An Interview with John Babcock

John Babcock, Partner, Rustic Canyon Partners, speaks with Growthink University's Dave Lavinsky

Dave Lavinsky: Hello everyone. Dave Lavinsky here from Growthink and today I'm really excited to be able to interview John Babcock.

John is partner at Rustic Canyon Partners which is an early stage venture capital firm with more than $900 million under management. Rustic Canyon is based in Los Angeles, California. They also have offices in Silicon Valley and Seattle. John specifically focuses on investment opportunities in clean technology, software and service, and advanced building materials.

Before Rustic Canyon, John was general manager of online real estate at the Los Angeles Times. Before that John founded the Delta Group which is a technology consulting firm that advises clients including Intel and Compaq.

Based on John's background both as an entrepreneur and a successful venture capitalist, I thought he would be the perfect person to speak to today about the process of raising venture capital. I'm really excited to speak with him today. John, thanks again for taking the time to speak with me.

John Babcock: Thanks Dave.

Dave Lavinsky: Excellent. So the first question I have is how can entrepreneurs determine whether or not venture capital is an appropriate form of funding for them?

John Babcock: Probably the first question is just figuring out the capital needs of the business. Venture capital is about the most expensive capital that you can raise. It's an asset class where the return expectations are around 20%.

It will be pretty dilutive to get but if your business has the growth characteristics that make selling a third of your business for a few million dollars a worthwhile enterprise, that's a good one. The businesses where you see venture capital a lot

tend to be ones that are fairly capital efficient, that tend to have high margins and that tend to have enormous growth characteristics.

Dave Lavinsky: Okay so you talk about high margins and tremendous growth characteristics. You also mentioned a couple terms that I'd like you to define, just in case some people listening to the call don't understand them.

You mentioned capital efficient and you talked about expensive capital and dilution. If you can sort of walk through those in more layman's terms it would be helpful for some people listening.

John Babcock: Sure. So capital – obviously being money – and the three classic areas of venture capital have been semiconductors and semiconductor development, software and medical devices and gene development.

The first two of those are quite capital efficient, meaning to get the business up and running and profitable, takes in the case of software $10, $20 maybe $30 million. To develop a semiconductor has grown a lot in cost. It used to be done for that same cost, about $10 or $20 million but back in the day even less. Medical devices, life science development is not very capital-efficient in that to get a drug all the way through to discovery is probably a $150 million endeavor.

So matching up the venture capital firms you're talking with the characteristics of your business. Something like a restaurant of course is fairly capital efficient. You can launch a restaurant for maybe a half million dollars. But there's not a growth characteristic in that if your restaurant works out really well, with no additional capital you can't grow it to a multiple hundred million dollar business or at least not easily.

The profitability of all three of those classic areas I mentioned – software, hardware, and life sciences – are north of 80%. That is, once you have your product available for sale, to produce incremental semiconductors or additional

copies of your software, is usually very, very inexpensive and incredibly profitable.

Dave Lavinsky: Got it. So you're talking about companies that can grow very quickly, and when they do get to that size, they have very high margins versus a restaurant I believe is probably about 5% margin, versus you're talking about 80%.

John Babcock: Sure. I don't think restaurants are quite that bad but even at 30% or 40% margins it's tough to have something that grows with the profitability characteristics of hardware or software and drugs, medical devices.

Dave Lavinsky: When you mention expensive capital, I think for new entrepreneurs they're going to say, "*What does that mean? Why is that expensive?*" Maybe you can talk about dilution and equity and how much it actually does cost the company, the entrepreneur.

John Babcock: Sure and I don't know if it's worthwhile to walk through just the basics of debt and equity.

Dave Lavinsky: If you could that would be great.

John Babcock: You've got an idea or business you've either launched or have an idea for. To fund it you need money. The simplest thing is to take it out of your own pocket. The next thing is to go to somebody else. The first thing people tend to turn to are the three F's: friends, family and fools. And in that money you do it in two ways, debt and equity.

The big difference is if you take debt you need to pay it back and if you take equity you don't have to pay it back. But instead of me giving you money that you need to give me back, we take money and for that you issue additional shares in your company.

Let's say you had a hundred shares in your company. You sell me fifty. Now I own 33% of the hundred and fifty shares in your company. You never need to pay me the money back but if we can grow your business and sell it I'll take a third of the proceeds.

What makes equity expensive is how much money you got for that one third of your company, for the fifty shares you sold me. Venture capital tends to have fairly high return goals. That is people are trying to own a lot of the company.

