An Interview with Dave Humphrey

Dave Humphrey, COO, Oklahoma Equity Partners, speaks with Growthink University's Dave Lavinsky

Dave Lavinsky: Hi everyone, this is Dave Lavinsky from Growthink, and I'm speaking today with Dave Humphrey. Dave is the Chief Operating Officer and Senior Investment professional for Oklahoma Equity Partners in Tulsa, OK. You can find Oklahoma Equity Partners website, online at www.oepvc.com.

Now prior to this, Dave was a principle at Davis Tuttle Venture Partners which is the oldest venture capital firm in Oklahoma. Dave also has deep operating experience during his decade plus with Cook Industries. Dave led over $300 million of acquisitions and expansions and was the CEO of a $200 million dollar business where he increased profitability six-fold. So, Dave I really appreciate you taking the time to speak with me today.

Dave Humphrey: Right, thank you Dave, I always appreciate the opportunity to interact with people like yourself that are supporting and helping entrepreneurs.

Dave Lavinsky: Excellent, I appreciate that. So, Dave, the question on the minds of nearly all entrepreneurs right now is, how do I raise capital now? I was hoping you could speak about this pressing topic today.

Dave Humphrey: Sure, I'd be glad to. I guess by way of prefacing it, let's talk a little bit about what's going on in the marketplace today. As we all know, we've experienced six months of very tumultuous marketplace going on with the sub-debt market ultimately bringing down the entire economy. We've all lost money in our 401(k)s and it's somewhat bleak. We're in an absolute recession. The concern is, are we going to go into a depression or not.

The government is spending billions and billions and billions of dollars trying to keep that from happening. There's a lot of back and forth and a lot of concern in the marketplace is that the right thing to do. Obviously, that's not a topic we'll

discus here, but just trying to play out what's going on in the venture capital community today.

Well, one of the concerns, of course with venture capitalists, is its source of funding comes predominately from institutional investors, such as pension funds and endowments from universities and other types of groups, trusts and various organizations like that, and certainly high net-worth individuals.

All of these constituencies have probably lost value in their portfolios. In particular, institutional investors, such as endowments and pension funds, allocate a certain portion of their investable capital in what they call alternative investments, which includes hedge funds, private equity funds, venture capital, and maybe even some commodity trading. Those have higher risk profiles and so they allocate anywhere from a couple percent up to as much as 10%. Higher risk, but higher returns, which is why they like to invest in that type of category.

Some of these institutional investors, because of the other side of their portfolios, not the bond markets, certainly, which they had some money in, but any equity markets they'd invested in the public markets have also gone down. Similar to ourselves and therefore they are now, in some cases, over-allocated on their percentages into those so-called alternative investments. So that's created some concern within the venture capital community from a long term standpoint.

However venture capital still has very long runway, we have a lot of capital that's been raised by the industry, in excess of $100 billion, they invest about $20-25 billion a year. You and I met at the World's Best Technology Conference Call the other day, which is certainly one form, and an excellent one, for people to pursue looking for investors.

So, the bottom line is that the market has pulled itself back from the standpoint of cash, of course, has always been king, and investors that have put money into a number of what they call portfolio companies are going to do everything they can

to preserve cash in their portfolios and keep cash back to be able to do follow on investing in that.

So, it is going to be a tighter market today, but it's not a non-existent market. The market still does exists and there are a number of states that are looking towards initiatives to try to support the venture capital communities within their states as well. So, the real key question that you've asked though, and let's get to that right now is, what does it take to attract venture capital, in any market, and in particular a tight market like we have today.

Dave Lavinsky: Right

Dave Humphrey: The keys to any deal from a venture capital standpoint, it takes three key elements and I've never heard anyone contest that these three elements are key in any venture deal.

First and foremost it starts with the management team. You've got to have a team pulled together, you don't have to have all the pieces, but you need a major portion of that team that's pulled together that has good synergy, meaning that the sum of the parts is greater than the individuals themselves and that they have a successful track record.

An ideal candidate for venture capital is somebody who's already started up a company, taken it through its growth period and ultimately exited. While that's ideal, that's certainly not the norm. Most people haven't done this before, but you do have to have some track record of success because the venture capitalist is investing in you as a team, as an organization.

