

# 36% Average Rate of Return



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Entrepreneur in Residence

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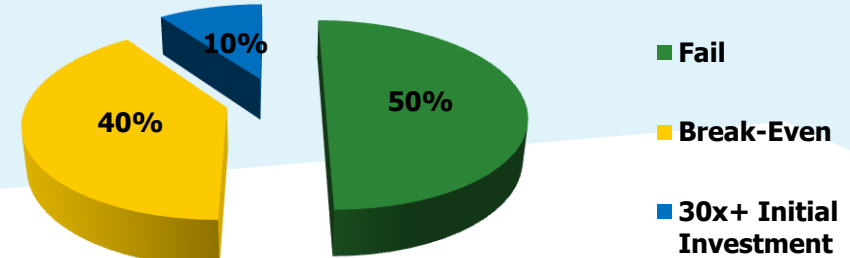
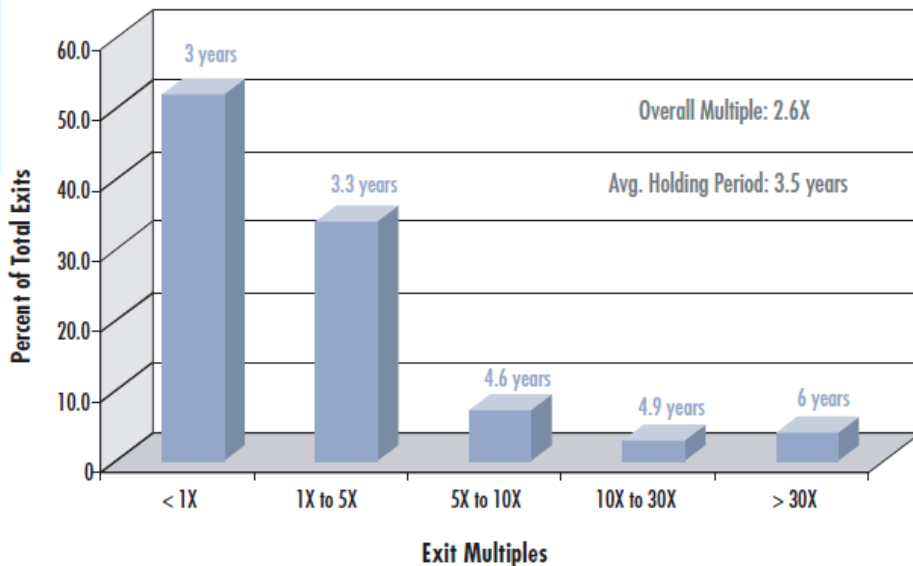
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## Start-Up Statistics

*Start-Up statistics are based on an analysis of Angel Investors. Angel investors are the earliest stage investors. They invest an average of \$200,000 per venture and have an average ROI of 2.6 in 3.5 years or an IRR of 27% annually. A good rule of thumb is five out of ten start-ups will fail, four out of ten will break-even, and one out of ten will return 30x+ the initial investment and account for all the returns.*

Distribution of Returns by Venture Investment



All assumptions about Angel Investors are taken from "Returns to Angel Investors in Groups," which is a survey of 539 Angel Investors experiencing 1,137 exits. The study was completed in November 2007 by Dr. Wiltbank of Willamette University and Dr. Boeker of The University of Washington. It is the largest study of returns to Angel Investors to date. The complete study can be found at:

[http://sites.kauffman.org/pdf/angel\\_groups\\_111207.pdf](http://sites.kauffman.org/pdf/angel_groups_111207.pdf)

A spreadsheet containing all samples and data can be found at:

[http://sites.kauffman.org/aipp/request\\_download.cfm](http://sites.kauffman.org/aipp/request_download.cfm)

## Value Added: Increased Equity

### 51% Equity - Scenario Analysis

Likelihood	Investment	ROI	Return	Years to Exit	IRR
52%	\$200,000	0.1	\$20,000	3 Years	Negative
33%	\$200,000	1.7	\$340,000	3.3 Years	19%
8%	\$200,000	6	\$1,200,000	4.6 Years	43%
3%	\$200,000	17	\$3,400,000	4.9 Years	76%
4%	\$200,000	35	\$7,000,000	6 years	81%

