

Part I: Introduction

The Process and Purpose of Opportunity Evaluation

It All Starts With the Idea

There is that magical moment in every entrepreneur's life when a flash of clarity and an amazing idea of how to solve one of our many worldly problems pops into his or her head. Entrepreneurs often have an interesting story to tell about this moment. But before you jump off the couch and invest time and money into your venture, every entrepreneur must ask, "Is there enough demand for this product that people will pay for it?"

To answer this question, there are many factors that need to be examined and the factors presented here will give some direction as to how this question may be answered.

Consider the compelling unmet need: Does your product fulfill someone's need? How compelled is the customer to fulfill this need? Is your product something they cannot live without, or is it just a nice-to-have? Is it medication you need to lower blood pressure or is it a cough candy for your sore throat? The greater the pain your product solves, the greater the demand for it. The greater the pain your product solves, the more you can charge for it.

Consider the case of the Startup product Gelfast², a hygiene dispenser that can be clipped to a doctor's waist, allowing the doctor to wash his or her hands between tending to each patient. Therefore, Gelfast significantly reduces the rate of hospital acquired infections. Without Gelfast, doctors would not wash their hands as frequently as hygiene dispensers are typically placed in a fixed location, such as down the hall from the examining rooms. Gelfast is a great product idea and it has managed to gain interest from the Dragons because the pain it solves is so great. Research shows that in the United States, hospital acquired infections lead to over 2 million illnesses, 26,000 deaths and an added expenditure of over \$4.5 billion each year. This information helps the seller identify who the potential customers might be.

²www.medonyx.com

In Gelfast's case it is not the doctors, but rather it is the hospital administrators. As a hospital administrator, saving lives and money would be very compelling reasons to buy Gelfast products.

It is not good enough that you think it's a good idea, others need to agree with you to such a degree that they'd be willing to pay for it. When a great idea comes to you, ask others if it is something they'd be willing to pay for, and if possible, ask experts in the related industry for their opinions. Of course, many entrepreneurs are afraid to share their idea with others for fear that it might be stolen from them. To mitigate this risk, speak to only those who are inside your network and those you can trust. Not only can these people inform you on the quality of the idea but they can also help you improve on the idea.

If it's a good idea, chances are someone else is already doing it, so the first thing you should do is perform an Internet search on the idea to see if there is any existing competition or if there are already potential substitutes. If you find anything similar, you must take these competitors seriously. If you don't, you may find yourself in an unfortunate situation, just like the idea pitcher from ePawn World. He wanted to take pawn shops online where people could buy and sell items they would normally bring to a pawn shop, but he did not take eBay or Craigslist seriously as competitors who have already addressed this need.

Below are some ways to find an un-served need:

- Identify an irritation. Take traffic for example—if you could find a way to significantly reduce traffic, many governments would be willing to pay plenty of money for your idea.
- Overcome an assumption, such as “garbage has no use or value”. For example, find a use for sleeves that have been taken off garments. Recycling companies take other people's trash for cheap and turn them into someone else's treasure— they sell junk at a profit.

- React to jealousy. WestJet and Porter airlines strive to provide better customer service than the competition and it works— both airlines have developed loyal customers.
- Changes in technology. With the introduction of the Internet, Amazon.com was able to build one of the world’s largest bookstores without ever opening a “real” bookstore.

When that brilliant idea pops in your head, remember it is only worth investing your precious time and effort to turn the idea into a real business if people are willing to pay their hard earned money for it.

What is an opportunity?

At some time in your life you've had an entrepreneurial epiphany. Suddenly your brain came up with an idea that could make you rich. An idea that could change the world. An idea that could be your opportunity for fame and fortune.

If you are Mark Zuckerberg that idea might have been Facebook. If you are Elon Musk it might have been PayPal, or Tesla Motors or even SpaceX.

In the annals of time, whenever there is a problem or an unmet need, people will try to fix it. These unmet needs are referred to in academia as **sub optimal solutions**.

The telegraph was invented to address the fact that the postal service was a sub optimal solution for rapid communication. Airplanes fixed the suboptimal solution to long voyages by ship. Facebook shifts the **utility curve** when it comes to sharing information amongst your friends and family.

But why are some ideas seen as opportunities while others are seen as delusions? What makes an idea an opportunity?

