment. Yes, that can be helpful to us. All of those mean zero, nothing. If you say, okay, I will send you a PO for you to sign, they will say, what? Yeah, I'll send you a po. Wait a minute, how much is it going to cost? Now you start talking and probably he will tell you, don't even worry about it, I'm not interested. Or yes, I am interested. Okay, Second, so when I say talk, prepare something that resembles the product. Second is something I like to ask everybody. Prepare a list of prospects. That sounds like so what? But if I give you a tool like Apollo, ZoomInfo, LinkedIn and other lists, they're not inexpensive. Many of them, I think Apollo is even free to some level. What query do you put in to get the list?

Give you an example. We're talking to a company and we think that maybe the customers who give training courses online, long training courses like three hour training course, four hour training course, this product might be useful for them. How on earth are you going to build a list for these kinds of companies? And is there a difference if they sell a training course for $100 or $500 or $5,000? It depends what training course we're going to do. That's what I'm trying to say. So just starting to think about how do I build a list like that will immediately show you that this is much more complex than you thought and you better start thinking about it before you develop anything. So just asking people to create a query to produce a list of potential customers, you will see.

Try it for yourself and you will realize suddenly that, oh my God, how do I do that? How the hell do It? Yes, you're going to face that question. When you have rigid expenses of $500,000 a month, you better think about it. When you have rigid expenses of $2 a month, it's inexpensive to think about it. You can do it over the weekend. Try to reach out to them. So knowing Their name is good, but reaching out to them is better. So you can use all kinds of mechanisms from LinkedIn connections you send them, you want to connect to them to LinkedIn ads based on all kinds of criteria. Plenty of platforms. They're inexpensive. Inexpensive in the sense that if all you want to do is some test and get 100 people to respond, it's going to cost you a few hundred dollars.

That's what it's going to cost you. But you have proven to yourself and to potential investors that indeed you know what you're doing. And for very short money, you will learn three really important things. First, what specific message certain prospects respond to. Remember what you do? You're sitting in your home, in bed, you raise your knees, you have a computer there, right? That's what you do. Cost you very little. Now you need to write an ad. You need to give them something that will catch their attention. And you have no idea what might catch their attention. If I go back to be body, what you want to tell them is if you're going through a divorce.

Well, people who go through a divorce and see if you're going through a divorce will probably pay attention to it, but a woman who just gave birth will not pay attention to it, but she will pay attention to postpartum pretental depression. Right. So the message has to get people to respond to, and you immediately see the connection that each message will generate a slightly or very big different set of potential customers. So you start with a message and you see who responds, or you build a message for them to respond. But now you have a more unified universe that you can talk to because you know what they respond to. And by knowing what they respond to, you know how to reach them. So you already built the top of your sales funnel with this process.

Okay, so when I say invert the process, here's what you're doing. You really have to do all of that on day one. You have to understand who is going to respond to what message. And how do you do that? Because then when you have the product or the solution, you already manage to figure out the process and you keep improving it along the way. So when you spend money on developing the product, you also spend money in building this wheel that will get your customers in the door in a growing number. You have to do that. So what is the difference between branding and marketing? I talked a lot about branding first, branding first, and then I talk about marketing. They are not the same. So I'm trying to explain the difference between what I mean by branding and what I mean by marketing.

So branding is the process that makes a change in the minds of people. Okay? The famous example, I always say, is the Kardashians. All of you know who they are. You don't make any action, right? You're not chasing them down the street, but there's something in your head that says, yeah, I know who these people are. It's interesting or not interesting, but I have an opinion. It's in your head. Nothing happened yet. Okay? So you want to make sure that people know about what you do. They don't have to do anything yet, but this is a preparation. You're going to get an email from Kim Kardashian. You're going to open it. Why? Just because you are interested, you're curious. You're going to get an email from Jonathan Stern. You delete it because you never heard about me. Spam. Psst. Out the door.

What is marketing? Marketing is a process to slightly change the behavior of people. Because now you want them to do something. It's not enough that they know they need to do something. Something can be as opening an email, but there's some call to action. You want them to click on your ad. You want them to set up a meeting. You want them to do something. And as you might guess, it's much more difficult than a brand. Brand is passive. They know about me. Marketing is active. If you haven't changed behavior, you failed miserably in marketing. Marketing is measurable. Okay? You send an email. What percent open the email. What percent click on the button. It's measurable. So I hope you understand. I always say start with the branding. Why? Because the brand is the first stage.