### 80% Equity - Scenario Analysis

Likelihood	Investment	ROI	Return	Years to Exit	IRR
52%	\$200,000	0.2	\$31,373	3 Years	Negative
33%	\$200,000	2.7	\$533,333	3.3 Years	39%
8%	\$200,000	9.4	\$1,882,353	4.6 Years	57%
3%	\$200,000	27	\$5,333,333	4.9 Years	93%
4%	\$200,000	55	\$10,980,392	6 Years	95%

Although no official statistics exist, Angel Investors take about 51% of the equity in companies in which they invest. The remainder of the equity generally goes to the entrepreneurs. Investors will retain 80% of the equity (due to the incentive fee discussed on page 8 - Compensation). By retaining 80% equity, the investors increase their average rate of return from 27% to 42% (this figure is prior to an hourly fee).

Timeline	Investment & Average Returns
Time 0	\$ (200,000)
Year 1	\$ 0
Year 2	\$ 0
Year 3	\$ 192,314
Year 4	\$ 310,588
Year 5	\$ 0
Year 6	\$ 439,216
<b>IRR</b>	<b>42%</b>

## The Four Metrics of Entrepreneurship

### 1. Growing Industry

Selling something into a mature or declining industry will necessitate taking market share. Selling into a growing industry allows for organic revenue growth - revenue growth at the rate of industry growth.

### 2. Large Margins

The value of the company will be determined by how much money it makes. A large net margin allows the owners to take a large percentage of revenues as earnings

### 3. Large Potential Industry

The larger the industry the more room for revenue growth. Five percent market share of a billion dollar industry is worth much more valuable than five percent market share of a million dollar industry.

### 4. High Valuation

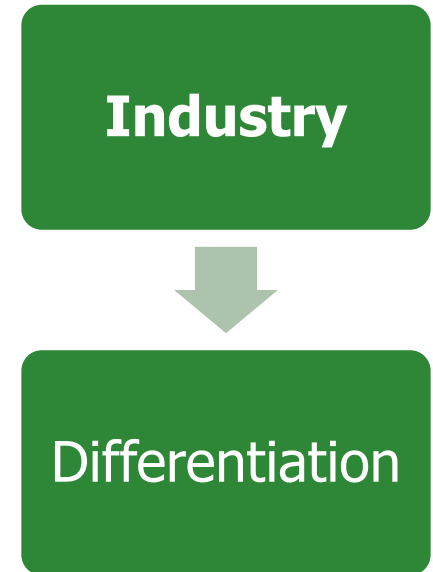
The business will be sold at a multiple to its earnings. A large multiple will lead to a high sale price.

HIGH RATE OF SUCCESS

HIGH RATE OF RETURN

# Industry

- What industries are likely to have the highest valuations when the company is sold?
- What industries are likely to be the largest, have the highest revenue growth and largest margins over the life of the company?
- For how much can investors sell the company?
- When are investors going to sell the company?
- To whom will investors sell the company?
- What are the start-up costs compared to the sale price?
- How can investors earn the highest rate of return?

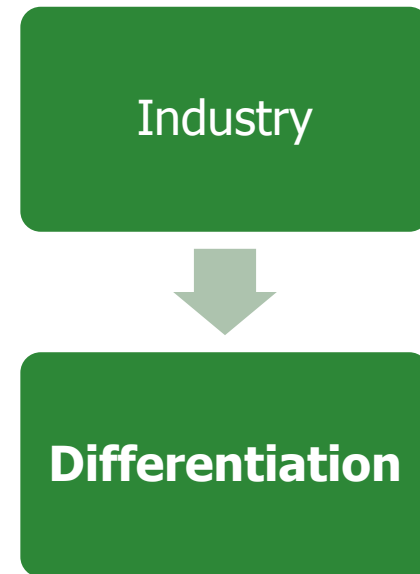


IRR	Time 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
85%	\$(150,000)	\$0	\$0	\$0	\$0	\$0	\$6,000,000

