Lenses of Investment

By

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How to spot a winning startup, early on.

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Introduction

I have been involved in due diligence and startup vetting for over twenty years.

At first, they all seemed different, as the products were different, the markets were different and founding teams.

I would write my diligence notes and share with the VC that asked for my input. In most cases I would not hear about the company again. Many pitches do not get funding, the majority in fact.

Some of the companies did get funding, and I would get to see if they made it or not, if they turned to a unicorn, or go public eventually.

They say that good engineers are lazy. If an engineer ends up doing something repeatedly, they automate it. Thus, after a few years of writing notes for each call, I started seeing the patterns and created a form. This form had the most common and repeated questions I ask, so at least I did not have to type those repeatedly.

With my risk management background, I then turned the form to a model, that ascribed values and weights to each question and answer. That allowed me to come up with a score for the startup. How likely is it to succeed from the little information available in the early days? Said differently, it scores "how hot" is this startup in the eyes of the investors?

Why did I do that? It turns out that the VC investors did not care much about my answer. They did not care if I think they should invest or run for the hills. They always seemed to care more about why I think what I think.

They wanted to know the reasons I ended up giving the company a thumbs up or a thumbs down.

This article explains the method I developed, the questions, the score and the overall model. It helps shed light on the most enigmatic part of investing, the part where you need to predict an outcome, with very little to go on.

My hope is that this model will help both investors and entrepreneurs to see through these "lenses." Focus on what is important, and what are predictors of "success".

Why create a model?

In my Startup Advice blog, I write about my experience in the four startups I founded. One post covers the two critical mistakes founders make, that ultimately costs them their business.

I use an example of a kid playing with a magnifying glass to burn paper, by focusing sunrays.

The two ways the kid will NOT achieve success are:

1) Not focusing the sunrays on the surface of the paper. The kid can wait for eternity, and nothing will catch fire.
2) The kid focused the sunrays perfectly on the paper, yet, keeps moving the magnifying glass to different spots. They can wait for eternity, and nothing will catch fire.

The same goes for startup founders. They either don't have the right focus on the product-market-fit. Or, they do have PMF focus, but keep changing their beachhead, their use case, their buyer, their market – and thus, never spend enough time to be known for something and be called on by buyers.

During my diligence calls, many times, a founder would share the same story. While they planned to sell product X to buyer Y, there is this one customer that asked for a different use of their product. Because this customer is paying them, they are taking a detour from their main plan, as it will bring cash in.

If this example resonates with you, we can then expand upon it. In the case that the founder **is focused**, and there is PMF, and the founder is patient for the sunrays to hit the same spot and start a fire… the next question is: **how big** can this fire be?

Surely, even a kid's lemonade stand will catch some fire, and will make some money. But that is not an investable business, that scales and VCs would fund.

What's in a name

Why Lenses of Investment?

To visualize the Lenses of Investment model, we begin with the sun. Yes, the sun above, that shines and provides "endless" sunrays.

The model allows you to know if you have a kid's lemonade stand or a potential Coca Cola.

The difference is in the ability and capability of the two operations to "capture" sunrays. The kid has the right product and can sell 50 cups of lemonade a day. Coca Cola has the right product and can sell 50,000,000 cups of Coke a day.

They are BOTH successful, and both profitable. However, by design, one can harness more sunrays than the other. That is how this model works, and calculates at the end the propensity to succeed.

Now, exchange sunrays with the worldwide GDP, as that is the totality of "sales" ALL companies can possibly get. This is why I used "endless" as even with infinite sunrays, there is just so much apparatus to capture them. Even if Coke could make infinite number of bottles, there are just so many thirsty people who can and would buy. Ergo, the worldwide GDP, represents in the model the MOST a startup (and in fact any company) can hope to capture from the total sales available.

Sunrays = Sales.

This year, the global GDP is estimated to be $124 Trillion. A founder better not show slides that amount to more sales than that 😉

If all the commerce is $124T, that means, each company captures a portion of this total. You can then divide it by geographies, market, market segments, use cases etc.