Four Criteria of an Opportunity

All opportunities start with an idea. And while ideas are at the heart of all opportunities³, for an idea to be seen as an opportunity, the following four axioms⁴ must be true:

- 1) The idea is **durable**: The idea is not a fad and will last long enough to allow for monetization.
- 2) The idea is **timely**: The market is ready to buy the solution this idea encompasses.

³J.A. Timmons. (1994). *New Venture Creation: Entrepreneurship for the 21st Century*, 4th Edition, Burr Ridge, IL: Irwin.

⁴J.A. Timmons. (1994). "Opportunity Recognition: The Search for Higher Potential Ventures," in Bygrave, W.D (ed.), *The Portable MBA in Entrepreneurship*, 26-54, Toronto: John Wiley & Sons.

- 3) The idea is **attractive**: The potential rewards and returns on investment far exceed the foreseeable costs and resources.
- 4) The idea **adds value**: The idea must lead to a product or service which creates or adds value for its buyer or end user.

Where do opportunities come from?

This book is about opportunity evaluation not opportunity creation and it is beyond the scope of this text to fully explore such. Notwithstanding, the topic should be addressed briefly.

Any time a large population's needs are unsatisfied, entrepreneurs see opportunity. Whenever new technology opens up new solutions, there is opportunity. Every demographic shift leads to opportunity. If new discoveries lead to new possibilities, then they also lead to opportunity.

At the heart of every opportunity lies an unmet need. In fact, the larger the need (either by intensity or population) the quicker the adoption.

What is opportunity evaluation?

Sometimes one simply knows by intuition that a product or service is bound for greatness. It doesn't take a genius to know that the human desire for sex would lead to huge sales of Viagra®. Likewise, one can see the value of email in an ever shrinking globe. However, unlike Viagra® and email, most opportunities are harder to quantify—either because the market for such solutions is unknown or because the idea is so radical.

Since our time, energy, bandwidth and capital are scarce, we have to be able to differentiate the good opportunities from the bad ideas. This is true no matter what role you play in the entrepreneurial ecosystem:

- Entrepreneurs have to choose which opportunity to pursue.
- Investors have to choose which opportunities to fund.
- Government and NGOs need to decide which opportunities are worthy of public resources.
- R&D managers have to decide which innovations to explore.

Thus, opportunity evaluation is generally defined as the systematic objective assessment of a venture's potential. Please note that the quantum of return (i.e., how much money you can make) is not the only driving measure in opportunity evaluation. Investors refer to the quantum of return as ROI, which stands for **Return on Investment** and represents how much money (and other benefits) will be generated by the investment. For example,

The ROI of a one year 3% government bond, is 3%. If you bought \$1000 of bonds, you would receive \$1030 at the end of the year (your original investment plus 3%, or \$30). Besides ROI there is also the probability of success to take into account. After all, a billion dollar idea that fails isn't as good as a million dollar idea that

succeeds.

Who is this book for?

This book is for entrepreneurs trying to decide which idea to take to market. This book is for business managers deciding which internal projects to back. This book is for students watching Dragons' Den or Shark Tank who want to better understand the judges' perspectives. This book is for investors looking for a systematic and objective review of funding opportunities. If you have ever had to look at two opportunities and decide which one is more likely to succeed, this book is for you.

Why measure at all?

Considering the degree of unknown factors (for example, uncertain market, unproven demand and technical feasibility) involved in opportunity evaluation, many students ask why measure at all? After all, if most of the inputs are best guesses on future states (e.g., what is the pro forma revenue projection for year 3?) how reliable can the output be?

While the foregoing is true (most information used in opportunity evaluation is estimated at best); it is equally true for all opportunities. As a result, while not objectively valid (i.e., a high score does not guarantee a high chance for success) the opportunity evaluation process is internally valid. This allows us to compare two radically different ideas (both enmeshed by uncertainty) with some confidence. Or put another way, a high score doesn't guarantee a chance of success; it only predicts that opportunities with high scores should outperform opportunities with low scores. To make matters worse, there is no post facto way of confirming this as ideas that score low aren't pursued, making it impossible to know if they would have succeeded.