They're not just investing in technology. They got to know that this team can execute that business plan. That put it together full well knowing venture capital is going into the deal, knowing that any business plan that is put in front of them is probably not going to be the plan we end up with at the end. So, we need a

team that's flexible, that can change as the market changes, as the market dynamics change. And so the management team is real key to any investor. They don't want to run these businesses. They want to invest in teams that can execute and run these businesses.

The second element in any venture deal is the niche or the element of uniqueness. There is going to be a lot of franchisees in this country that are going to get funding from friends and family, and maybe some angel investing, but they're not going to get venture capital money.

That's just a "me too" strategy that somebody else has developed a great concept that's good. I'd like to take that and start up a business. Now that's a great way to start up a business and get some grounding and develop that so-called success factor we talked about earlier. But, it's not a method to get venture capital. We're not going to invest in franchisees.

Venture capitalists might in a franchisor if somebody's got a great concept. The key is, what do you have that differentiates your business? And it's usually technology and certainly at the World's Best Technology Conference, it's all about technology. And so groups that appear there start with the technology. They develop some kind of unique niche, some better mouse traps, something that's a unique element all around the technology.

It can be tech-based; it could be performance-based; it could be execution-based that differentiates you in the market, but in most cases it's technology that's generally patented. And you can apply to that marketplace and provide you with an exceptional advantage in the marketplace either on cost or performance or some other element that is key to that marketplace.

The third key element is the market itself. Now it would be great to be in a growing market, that's growing at 10 or 15 percent and by dropping into that market, you're going to be able to capture your portion of the market and grow

with the market as well. Although most markets that we look at often don't perform like that. And we don't bank, we being venture capital, on the fact that it may be growing now, but it isn't going to be necessarily growing five years from now. We're lucky to exit this business.

So, the key for us is size and the breath of the market. And if someone has got a really, really, really great product and they believe they're going to capture significant portion of a 100 billion dollar market. We're going to get to $50 million dollars in three to five years. You go, "*That's really great*."

The problem is when you got 50% of the market share at the end of three to five years, your growth is now tapped and therefore your exit opportunity is going to be taped as well. So, while often times we look for businesses that get 30, 50, 100 million, even half a billion dollars in revenue, we don't start with markets that are 100 million dollars.

I will tell you though, often times I find entrepreneurs, they'll misidentify their market. They'll be in Texas, or they'll be in New York, or they'll be in California, and they'll say: "*California is my initial market and here's the size of that market*."

The next question though is: "*Are you prohibited from marketing anywhere else?*" They say, "*Well, no, that's just my entry level market*."

Well I go, "*Tell me what the whole market is. Is your market the entire U.S. market or is there an international opportunity*?"

So, I want you to define the total market opportunity, not where you're initiating your market play, but the total market. Because if you define that market as only one state, full well knowing within the next five years you're going to have to execute outside of that market area, now you've under-defined your market and you're going prohibit my ability to want to pursue that deal.

So, its real key for you to identify what your market is. It may be growing, it may not be growing, but it has to be of significant size to attract our interest. So those are the three key elements of any deal.

Now what does it take to attract venture capital, ultimately? Well obviously it takes those three key elements. In addition, I'll tell you, it works like any other marketplace today.

And that is that *networking* is certainly a key. If you can find somebody who knows somebody who knows a venture capitalist, that always helps to open the door. It's not going to get your deal done for you, but it's certainly going to help with the introduction to the venture capitalist. Giving a sense that somebody knows you and helps validates that you're a real player in that marketplace. So networking your way into a venture capital firm is always key.

It starts with the business plan. Now, in some cases, you attend a conference like the World's Best Technology Conference. In that case it starts with a presentation. Now those types of presentations – many people can tell you how to do that.

I noticed that you had interviewed Guy Kawasaki. Guy has his keys to presentations, such as the size of the font, the number of points on each side, no more than ten slides, and have your elevator pitch ready at a moment's notice, which is always key and important.

I don't necessarily completely agree with everything that Guy says, but I do basically fundamentally agree that you've got to have your important points down pat. And you've got to have your elevator speech ready.

When you present, if the presentation is a five minute, seven minute, ten minute slot, you've got to communicate in that five, seven, ten minute slot why somebody

should be excited about your deal. Meaning you've going to have to communicate a little bit about your management team, a little bit about your technology, a little bit more about your market and the opportunity and why you think you're going to generate a successful deal, and why somebody should be interested in investing in it.

So it's not all about the technology, it's much more about the marketplace and the team. But tech certainly is a key differentiator as you pointed out.