People will not respond, as I said before, or respond in very low numbers. If you don't have a brand. If you have a brand, they will respond much better. It kind of accelerates everything you do now. How can you create a brand when you don't have a product? Easy. No, because you're talking about the problem. If you are going through a divorce, they will look at it. Why? Because they're going through a divorce at this moment. They want to know what you're saying. You don't ask them to do anything. You give them some advice. I don't know what. It doesn't matter, really. You just want to get them to know you. And the only way to get them to know you at that moment is talk about the issue that you really want to talk to them about, not the solution yet the problem.

You will be surprised in many B2B applications, customers don't know they have a problem. I'll give you an example. When I built ZoomInfo, were looking for, you know, were in the early stages. We were looking for potential customers. And one of the ideas we had was to go after universities. They usually have a development office. The development office means we're going to chase every alumni who made money and convince them that they made money because they studied at MIT or Harvard and they should give us half of their money. That's what development office does. So since were tracking all press releases and all newspapers and so forth, and usually they talked about which universities they graduated, we had a list. So we called. I remember it like today, because it was so funny. We called Upenn University of Pennsylvania.

We got to the head of the development office, and we showed her what we do, and she was very excited. So she asked, how much does it cost? We said, $20,000 a year or whatever. And she said, thanks, but I don't need it. I said, why don't you need it? And she said, oh, I have 10 people here who read all the newspapers every day. She didn't have a problem. She had 10 people reporting to her. She had a big office. She had, you know, she was a manager with our tool. What is she going to have? Nothing. So she didn't have a problem. So I'm trying to tell you that a lot of customers don't really understand they have a problem. They don't. You think they have a problem.

So your first issue is you need to convince them that they have a problem. It's that bad. When I say sales is difficult, you start to understand why it is difficult.

How Steve Jobs convinced us that we have a problem.

He didn't. He's a genius. I'm not. So I work with, you know, recipes.

Because nobody had a problem before the smartphone.

That's not true, by the way. This is a big mistake. People build, you know, handheld computers for about 20 years before the iPhone. Did you use PalmPilot? Did you buy one? Yeah. Okay. It's a predecessor of it. Why didn't the Palm Pilot shoot out the roof? For two reasons. Number one, there was no Internet. So your Palm Pilot was a small island with an address book and a phone. I didn't have any phone. Even. Okay, whatever. It was not interesting. It was not interesting. Okay. When you are connected to the Internet and you can find a lot of things, it starts to be very interesting. It connected to the Internet when 3G came about 2007. When was iPhone launched? Seven, six. About the same. Okay, so that's number one connection to the Internet had nothing to do with iPhone. Had to do with reality.

It was an enabler. Enabler, Right. But you need enablers to make money. Second, he built it so that you can put applications on top of it. Okay, that's his genius. I said he's a genius. But the enablers were in place and we shouldn't take those out because I can give you. I have a presentation like that. I can give you a list of 10, including the Newton. That was done by Apple 20 years before and was a total failure. So he didn't convince people. He just gave them a solution that worked. That's all. Same goes for the. What's called the music player. Same thing. He solved the problem of where do I get the music? Before the ipod, you stole it from a friend, right? They gave it to you under the table because there was no way of getting them.

He did a deal with the music companies and they all agreed to give you any song you want for 99 cents. Business genius. Okay, let's move on because we are running out of time soon. A business model is a critical element that can make or break your company. What is a business model? So I'll have a whole lecture about it in the future, but it involves answering the following questions and many more. Who are your customers? I think I talked about it a lot here. So a customer is not everybody who has. This is not. It has to be far more accurate because you need to know how to get to them. Second, packaging. What exactly do you sell? That sounds to people like, what are you talking about? It's obvious what I sell. Roy, can I use you as an example? You agree?

Okay, so Roee sells a software that does demand forecasting. Basically, it tells Nuva how many yogurt they need to produce next month. Based on history, I'm oversimplifying it. And when we. When Roy started selling, we realized that, hey, most people don't really understand what we do. The market is very embryonic, and they didn't buy. So we started selling. Rory, not me. I didn't do anything. Training. Because he had a lot of training courses. So as we started selling training, if you see the list of customers or companies who attended this training course, it's like everybody in Israel virtually. So that created demand. Then we packaged a piece of consulting that used the product called value analysis or savings analysis. They pay $7,200 for that, and it takes them to the next level of understanding what that tool can do for.

So that's what I mean by packaging. We took the sales cycle and we broke it down to individual pieces so that I can charge, or Rory can charge each piece independently instead of giving everything for free just to sell the software at the end. I'm working now with Danielle. So we do something and the question is, what do we charge for? For the storage, for the number of time people watch it for. You know, by. There are about 10 different parameters we can decide to charge for or not to charge for. Can you go to Amazon, aws, Amazon Web Services? And they charge. You don't understand what they do, right? Because they have a list of 10,000 things that they charge for or not charge for. Why? Because that's the way they decided to package it.