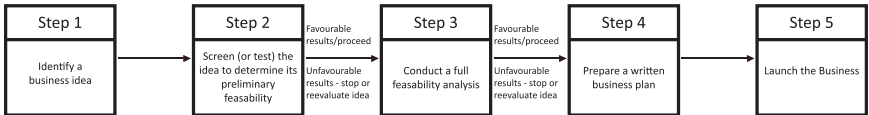
Notwithstanding, this book is meant to provide readers with a framework formally unknown to the general population. It is designed to ensure that entrepreneurial enthusiasm isn't driving

your decisions on which ventures to pursue.

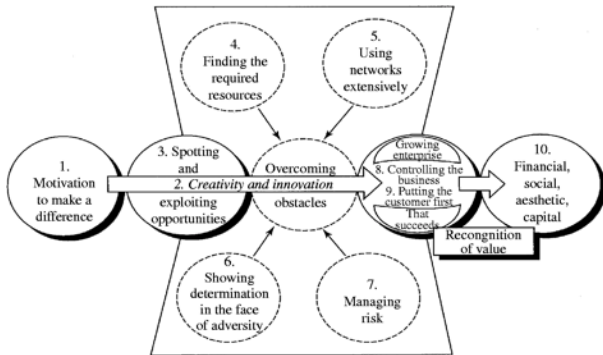
Where does Opportunity Evaluation fit into the overall entrepreneurship process?

Most attempts to model the entrepreneurial process (including the famous Timmons Model⁵) note opportunity evaluation as a key stage in the formulization of a new venture. Typically, it is advisable to look before you leap, and evaluating an opportunity before investing time and energy (and money!) is the best way to do that. Below are two diagrams taken from the academic literature that showcase the role of opportunity evaluation in the entrepreneurship process.

Model 1: From “Formalizing the front-end of the entrepreneurial process using the stage-gate model as a guide⁶,” by Barringer and Gresock (2008) we see opportunity evaluation in stages 2 and 3 below.



Model 2: From Bolton & Thomson (2004), note Stage 3.



⁵J.A. Timmons and S. Spinelli. (2003). New venture creation, entrepreneurship for the 21st century, 6th ed. Toronto: McGraw-Hill.

⁶Bruce B. Barringer & Amy R. Gresock. (2008). “Formalizing the front-end of the entrepreneurial process to improve entrepreneurship education and practice.” Journal of Small Business and Enterprise Development, 15(2): 289-303.

What is the cost of poor Opportunity Evaluation?

According to the Global Entrepreneurship Monitor⁷ in 2010,

“Some 110 million people between 18–64 years old were actively engaged in starting a business. Another 140 million were running new businesses they started less than 3½ years earlier. Taken together, some 250 million were involved in early-stage entrepreneurial activity.”

But how many were pursuing poor opportunities? How much time, effort and money were tied up in bad ideas? How much do poor opportunity evaluation cost us all?

There are opportunities around us each day. Some are good and some are not. Most people fixate on the “opportunities missed.” In over a decade of venture capital, I have heard statements like the following dozens of times: *“XYZ is a great business. I had the idea for XYZ years earlier.”*

The statement’s speaker will then go on to opine on how wealthy they would be if they had pursued the idea for XYZ. The problem of course is that success is measured post facto (after the fact). So the inventor first sees that XYZ can succeed before seeing how much money it could generate. This retroactively endorses the idea without forcing the entrepreneur to act upon it. Put another way, Mark Zuckerberg was not the first to explore Social Networks; but now that it is a huge success, many people want to take credit for it.

But even the cost of “what could have been” is infinitesimally small when compared to the resources squandered on bad ideas and the costs associated with them.

If Mr. G spends all his time, energy, social capital, bandwidth and money on idea Z. And if idea Z turns out to be a poor opportunity;

⁷www.gemconsortium.org

then Mr. G is not only out all the time, energy, social capital bandwidth and money he invested in idea Z but he also has an additional **Opportunity Cost**.

According to Investopedia.com⁸, Opportunity Cost represents:

1. The cost of an alternative that must be forgone in order to pursue a certain action.
2. The benefits you could have received by taking an alternative action.

For example, if an executive decides to go back to school to obtain his MBA. here will be direct costs (tuition, school books, bus fare, etc.) and there will be opportunity costs (salary not earned while in school; work promotions not pursuing, etc.). In order to understand the true cost of the MBA, one has to account for both direct costs and opportunity costs.