Dave Lavinsky: What do you find that turns you off when you're sitting through yet another presentation?

Dave Humphrey: One of the key things I always hate is when people do a top-down market evaluation, rather than a bottom-up. And by that I mean they say, "*This is a billion dollar market. And if I can just get one percent that's 10 million dollars, and if I can get 10% that's 100 million dollars.*" And what I've got now is I've got a plan that basically doesn't have any execution involved in it. It just says "*If I can.*"

What I need is somebody who can build a plan from the bottom up. Meaning I'm going to hire this many people, it's going to have this long a sale cycle, I'm going to approach this many customers during that time, I'm going to execute and generate this much sales with some hit ratio. And that builds up into a market model over time.

"*I'm going to hire this many employees to do all of this.*" That's a true execution model, where it ties the costs and the revenues together. It demonstrates performance and execution. That's a plan we can work with versus if someone tells me right off the bat about the size and percentage, I'm immediately turned off and I'm not listening anymore.

Dave Lavinsky: When you're doing the bottoms-up, a lot of times the entrepreneur might get too aggressive in terms of that they're going to grow the revenues too quickly. On your side of the table is it more of a gut feel whether they think they're too aggressive or less aggressive? What are your thoughts when the financial projections get very large very quickly?

Dave Humphrey: I guess the question is, are they making a presentation at a conference to try to draw my attention? If I'm hearing these huge numbers, that's not exciting me, because I question anybody achieving a billion dollar performance in the next three to five years.

Certainly 100 million dollars, 50 million dollars, those are reasonable – those are the kind of deals that we look at doing. And I'm not going to *not* do a deal because they tell me they're going to do a billion dollars. But I'm going in with a little bit more hesitance – a little bit more of a questioning attitude.

If, on the other hand, it's during the interview process – and again, let's take us through the steps. If you're not presenting at a conference, the normal process is you're going to send me your business plan and I'm going to review the business plan in detail. If I can't get through the executive summary because it's not a fit – it's too early, it's too late, not big enough – then we're done and we're not going to get past that.

If, on the other hand, I like what I'm reading, it makes sense, I like the space, I like the size, I like the play, I like the team, I'm going to read down and I'm going to get into more details. If I still like what I'm reading, then I'm going to ask to meet with you and you're going to come into my office and we're going to sit down and visit with a team of guys.

Now with my fund, I'm a single player, but I co-invest with other VCs. So other times, myself and a VC will sit down and have that conference. Sometimes I will take the first, being myself and I will follow up with my co-investors. And so that

is when you have to sell us on the team. That is when you have to sell us on everything you have put in that plan and why it's valid. That's when you get into the real nitty-gritty details of the kind of quality people you have in the organization, the kind you're going to hire, why you believe you can execute these levels.

And, why you have the experience to demonstrate, because that's the other key. If you're going to go and sell to the, in the telecom industry and sell to the baby bells, I know without a whole lot of thought process, that's not an easy process to do. They are hesitant to buy new technologies. They are a slow buyer. It's a bit of a ramp up and its going to be a long sales cycle on something like that. Even though I have never worked in that industry, I am fairly confident that's how it works.

So you're going to have to demonstrate that you have experience in that industry to me. Prove to me that you have the right team pulled together that can get you there. Whatever the industry is, you're going to have to have a team that has knowledge and experience in that space to demonstrate to me that it's a believable plan. And that comes down to that plan and the believability that's around that team.

Dave Lavinsky: Now what advice would you have. You've come back to the team a few times as your number one in your three key elements. What advice do you have for the entrepreneur right now as the sole practitioner in terms of bulking up his team and getting the skill sets that they currently don't have – any thoughts or words of wisdom on achieving that?

Dave Humphrey: Well, that's a real, real difficult question to answer because I don't know the entrepreneur themselves. Let's characterize some of them. We have some that are very, very steeped in technology. They are coming out of the universities. They are coming out of the research centers that are federal labs, etc. So they are so steeped in the technology they don't really have a good sense of

what it takes to start a business. They are starting with a big disadvantage. Great technical advantage, but big operating and execution disadvantage. And that is a big hole they are going to have to dig themselves out of. They are going to have to find the key players within the industry.

Then you are going to have to find key telecom guys to come in and join your team. You may need to visit with consultants. Visit with people you know own those labs. Network you way around industry contacts that are a real key at making your company a success.