In a perfect world, the model calculates how much of this total this startup COULD capture. Thus, we can estimate the probability of success.

Because we live in the real world, where perfection does not exist, we need to add demerits. If the total sunrays above this startup is worth $10,000,000 of sales, we can further reduce it based on the ABILITY of the company to capture the rays.

We started with ALL sunrays, ALL sales ($124T), and then reduced the light passing through into this one startup to $10M. Meaning, if they perfectly execute their plans, for their first product, that is what they will capture, at most.

That could be great, as they can then add new products, and keep growing.

However, if the total sunrays they can capture is $2M, and their funding will run out… there is no second product, ever.

The Lenses of Investment model is a pun. The model is based after a real glass lens, the figure of speech works here just as well. Lens is used both figuratively and literally. Investors can keep adding new lenses through which they evaluate how much light is still left as a "bottom line."

To summarize, the model analyzes how much light will pass through, and thus, how much light this company could capture.

Here is a visual to help imagine the lenses the light goes through

This guide is for model version 3.4
The Excel file opens in read-only mode, and you can save it

What options each lens has for light passing through?

Each lens, has four options:

1) **No lens –** The light passes through with 100% of the amount of light that preceded this lens. It's a passthrough of all the light, and does not degrade, or enhances the sunray. The score is 1 and will not help move the score to a favorable range, and not penalize the score.
2) **Convex lens –** This lens increases the focus of the light that entered and makes it brighter/hotter. For example, if the company has a pending patent, or a granted patent, the model will increase the viability of the enterprise to capture light. The score is between 6 and 10 and will help move the score to a favorable range. Place 6 if the review is fair/average for what you would expect. Place 8 if its better than average. Place 10 if you think this is the best answer to this diligence question.
3) **Concave lens –** This lens decreases the focus of the light that entered and makes it less bright/hot. For example, if the company has a product in a very crowded space, the model will decrease the viability of the enterprise to capture light. The score is between 0.1 and 0.9 and will not help move the score to a favorable range. Place 0.9 if the review is worse than average. Place 0.1 if it's the worse answer. Do not place 0, as it is a reserved number for a Blocked lens.
4) **Blocked lens –** This lens is completely opaque, or blackened out, so NO light passes through. In such cases, no light will reach to the paper, or the bottom line, and thus it is a showstopper. It is as important to give the model the data on the good news, as the bad news. Identifying a Blocked lens could be the difference between winning or losing your investment completely. The score is 0 and will create a showstopper. This score is enough to rule out the rest of the items, as the light will NOT passthrough, and NO revenue is expected at the end of the series of lenses. No light in bottom line.

Let's fill the model

The model is divided into sections, the market size and the company itself.

The first section is about **Gross Worldwide Product ($MN)**

Helper tip for this lens reads: Total sales (light) available worldwide - this is a fact, not an input

The first section is about **Market Value**

Helper tip for this lens reads: What market is the venture in? Transportation, Cyber Security, Biotechnology, AI etc.

The next section is about **Market Segment Worldwide ($MN)**

Helper tip for this lens reads: Total market size for the segment, as published by analysts or known. Transportation -> Airplanes

The next section is about **Company Total Available Market ($MN)**

Helper tip for this lens reads: TAM (Total Available Market), what size of the market segment the venture covers. Transportation -> Airplanes -> Consumer VTOL

The first section for the company itself is about **The Idea.**

What is the venture about?

Helper tip for this lens reads: Indexing every page on the internet or selling ice to the Inuit (formerly known as Eskimo).

Say that the founder pitches you on building a new car that runs on air, that sounds like an amazing idea and should score a 10. Alternatively, the pitch could be about manufacturing ceramic plated horseshoes, that last ten times as long as the current ones. "Think about all the horseshoes we can sell in New York City alone with the amount of horse and buggies they have over there…"

Oh wait, this is not 1903. This will not score a 10, and it is up to you to decide if it gets a 6 or a 0.