Take Farmer Q for example. Farmer Q owns 100 acres of prime agricultural land. Farmer Q has a choice; she can grow Carrots or Potatoes (or some mixture). But if she grows carrots which later go out of fashion (or there is a large oversupply of carrots produced) driving the price of carrots down before she can sell her crop; then not only will Farmer Q lose the money invested in the carrots and not only will she lose the revenue that those carrots would have generated; but she also loses the money she could have made in potatoes.

So what does poor opportunity evaluation cost us? Well, there is the capital, energy, attention and passion that is wasted, but there is also the opportunity cost. For every bad idea that moves forward lowers the resources available for the better ones.

Venture capitalists invested \$21.8 billion in 3,277 deals in 2010⁹. In the venture capital industry it is widely accepted that on average, that only 1 in 100 pitches to a VC get funded. Based on this rule, we

⁸www.investopedia.com/terms/o/opportunitycost.asp

⁹www.NVCA.com

can see that if 3,200+ deals got funded, then at least 300,000+ pitches did not get funding that year. Yet, of the 1000+ entrepreneurs who pitched me personally in 2010, each enthusiastically proclaimed their idea was the “best I would ever see!” So why the disconnect? In three words: Poor Opportunity Evaluation.

In 2011, 61% of non-business owners say they want to start a business¹⁰. Yet on average less than half of these ideas will service 5 years. A third of them will be dead within 24 months. If only entrepreneurs and inventors spent more time evaluating opportunities and less time pitching them.

In the last decade I’ve heard over 10,000 pitches. Not one of them thought their idea was weak. Tune into Shark Tank® or Dragons’ Den® any week and for every great idea you see, you will sell half a dozen not so great ones. Yet before they enter the Tank (or Den) each whole heartedly believes their idea is the best. If only they weren’t so weak in opportunity evaluation they would save themselves so much heartache, wasted time and lost capital.

¹⁰www.sba.gov

How to use this book

This book is meant to provide the reader with a formal, objective tool to evaluation opportunities. Narcissistically, I've named this tool the WiseGuide™ and you can see it in action online at:

www.USEtheWiseGuide.com

Following this introductory section, we will move directly into defining and demonstrating how to score the 44 elements that make up the WiseGuide™ scoring system.

In Part III we discuss potential pitfalls that can kill a great venture. Even though we leave this discussion until after the 44 elements are illustrated, in the “real world” opportunity evaluators typically check for pitfalls first, and only upon finding none do they undertake a more thorough review. Because of this, the framework presented here follows a Stage-Gate model¹¹ of decision making.

Part III is followed by a “Tool Kit” of the concepts in action. This section is meant to illustrate how the elements come into play as well as provide the reader with practical and grounded examples from the real world.

For the most part, examples come from my work as a venture capitalist and from my years of experience working with the business reality show, Dragons' Den (also known as Shark Tank).

We have also been blessed to have contributions from leaders in opportunity evaluation. We have spread these short essays throughout the text in the hope that their perspectives will help round out readers' opinions. These sections will be easy to spot, as the author's name is listed below the subsection.

Finally, knowing the issues with your opportunity is only the start of the process of opportunity assessment. Smart evaluators also

¹¹en.wikipedia.org/wiki/Stage-gate_model

look to see which elements could be quickly, easily and successfully upgraded and evolved. Sometimes, an investor brings domain. To help with this evolution process we have added, wherever applicable, a section entitled Raising the Score.

How to gather the data needed

This text is not a guide to Due Diligence. It is not meant to cover all the variables that need to be accounted for prior to commitment. It is simply a starting point for opportunity evaluation. It is meant to facilitate an exploratory conversation and to help opportunity evaluators decide if more attention is warranted. As a result, external references are not required. Third party evidence is required. Why?

All entrepreneurs think they have the next great thing, as a result investors and other opportunity evaluators can't rely on self-serving statements. Instead, whenever possible, seek out third party, arms' length information. What are your actual sales? What have your potential clients said? Who else believes in the greatness of your opportunity?

Quality of Evidence

The stronger the evidence presented, the higher the score. The greater your ability to prove your assumptions using external validation, the better the score. For example, sales are great but sales to well-known brands are even better. Saying that your product is needed is good but showing the rapid adoption of the product is better.