Most things I invest in have some chance, sometimes a meaningful chance of completely failing. That is, the chip doesn't work and my $3 million or $8 million is just lost. So when you play that sort of game you need to make sure that when it does work it's very lucrative because you need to risk adjust for when it completely fails.

Dave Lavinsky: Got it. You mentioned earlier your goals for the average return would be about 20% per year. I guess you say it's expensive because of interest rates. If you take a loan it's probably more in the 5-10%. Is that where you're saying it's more expensive? Is that how you define it?

John Babcock: Precisely Dave.

Dave Lavinsky: Okay. Excellent. I think that's very helpful. I appreciate that. Let's say that a company has deemed itself and has the characteristics that are relevant for venture capital as you just mentioned. What would be the best way for the entrepreneur to first make contact with a venture capitalist like yourself? Would it be e-mail, phone or what other ways are the best ways to go about it?

John Babcock: Coming in completely cold is e-mail but that's a pretty tough way to meet us. I tend to think our portfolio CEOs – and we have investments in

probably fifty companies, so there are a lot of them out there – are a great way, to see if you know any of them and can convince them that your business has merit.

As you can imagine we have great confidence in our CEOs because for each one of them we've given them several million dollars. It's someone whose judgment we trust. An introduction from them is valuable. Introductions from attorneys, accountants, other professionals that we know and have worked with are good. Just the same as you can go on a blind date but people tend to prefer to get introduced by friends.

Dave Lavinsky: Agreed. Agreed. Okay so for the most part referrals help a lot. What about going to conferences and meeting at conferences? Is that a good strategy? A bad strategy?

John Babcock: I think that's actually a pretty good strategy. I would have said that wasn't true.

I was a judge for a fast pitch competition which is one of those things where the guys do the elevator pitch for ninety seconds explaining their business. Then I hold a number up from one to ten and there's three of us and five hundred in the audience. It seemed like a good theater and a terrible place to find a deal.

I saw an entrepreneur called Jeff Solomon who started a company called Leads 360. It was unbelievable. It was just a great business. He won the competition. I chased him up afterwards and wrote him a check for $3.25 million a few months later.

Dave Lavinsky: Wow. That's awesome.

John Babcock: I speak at conferences from time to time and have actually also found another deal from that. Somebody who just walked up to me after I spoke introduced themselves.

Dave Lavinsky: That's excellent. So that definitely in your case is a winning strategy as you've done two deals of that nature.

John Babcock: Yeah.

Dave Lavinsky: Excellent. That's very helpful. What about online networks? I believe you and I are friends on LinkedIn. I'm not a huge user of it. Is that another place that someone could get referred to you? Is that something you guys take seriously?

John Babcock: I don't know if I've checked my LinkedIn inbox in a year or two so that wouldn't be the best way to reach me. But it's certainly a good way to play the game of who do I know at XYZ venture capital firm, and maybe I know someone directly, but more likely you know somebody that I know. LinkedIn is pretty handy that way. I certainly use it a lot when I want to do due diligence. Who do I know at Nike? I find that service really works.

Dave Lavinsky: Excellent. What about angel investors? Do you guys work closely with angels and introductions from angels? What is that like?

John Babcock: We have members with both the Tech Coast Angels and the Pasadena Angels, though I have not done a deal with them yet. Actually as I think about it, it was a Tech Coast Angels thing that I was a judge for.

Dave Lavinsky: Okay.

John Babcock: So in that case perhaps I front-ran them. I think those are reasonable groups to do it. It strikes me today they're a pretty tough group to get funding from. But no, I'm always happy to look at deals that they've funded. Looking backwards I realize I haven't done a deal that they have done. I haven't followed them in any investments.

Dave Lavinsky: Got it. If an entrepreneur they've figured out that they do have a company that is applicable for venture capital, how should they make the decision with regards to should they raise an angel round or are they ready for venture capital?

John Babcock: Think about the risk factors in the business, and figure out which ones you can eliminate with how much capital. You can sort of do a backwards timeline from "here's when we're a big company," "here are the big risk steps," and "what you want to do between each."

You want to raise as little money as possible to eliminate major risk steps. It's sort of trying to figure out, hey, if you can really improve a couple things for $400,000 don't raise $2 million because it's going to be too dilutive. If there's nothing really proven until you have spent $2 million, don't bother raising a half million.

It differs by business but I think you can solve it a bit. Certainly one thing to do is go talk to guys who are venture capitalists and say, "*Hey I'm trying to raise $4 million*." If they tell you, "*No, it's too risky*" or "*No, I value your company at $1.5 million*" and going back to my parallel, that's you selling me a two-thirds of the company for $3 million, probably tells you that you need to take another path.