IRR	Time 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
91%	\$(250,000)	\$0	\$0	\$0	\$0	\$0	\$12,000,000

# Differentiation

1. Research the competition to understand how each competitor differentiates itself
2. Develop an idea of what the target market wants and its preferred mediums
3. Test market different forms of differentiation
  - Circulate multiple ads selling the same product or service different ways and measure responses
  - Send salespeople out selling the same product or service different ways and measure responses
4. Find the best form of differentiation and project revenues, expenses, and profits on a larger scale



# Entrepreneurship: Beating the Statistics

There are two ways to beat start-up statistics. The first is starting companies that have a higher rate of success than the stats. The second is starting companies that have a higher rate of return than the stats. My method of entrepreneurship involves researching the stock market then coming up with ideas. This method is designed to have a higher rate of success and return than the stats. This is done by finding the largest industries with the highest valuations, revenue growth and margins.

The stock market is the most comprehensive collection of information on industries and companies in the world. Stock analysis can be divided into two approaches relevant to entrepreneurship. These approaches are bottom up analysis and top down analysis. Bottom up analysis is the process of selecting stocks based on analysis of individual companies. Top down analysis is the process of selecting stocks based on industries.

Every entrepreneur in the world employs a bottom up approach to entrepreneurship. They come up with an idea and then research that idea. The most important part of entrepreneurship is the idea. It is the idea that determines industry size, valuation, revenue growth and margins. To come up with the best ideas, I employ a top down approach. This involves first researching industries then coming up with ideas.

Private equity firms sometimes employ a top down approach when selecting companies for investment. They do this by specializing in certain industries. Private equity firms are disproportionately concentrated in software and biotech. These industries have the highest valuations, revenue growth and margins. For example, in 2010, 25% of Venture Capital deals were software companies and 14% were biotech companies.

My job is to find which industries are the largest, have the highest valuations, largest revenue growth and best margins then start companies in those industries. Under this system, companies are more likely have high rates of success because their industries are experiencing high revenue growth combined with high margins. They are more likely to have high rates of return because they are in large industries with high valuations.

# Bio



## University of Wisconsin – Milwaukee

- Specialization: Investment Management Certificate Program
  - 14 students start a fund, manage a real portfolio, and perform the duties of an investment firm
  - Information technology analyst specializing in software

## Dana Investments

- Researched and traded stocks, private equity and fixed income

## Raveling Companies

- Managed the startup of company selling earth moving buckets
  - Tasks included financial forecasting, market research, business planning, branding, idea consultation, extensive legal matters, site selection and cost controlled implementations

## Only Designer Fragrances

- Managed the startup of a drop ship company selling cologne and perfume
  - Tasks included tracking the fastest growing online industries, differentiation research, scenario analysis, website design, Google advertising, market research, branding, financial forecasting and business planning

## Deal Lot

- Managed the startup of software firm selling used cars online
  - Tasks included tracking the fastest growing online industries, differentiation research, scenario analysis, financial forecasting, market research, business planning, branding, idea consultation, fundraising, software design, location renovation and cost controlled implementations

## University of St. Thomas

- Major: Entrepreneurship

## Marshall Enterprises

- Managed the startup of a company selling various products such as pillows, duvets and toys at flea markets and festivals at the age of 15.
  - Tasks included scouting locations, purchasing inventory, pricing products, selling products, employee management and travel

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## Compensation

Because traditional entrepreneurs hold no equity in companies, investors make 49% before fees. This assumes traditional entrepreneurs average 49% equity after accepting private equity investments.

It can take a month or more of labor to start a company. A month of labor costs \$36,000 (160 hours @ \$225/hour). This is included at time 0.

### Average Returns to Company Before Fees

IRR	Time 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
49%	\$(200,000)	\$0	\$0	\$240,392	\$388,235	\$0	\$549,020

Fee Type	Amount
Hourly Fee	\$225/hour (\$18,000/80 hours Upfront)
Incentive Fee	20% Equity in Subsidiaries

### Average Returns to Company After Fees

IRR	Time 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
36%	\$(236,000)	\$0	\$0	\$192,314	\$310,588	\$0	\$439,216