To account for this in your assessment, give extra points for any element that is presented with third party evidence (footnotes, sales receipts, feedback from focus groups).

The Credibility Factor

When you Google your name, what hits do you see? Perhaps that paper you wrote in university, maybe your LinkedIn profile,

or possibly pictures from that conference you attended. Do they portray you in a positive light?

In any partnership “trust” is essential, and every investor wants to ensure you’re truthful because, ultimately, they need to trust you with their money. In the beginning, every investor will check over two things:

1. Are the entrepreneur’s claims true?
2. The reputation of the entrepreneur

It’s difficult enough to build a business from scratch, imagine doing that with a partner you can’t trust. With this in mind, entrepreneurs must be completely honest with investors and only make claims they can back up. Too often entrepreneurs turn into blowfish before meet their investors. These are the entrepreneurs who to “inflate” themselves moments before the presentation and over value their companies, and the inflation always shows through.

Upholding the highest level of honesty and integrity and making claims that you can back up ensures investors will perceive you as credible. This credibility earns trust, convincing investors you will use their money wisely.

How to use the WiseGuide™

At the back of this book and online at www.USEtheWiseGuide.com, you will find a template worksheet for opportunity evaluation. It has been broken down into eight categories and each category is weighted. The weighting is based on feedback from more than 100 professional investors.

The eight categories cover the major areas reviewed in the opportunity evaluation process are listed below:

- **People** ⇨ who is behind the project?
- **Pain** ⇨ what problem are you addressing?

- **Product** ⇨ what solution do you offer?
- **Province** ⇨ to what market or industry are you selling?
- **Pitch** ⇨ how will you deliver a clear, two-minute overview?
- **Plan** ⇨ what is your go-to-market strategy?
- **Proposal** ⇨ what are you seeking to gain, what are you willing to give?
- **Pitfalls** ⇨ what things should you avoid?

In each of these eight categories, there are several sub-elements. Each will be rated by the reviewer. Ratings go from -10 (very bad) to +10 (very good). In total there are 44 elements in the WiseGuide™. Each element has a rating and that rating is multiplied based on the importance and impact (5 for impactful, 3 for important, 1 for average). The weighting is based on investor experience.

Weightings are based on the impact that each element may have on an investment decision and may relate to investor capital, investor time and so on. To represent these relative weights, I have assigned a multiplier to each element based on categories:

- **People** ⇨ 5x
- **Pain** ⇨ 5x
- **Product** ⇨ 3x
- **Province** ⇨ 3x
- **Pitch** ⇨ 1x
- **Plan** ⇨ 1x
- **Proposal** ⇨ 1x

The result should be a number between -1340 and 1340.

What is a good score?

“Good” is a very subjective term. The top score possible on the WiseGuide™ is 1340. For those who are extremely risk adverse you would want your score to be no less than 1150 (85%). For those who are more entrepreneurial in nature, no less than 810 (60%) or more makes the opportunity worth pursuing.

However, I would caution against this type of thinking. Instead, look for the opportunity in which you have a competitive advantage. If you have deeper Domain Knowledge in opportunity 1 than opportunity 2, it might be worth pursuing opportunity 1 even if it has a lower overall WiseGuide™ score.

On a similar note, once you have generated an opportunity’s WiseGuide™, revisit the lower scoring elements. Consider if you are able to impact that score. Perhaps you find a partner with Business Acumen, taking that key element from a -5 to a +10. Perhaps you might be able to secure some IP, raising that element from a 0 to a +5. In other words, don’t simply calculate the score and walk away. Examine the scorecard with your partners and determine if any elements could be improved.

¹²Based on a survey of 500+ innovation investors.

Same Opportunity, Different Scores

Two investors are unlikely to generate the same score, even for the same opportunity pitched at the same time. The main reason for this is that each reviewer has their own experiences that impact their reception of the pitch. These differing experiences influence how they perceive risk and in turn how they rate each element. As a result, two reviewers may see the same facts, but perceive them differently. Don't be disturbed by this. The key is not to have an absolute score but a relative. Is opportunity A better than opportunity B? Is B better than C? Once again, this leads to internal validity (I use the same experiences to judge each opportunity) but scores will be different from reviewer to reviewer. This raises the issue of bias.