Dave Lavinsky: Agreed. So you need to figure out how much capital you need to really get to your next point where you eliminate an area of risk.

John Babcock: Definitely. We talk about a little bit like trying to cross a river by hopping from one rock to the next. The reason for that analogy is if you needed a million dollars to get to your next milestone and you raise $900,000 you're going to get real wet. To fall even a little bit short and to run out of capital

is crushing. Trying to figure out how far it is to that next rock and if you need a million, raising $1.1 or $1.2 million is a pretty good idea.

Dave Lavinsky: That's a great analogy. What are some of the rocks? You called them risk gaps or steps. Can you give some examples? I guess that would be like creating a prototype that works, getting your first customer – are those the type of things you're talking about?

John Babcock: Exactly. Particularly if it's a really novel business, I think trying to demonstrate customer demand is very important. If it's really ambitious technically, obviously if you can build the whole product that's terrific. Short of that, if you can identify where the highest risk parts of it are and can solve that problem, that's a great way to do it. And if not, trying to show progress on the hardest parts and a reasonable path to the smaller ones.

Dave Lavinsky: I think that's great.

John Babcock: Yeah. Trying to figure out where the risk is. As you can imagine, in a business I've got where a third of what I invest in completely fails. Actually I've been a little more risk-averse since I haven't failed at quite that level. But that's sort of industry norm. Eliminating risk is really important to me. To eliminate some risks makes a big difference in valuation.

Dave Lavinsky: That's a great point. I haven't really heard very many venture capitalists speak on this in terms of an entrepreneur looking at their business and identifying all the risk factors and the goal is to keep crossing the stream, crossing the river, knocking off each stone to eliminate risk. I think that's a great way to look at your business and also to help you with your milestones and action plan.

That's great.

Let's say that someone has eliminated some of the risk, that they're ready for you guys. What material do you want to see before deciding to invest in a company and in what order? Executive summary, PowerPoint, business plan -- what information are you looking for and at what point?

John Babcock: That depends a lot on the stage of the company. I'm working with an entrepreneur now who's literally been three for three. Each company he's started has been at least a $100 million exit.

It's an absolute seed stage deal. We'll be giving him maybe a million dollars. I can meet with him two or three times, walk through the risks, but we're really seeding this thing so there's not much more to do. I'll do another half dozen additional reference checks. I did not fund him on his original three businesses. Hell, I was probably in school or high school when he was funding his first one. In that case there's not much to it.

I've got another business I'm talking to now where the company launched with $250,000 last year. In the first quarter this year they did $5 million. In that case I'm doing a lot of financial modeling, deep due diligence into everything that's going on in the business because there's a real company there.

In terms of the order of what's the easiest thing, I'm a bit indifferent as to whether it's a two page executive summary or PowerPoint. But trying to understand the business and know who the management team is in five minutes is pretty important because you can imagine, most VCs use the analogy of a funnel.

There are a lot of companies at the front of the funnel and you fund. People tend to fund 2%, 3% of them. There's a need to be quick on eliminating things at the front of that funnel. I'm not going to go twenty pages into a business plan before that.

Dave Lavinsky: Got it. So you want to get a quick sense either in a PowerPoint or two page executive summary to understand what the business is. And then what other things did you find particularly critical? You mentioned the management team. What about the financials, the marketing plan? How important are each of these sort of areas of the PowerPoint or executive summary?

John Babcock: As you probably know there's not agreement about that in the venture capital industry. Being an MBA we tend to do a VEN diagram, the circles being the market, the technology and the management team. There are very successful entrepreneurs who claim that each one of those … different VCs each claim that it's a different one of those that's the most important. There's not agreement in the industry and there's not agreement within Rustic Canyon Partners, my firm.

Dave Lavinsky: Got it. But those are the three areas though.

John Babcock: Those are the three areas. I will say I think it's the market. There's a quote I love of Warren Buffet's. "When a tough manager meets a tough market, it's the market that usually keeps its reputation."

Dave Lavinsky: Right. Good point.

John Babcock: Being in an area where great success is possible is to me probably more important.

I think the great management team one tends to be awarded retroactively. If you were anything involved with dotcom in '98 you were part of a great management team because that market lifted most boats. If you were part of dotcom in 2001 you were clearly part of a bad management team because you failed. Some of the guys did both.

Obviously what I'm interested in is what are you going to do from 2009 to 2012? It's not always obvious which of those it is. A management team is very important. It's just a difficult one to ascertain.

Dave Lavinsky: Now what if their management team is weak? What role do you play in helping them complete their management team? In your personal case if you thought the market was good and the technology was good but it was a weak management team is that something you would consider? And if so would you have provisions in the agreement you would bring on a CEO? How does that work?