So what you see is that packaging is really critical to the success of the company. It has to be simple. It has to be something that customers feel they pay for the real value and don't pay for bullshit and all kinds of other things. Okay, pricing, that's my favorite one. Most people believe that people pay by the value. And the question is, what's the value? So my answer to that is there is no specific price for anything. It's whatever you are able to charge. And you better charge high. Why high? Because then you need fewer customers to make more money. I try to be as simple as possible. Okay, if you need to pay $100,000 a month, you want customers who pay you $50,000 each. Because then you need two customers, right? I used to have a very smart VP of sales.

And he said, here's my solution. If every one of my salespeople need to sell $50,000 a month, I want them to have in their pipeline one deal for 50,000, two deals for 25,000 and five deals for 10,000. He says somehow in this mix, they will get to 50,000. Okay, so you really want to try to charge as much as possible, but make sure that it's not a huge impediment to sales. It's art, going with the low price. Believing that a low price will get you more customers is just not true. Most expensive things are sold to companies. It's not their money. They are not sensitive to price. They'll get the same salary. It's not coming from their pocket. And you have to understand it. And how does the company decide whether it's worth it or not? They have no way of deciding it.

That's the reality. So I have a whole Story about pricing, but that just to make you understand what is a business model, what you see again and again is that how do you present the product that people buy makes a huge difference. I wrote in here energy companies. What do I mean by that? So people developed all kind of technologies to produce energy, windmills, low temperature generation, solar, whatever it is. And they wanted to sell the technology. They wanted to sell, you know, generation stations and they couldn't, it was too expensive. So many of them changed their business models. Instead they sell you energy. If you think about water desalination in Israel, it's done by private companies. What they do is they sell water, they don't sell you the water desalination process, they sell you water.

And the way that the government got them to do it is the government committed to buy, I don't know, a few million metric cubes every year at a certain price. So it guaranteed income to them. So the packaging can be very sophisticated. So you don't necessarily say, okay, here's what it cost. Buy it many times. You need to package it in a way that makes sense to the customer. And the energy area is very used to it that they don't sell the what produces the product. They sell the end result. Okay, all right, let's move on because we are running out of time soon.

So if I repeat it, and I think now number 12 or 13, just hopefully if I repeat it enough times, you will remember you have to do all the above with sport before you spend money on product development and even more

importantly, before you hire anybody. Remember what I said, you are an entrepreneur and a founder. You want to be the CEO. You are a salesman. If you are not a salesman, don't even show up here. Second, start selling. Start selling. We will help you. But start selling only when you convince yourself that there is a market, that you know how to reach it, that you understand what makes them respond. That's the first time you're starting to spend a penny on product development.

And by the way, your product will look very different than what you thought it will look because the people who respond to you will take you into a direction that might not be your original direction. You don't want to pivot when you have $500,000 a month rigid expense. Second, instead of looking for a co founder, this is really a subtle but very important point. Remember I asked you why do you want a co founder? And as I said, many people at the end say, it's lonely, it's scary to be alone, things look so big, so scary, I have no idea what I'm doing. I need a body. I need somebody next to me that will help me. We suggest gamification, which is the new word right now. You gamify everything. Tax paying, everything is gamified.

So you can start playing games because the cycle of the game is very quick. You put an ad in Facebook, you get responses within hours. So you can play a game, you can test your ideas on a daily basis. It makes it fun. You don't need a co founder, you need to play games. Because when you get feedback, when you get results, the world looks different, you're not lonely anymore. You can even do it while you're working full time somewhere else, which I usually don't like. But this you can start doing very important. Use what you learn about the sales funnel, packaging and price points to build a more realistic sales model. And it will be much easier to raise money. If you come to me and you said, here's what I did.

I figured out this market, I figured how to reach to them and they agreed to pay $150 per session. Okay, now I can multiply one by the other and I say, okay, I can see you can make $50,000 a month just by multiplying the numbers. That gives me a better feeling. Why do you need money from me? Literally, I asked it all the time, why do you need money from me? Just go do it. Some did it, they didn't need me anymore. They went and did it themselves. Okay, I told you at the beginning that I said at the end what we studied. So I'll go through it fast. We want to look at the life of a typical first time entrepreneur. The process of fundraising, the ecosystem of venture capital, the mathematics of fundraising. The most important thing is the tightrope.

When you raise money, how many things you don't control play a role in your ability to raise money. That's really important to remember. We told you why 9 out of 10 companies fail and why even the number 10 failed. Then I showed you the smarter way. Any questions? Two things. Either it was so clear there's no question, or you didn't listen to one word. Thank you so much.