You know, that's one point. Someone else that is of the industry, and they went out and found some technology. And they've linked themselves up with maybe some of these university people or federal lab people, or other some type technical background. So they've already got the elements of a team. And this guy's an industry player, so he knows who the other guys are in the industry.

But again venture capitalists are not going to do the deal or give you three to five million dollars because you have a great idea. You've got to be, you've got a great business to invest in.

Dave Lavinsky: I definitely appreciate you walking through that – definitely – and I think you mentioned twice now something which I preach a lot, which is *networking*. And networking, it works for everything. It works for building your management team, it works for meeting investors, it works for meeting advisors, and for clients as well. It is all about meeting the right people and building your team and building your company through networking and relationships.

Dave Humphrey: Exactly, and that's why I think people like yourself play such a key role in particularly in embryonic or young start up engineers or in entrepreneurs that have a concept or idea. They don't really know how to form a business around it.

You can help them with the networking, you can help them with what it's going to take to build a team. You can help them with these other elements and concepts. That's not a job I want to do, you know, that's not the role I play.

My role is to look at, you know, I look at over a hundred business plans a year on my own. Focusing only on the Oklahoma mart. When I was with Davis Tuttle Venture Partners, as you mentioned previously, with a larger fund and more partners, but I was the gate keeper, which meant I looked at about three hundred deals a year in that fund. And the whole fund took in about five to six hundred deals a year that we would look at, and we'd do two to three. So, we just know that it's a numbers game. We don't intentionally try to look at three hundred knowing that we are only going to do three. That's just how it works out.

Some are bits, some aren't ready, some are ready but we can't agree on terms or valuations or conditions, there's lots of reasons why deals don't get done. So we have to look at a lot of deals before we find that one that makes sense for us.

Dave Lavinsky: Excellent, so two quick things that came out of that are that venture capital firms are made up of partners, and a lot of people don't understand that it's not like you meet the one partner and they say "Yes" and it's done. You have to push it through that process, and deals obviously take time to do.

You know, a lot of entrepreneurs say, "*Hey, I need capital right away*" but even if you're interested, I guess now it's a faster process for you – is that correct? – than it was when you were with Davis Tuttle, in terms of the process from when you like a deal to when you're able to finalize a transaction?

Dave Humphrey: No, it's not really a faster process, it's about the same. The difference was that Davis Tuttle – the thing that's real important to understand is that these are partnerships. The way that venture capital funds are set up is that they go out to investors – "limited partners," they're called – and they get them to

invest into what's called a blind pool, which means the investor has no say in where the money is going to be invested. They don't get to make a determination of, "*We're going to do this deal and not do that deal.*" So that's important.

But nonetheless, it is a group made up of partners. And in addition, venture capitalists love to co-invest with other venture capitalists. It's a very collegial industry. The reason they do that is that they want enough dollars around the table to take the deal to completion.

That's another element of risk they can eliminate. Because venture capitalists – it's a very risky space to be in – you're starting out with very early stage businesses, some have no track record of executing on their plan. They don't have any revenue in other words, and what venture capitalists are really in the business of is minimizing the risk.

So they're trying to pick the right teams, pick the right product, pick the right marketplace, and be able to execute and generate revenues for themselves, and income and ultimately profitability for them and their investors.

So that's the bet they're trying to make. Their goal is to try to minimize the risk elements. One of those elements of risk is, "*Is there enough capital around the table to take this thing to completion?*"

If it's the first round of investing and there are two venture capital firms and they're putting in a million dollars each, but the maximum they can put in is a million dollars each, they're now at their cap and they're out of capital. They can't reinvest, they can't put any more in.

If the company needs more money later on, they're tapped out and the new round of investing can dictate the terms. Nobody ever likes to get to their cap within the fund, so they like to attract other VCs. One, for that extra capital, and two, there's

that many more hands and eyes looking at the deal – validating that it's a good market place, a good management team, a good opportunity.

Dave Lavinsky: Excellent. Well Dave, I definitely appreciate your time. This was extremely helpful, a lot of things – a lot of nuggets of information that you are so readily able to talk about – is news to a lot of people. I think it was extremely helpful to all entrepreneurs, particularly entrepreneurs in Oklahoma that might fit your criteria. I definitely encourage you to go to their website at www.oepvc.com. Dave, thank you again for your time.

Dave Humphrey: Dave, thank you so much. I very much appreciate what you're doing.