John Babcock: That's a hard, direct conversation before we invest. I'm actually talking with a company now where I started to have what I thought was a hard conversation. Real ambitious, high energy CEO but not a guy with a lot of management experience.

I told him, "*Hey we won't invest unless it's real clear that we're going to get a new CEO. I don't think we need to get somebody in the day we close but we need to be real clear on that.*" He said, "*Yeah.*" I brought him in to my partners. My partners came back to me and said, "*We're not investing until the CEO is ready to join the day we write the check.*"

If I'm not quite confident that you're going to be the CEO for the next two years, that's a conversation we have before we invest.

Dave Lavinsky: Got it. But it's still possible for them to get your interest and get to a point where you would invest upon some event like getting a new CEO.

John Babcock: Yeah. Absolutely. Obviously you can imagine that's a hard hand-off. You've been working, growing this business for two and a half years, probably to the detriment of almost everything else in your life. This is your baby. So to hand it off to somebody else you need to have great confidence that

you're handing it to someone who is going to take it as seriously and do better with it than you would.

Dave Lavinsky: Agreed.

John Babcock: All the traits that make someone a great, ambitious, hard-working CEO make that a difficult hand-off. It happens. It happens successfully. But it's hard.

Dave Lavinsky: Agreed. The wording "your baby" – it's very, very difficult to do. I find it's very difficult even when the entrepreneur has grown the company even further and raised venture capital and gone to a later stage, a lot of times they have to hand it off to a more professional CEO at some point. It's always a challenging decision to make.

I think a lot of entrepreneurs need to understand that would you rather have a large piece of a smaller pie or a smaller piece of a large pie. With the capital and the advice the VC can give you and with a seasoned CEO you can probably have a small piece of a much bigger pie which is more valuable.

John Babcock: Yeah. It's hard. What I tend to do and what I did with this company I'm talking with right now is introducing the CEO to a couple of candidates. I know some reasonable CEO candidates in town. One seeing if he can work with them and they want to work with him and also just seeing if he can accept any of them.

One of the things you get is, "*Yeah, yeah I want to bring in a CEO*." And then when you bring in actual candidates they say, "*Yeah that guy -- he's about seven feet tall. I was really thinking about someone around nine feet tall*." They say they want a new guy but nobody is actually good enough to run their company.

Dave Lavinsky: That's a great point. It's one thing to say that you're ready to commit and actually to commit. I think it's great for a lot of entrepreneurs to put themselves into that process because in most cases they will eventually bring on somebody else if things succeed. It's something to always start thinking about.

What are some of the common mistakes entrepreneurs make when pitching to venture capitalists and Rustic Canyon in particular?

John Babcock: Oh I'd say feeling like identifying the risks of the business. Feeling like glossing over the risks of the business are going to make me more comfortable because I'll feel like the risks aren't there – when, in fact, what that's doing is making me worried that the management team doesn't see the risks in front of them.

Dave Lavinsky: Got it.

John Babcock: It may be a little bit of salesmanship, but talking about why the business is compelling and exciting and why you've been dedicating the last year of your life to it and why you think it's going to be huge is important.

But I think being real clear about if it's two years from now and God forbid the business didn't work, here's what I think might have gone wrong. Here's where we identify – you can do the whole MBA strengths, weaknesses, opportunities, threats. Here are things in the market that make it difficult.

The first two page executive summary is a bit of a sales document so I guess it doesn't need to be there. But once you're in talking to us, making it clear that you know what those risks are puts me at ease. There's not a business that doesn't have risks so my concern is financing guys who don't see them.

Dave Lavinsky: Got it.

John Babcock: The other one you hear a lot is guys who say they don't have competition, which is sort of a horrible red flag.

Dave Lavinsky: Agreed. So really a lot of it you're saying is really addressing the risk factors head on, explaining what they are and how you're going to overcome them.

John Babcock: Yes.

Dave Lavinsky: Excellent. What about if the entrepreneur seems good in terms of the market, technology, and possibly a good management team but if the entrepreneur is just not a great presenter? What should they do about that? Is that going to possibly prevent the deal from being consummated?

John Babcock: I suppose you need to try to figure out on yourself is it that you have poor presentation skills or that you have poor communication skills, the latter being a prerequisite really for any CEO?

We don't need one to be Anthony Robbins coming up to present in our conference room, but the ability to communicate very well is really a prerequisite of a CEO. If you don't have that level of communication skills it's hard to figure out how you're going to lead a large group of executives, and how you're going to work with a board and typically how you're going to win customers and everything else. Those are a lot of things that require communications skills.