Skating to where the puck is going/now/was?
Helper tip for this lens reads: Building security for mobile phones, anti-virus for MS-DOS.

Say that the founder pitches you on building a fax machine with an Apple-esque design. One would think this is a market that is dead, and no fancy design will bring back the use of fax machines.

Riding a Mega-Trend
Helper tip for this lens reads: Is there is an industry trend rising: Social, Big Data Analytics, 3D Printing, AI

When assessing how hot is your startup, and the odds of getting funded – you also need to consider the trend du jour. It also helps an investor to know that the venture is throwing itself into a trend, which may help increase the chances of success and/or an exit.

The next section is about the **Market.**

Size ($ Market Size)
Helper tip for this lens reads: How big is the industry the venture is in? Note that this venture may create a new industry.

If the venture is in cybersecurity, you can figure out how big is the spend, the sunrays, of this market. If this idea is like Uber, you need to consider both the current market (taxi rides) and the potential NEW market, of rides that will now exists only because you can be a part time driver. If before getting a medallion in NYC was difficult and expensive… now you will a whole new set of drivers that did not exist before.

Same as the case of AirBnB, where new lodging spaces are now going to be available that were not before. So you can't just asses this opportunity based on the hotel industry numbers, and the cannibalization of those sunrays.

Opportunity ($ TAM)
Helper tip for this lens reads: How big can this venture be as part of an industry or create.

If the startup is focused on bitcoin payments for the cannabis industry in Costa Rica, you can make some assumptions about the total opportunity. You should not extrapolate the number into payments in grocery stores and other territories – as it may not have product market fit.

Number of potential clients
Helper tip for this lens reads: All Internet users = 10 companies worldwide.

This means that if the startup is potentially aimed at all internet users (say OpenAI), then the score is 10/10. The fewer potential clients of this startup, the smaller the number you should plug into the model.

How crowded is this space
Helper tip for this lens reads:
Many players = 1
few = 3
One = 5
None = 6

Being first to market could have an advantage. However, you also need to trailblaze and crack the code before anyone else. There is no advantage until the advantage is seized. Thus, this model on penalizes for a crowded space (risk of not rising above the noise) and par for the course if you are first to market. Note that the lenses here do not go into a fraction, and only add more difficulty to capture light.

The next section is about the **Product/Service.**

Existing market or new category
Helper tip for this lens reads: Is the product entering a well-defined market or creating new category.

Some investors are happy to see a new category being created, and thus, will score the opportunity higher. Some investors will see a new category as the most difficult endeavor and score the opportunity accordingly.

Cool Factor
Helper tip for this lens reads: Is the product cool? Nest or Honeywell?

In the world of Apple changing the game of design, to make tech look cool – a new generation of startups followed suit. No longer, a product is investable if it only serves the purpose of its function. Form needs to join function.

Vitamin or headache pill
Helper tip for this lens reads: Is this solving a problem for a business, or only enhancing it.

If you get up in the morning and feel fine, you can still take a vitamin and feel good about taking care of yourself. Yet, when you wake up with a pounding headache… the vitamin pills are not what you reach for. In business, the same thing happens, and solutions are either solving a big headache, or are considered nice to have. Especially when budgets are cut, you want to be in the category of solving a pain.

Do users need to change behavior
Helper tip for this lens reads: Does it require users to do something different, such as carry a token, remember something.

This lens and the one that follows it, are critical to the evaluation of a new startup. So many founders underestimate the difficulty in changing users' behavior. Thus, dig in and ask the hard questions, as there is little data to support success – when big changes are required. Here are some historical precedents to showcase that even if the product is awesome – it is hard to change behavior: Google Glass, Meta Oculus (for non-gaming uses), Man purse (Murse), Juicero, Hydrogen cars, PGP.

Does the product cross any taboo

Helper tip for this lens reads: Does it require to swab your mouth to pay at a supermarket?

This lens also has a helper tip in the scoring column. "If yes, score 0". This is a lens that does not allow any light to pass through it, so there is no reason to think the startup will succeed.

The next section is about the **Intellectual Property.**

Patent applications

While patents, even when granted, are not easily enforced, they do give an investor some protections and sense of security. If the founder applied for patents, it gives the investor more chances to protect the business and create a moat.

Patent granted

While patents are not easily enforced, they do give an investor some protections and sense of security. Especially if M&A is the exit ramp, it may help with increasing the value of the venture.

Game Changing Patent

Helper tip for this lens reads: Patents that will require an industry to pay? One click ordering (Amazon), or micro deposits to verify accounts (PayPal).

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The next section is about the **Product Stage.**

Helper tip for this lens reads: Pick the stage of the product. The higher the stage, the higher the score. This is a self-explanatory lens, and you need to pick the stage of the venture. Starting with a dream in the founder's mind and ending with a GA (generally available) business with over $1M in annual sales.

The next section is about the **Scaling.**

Quality of infrastructure

Helper tip for this lens reads: Is the deployment based on standards

In software, you are not an island. You integrate to systems that existed before you showed up. Unless you have a rip and replace an entire ecosystem. Thus, to be able to "fit in and stand out", you should make the integration based on standards – which in turn will allow you to scale. If the founder expects the world to "Just upgrade their JVMs to the latest version so we can use this whizbang tech…" – you are in for a rude awakening when the customer will say they are not upgrading until sometime from now.

Ability to extend/scale

Helper tip for this lens reads: Can the infrastructure scale with the business

The ability to use infrastructure as a service, cloud provider that scales and a team that is familiar with capacity planning – is what this lens is scoring.

Business Model: Perpetual, SaaS, Freemium

Helper tip for this lens reads: Score this based on your appetite for business model. Usually, subscription is desired

Channel-partner ready

Helper tip for this lens reads: Can the product or service be sold by others easily

This dovetails with the scaling question, but from a channel perspective. If the solution is only able to be sold by specialized salespeople, it may hinder the ability to scale through a channel GTM.

OEM license options

Helper tip for this lens reads: Can the product have OEM license opportunities as a channel (Google Maps).

API based products, can be sold as a complete solution with a portal footprint. If the API can also be used by others, as an OEM (original equipment manufacturer) – it can enable more use cases. OEM means, that if you sell ketchup only in retail glass bottles, you cannot really sell it to factories who will use it inside their products. Think of Google maps as a complete application where you can get yourself directions and food around you. And yet, because this app is using the API, it can be consumed by ANYONE within their app as an OEM. ChatGPT could have only sold their primary portal/app as their product. By exposing the API to others, it allows for more use cases.

Price range fit the market

Helper tip for this lens reads: Is the pricing fit the market willingness and ability to pay? Competitive?

Beauty is in the eye of the beholder. Founders may price their solutions from their perspective only. Beware of that, as it will take a long time to change their minds, and you may open yourself up to competition.

Priced to value?

Helper tip for this lens reads: Is the price based on costs, or the value it brings to the buyer?

Pricing is a topic that has endless debates and theories. This lens is about the price the startup is using, and if it is based on their COGS (cost of good sold + margin), or based on the value they provide to the buyer, or something else.

You would score this lens higher, should the pricing model and actual price be tied to the value. Referring to the question of vitamin pill vs headache. Say that the cost of an 81mg aspirin pill is 5 cents (the COGS). If you try to sell it to someone who feel great, you can't even get 5 cents for it. If the customer has a headache, they may be willing to pay you $10 for it. If they are about to do something important, like give a speech or compete in the Olympic – you could get $20 for the same pill. Should they god forbid have a heart attack and you can save their life with this pill, they would be willing to pay more. Price to value is tricky, and should be what the venture aims to achieve.

The next section is about **The Team.**
The founder/s comes first.

Founder/s Experience

This lens gives you a score of how well this founder is suited for this venture. As in, some people want to have a food company, but they have no knowledge of this space. Similarly, non-technical founders may have a harder time to build software teams that scale.

First-timer

Helper tip for this lens reads:
If No, score 10
If Yes, score 1

There is no ambiguity about this lens. You either had a startup journey before as a CEO, or not. Nothing can prepare you for that, and no book can teach you what to do. The lessons learned, the proverbial "scar tissue" is what the investor is after. If it is not a first timer, you should give this lens the full aperture of light coming through – 10/10. Any other answer is a score of 1.

Respected in their field?

This lens should help you score the ability for this founder to gain the force of nature needed to bend the universe. Here is an example of a 10/10 – Thinking Machines Labs

Failed before? Scar tissue?

This lens allows you to give a score to founders who may not have been in the number one box (CEO) before but learned through other experiences what a startup journey is all about.

Do they know they don't know? Know it all?

"The more you know, the more you know you don't know" – Aristotle

If when you ask a question there is only bravado, confidence, certainty… you are risking your investment. Founders assume (wrongly) that answering "I don't know" – means they will not get an investment. However, "I don't know, and I will find out" – is a perfectly normal answer when you are a trailblazer. After all, you are in uncharted territories.

Can they lead a product? Say "No"?

The best thing a CEO can do, is say NO. Simple. To focus, you say NO a lot.

Can they attract talent?

In the early days, when the team is small, and everyone is doing everything – this is less critical. As soon as the switch is made from 0 to 1, from a dream to an MVP, you need to hire GREAT talent to help build the company. The CEO is the best salesperson for the product and the company. They ought to be able to attract top talent, to win.

Can they tell a story in a captivating way?

Helper tip for this lens reads: Can you sit and listen to them for the next 10 years in board meetings? Will prospects?

Founders are not for everyone. Some could be super annoying. To have self-awareness of their idiosyncrasies is a key factor to their success. Ask yourself: "Am I going to dread every time they call me?" If the answer is yes, this investment may not be for you. It could be for someone else.

Are they determined?

Helper tip for this lens reads: How bad do they want to win? Are they on a mission?

This question is hard to ascertain in the process, and founders will tell you what they think you want to hear. Nonetheless, this is a critical lens, as if they are not determined, they will fizzle out. Fact is, 9 out of 10 startups fail, because there is no stamina to keep going. Note that the weight of this score has a factor of 3, meaning if your score this a 10/10, it will count as 30 in the weighted score.

The next section is about **VP of Engineering/CTO.**

Can they attract talent?

Respected in their field?

Can also be an External CTO?
This lens can help you asses if you only have a good technical talent, or if you could also get technical thought leadership in the space. It is rare to find a CTO that can do both, as most are introverts.

The next section is about **VP of Product.**

Are they a real alchemist?
Helper tip for this lens reads: *Can they blend art and science?*

Can they attract talent?

Do they have a sense of what's cool?

The next section is about **VP of Sales.**

Are they a rainmaker, Level 1 salesperson?

Can they attract talent?

Do they use a sales methodology fit for this company?

Have they closed big deals before?

The next section is about **Team Dynamics.**

Family/Friends ties?

Ability to Execute

Worked successfully before?

Will the business needs trump personal relationships?

Are they a herd that will leave as a group?
Helper tip for this lens reads:

If No, score 10
If Yes, score 1

Culture: Inclusive, Dynamic, Driven, Results Oriented

The next section is about **Funding/Backers.**

Notable angles backed this venture already?
Notable VC Investors?
Did the founders invest their own money?

How realistic is the pre-money valuation?
Is there a clear path for an exit?

The next section is about **The X-Factor.**

Is there industry buzz in the air about this?

After all, do you have a strong X-Factor gut feeling?

How to read the score?
Each lens has a value you set, and a corresponding Red/Yellow/Green.

Most lenses have a weight of 1, which means, your score is directly taken, as is, into the Weighted Score. Some lenses are MORE important than others and carry a heavier weight in the success factor.

Check the Total Weighted Score Average, and the legend of score ranges.

Total Weighted AVG Range
0 in any row Showstopper

1 to 7.99 Pass

8.0 to 9.99 Consider investment

10-10.99 Invest

11+ Don't let them leave the room without a term sheet