If it really is just the in the boardroom kind of thing, you can practice. You can go to guys who help. I wouldn't look to add someone to the team just because they present well. I don't know that that skill is that important but certainly communication skills are.

Dave Lavinsky: Got it. So if the communication skills in general are poor, it goes back to what you said before, which is maybe that entrepreneur is not the

right person to be CEO. Maybe they should start looking for a CEO to run the company

John Babcock: Right. It's hard to imagine -- any job requirement you see for a CEO from startups to Fortune 100 tend to say "Excellent communication skills required."

Dave Lavinsky: Agreed. How does an entrepreneur tell whether or not a VC firm is interested? Do VC firms typically take a meeting and then let it sit? Or do they pretty much get back to him pretty quickly saying "yes" or "no"? How does that work?

John Babcock: Well I will confess that getting back particularly on no's at the front of the funnel is something I work to do better sort of everyday, but it's in the New Year's resolutions category of exercise and eat right and clean out the garage that I work on endlessly and is so time consuming that it's never something I do as well as I wish I did.

VCs tend to, if it's horrible, I'll say it right in the meeting that we're not going to go further, which is something I didn't do at the start of my career because it's so awkward, but I do now.

Most VC firms have a full partnership meeting on Monday so if you've gotten further into the process such that it's going to be a group decision those are typically done on Mondays. So Monday nights and Tuesday mornings people tend to get a lot of feedback. If you've mailed stuff in, depending what the guy's inbox looks like, that is something between a couple hours and a week or so.

And if you haven't heard back in a week or so, it's probably fair to resend on the "Let me know if you got this, if you have any interest" level.

Dave Lavinsky: And how much persistence is good versus overbearing?

John Babcock: I think it's fair to do a third e-mail if you haven't heard back. Look, if you contact Rustic Canyon you deserve a response. We work hard to make sure that happens. Whether it's positive or negative we try to come back.

I'd be lying if I said I haven't failed to get a response back to somebody within in a week but you should. If they haven't three times, shame on them. It's certainly not worth you doing a fourth e-mail.

Dave Lavinsky: Got it. Makes sense. Do you have any advice for how an entrepreneur should think about structuring a VC deal in terms of percentages, valuations, etc.? Maybe you can talk about some key areas of negotiation.

John Babcock: Yeah and depending how long you want to keep this interview, the market may turn. Right now it is certainly a time to be a term taker and not a term setter. It's pretty difficult to raise capital now from venture capitalists both for new deals and my own portfolio companies that need additional financing.

I would say the answer on valuation – if a VC asks about it – is to say, "Let the market decide." Your job as an entrepreneur is to get at least two term sheets such that you can have a market dynamic and try to bid that up to the highest price possible.

You may end up doing trade-offs if someone else is giving you a slightly lower valuation, but they have a really large fund. And that's going to be important because you're going to need another round or it's a slightly lower valuation. But that VC knows your market cold or you just get along with them well or he's done three other investments in this area and has great contacts.

At some point there will be some non-financial decision points on it, but try to establish fair market. There are few things that identify someone as an amateur to me as quickly as someone telling me "*We're selling 20% of the company for $2*

million." Because determining a market clearing price is just done by a willing buyer and seller. I think it's worthwhile just to let VCs tell you what their terms are and then to accept them or reject them and ideally to get into a two term sheet situation.

Should I jump into the basics of venture capital?

Dave Lavinsky: If you could that would be great.

John Babcock: I don't know if you want to talk about preferences and participation and the like?

Dave Lavinsky: I think that would be very helpful if you have time to go through that.

John Babcock: Sure. Let me see if I can do it quickly. If I go back to my example at the back, you add a hundred shares to your company so each share owned 1% of the company and you sold me fifty more shares, whatever it was. We'll make it easy, for $50.

Now each share obviously owns 150th of the company. In that example as I talked about, if we sell the company, I get one third – which means I'm buying what's called common stock, which is most of the stock you buy on public markets where people go out and buy shares of Microsoft and the like.

Venture capitalists almost always invest in *preferred* shares which have a couple of things. They tend to have some protective provisions meaning that you can't sell the company without the preferred investors agreeing to it. They may have things that also allow them to do things like block the sale of additional shares without their approval. There are a bunch of things essentially to stop the venture capitalists from being bullied by the entrepreneur who will likely own more than half of the company post financing.

The other thing preferred stock gets is it gets its money out first. Let's go back to my example where I've got $50 in the company for a third of it and we sell the company for $100, if that was common I'd get $33 back. If it was preferred I would get the $50 back because that money comes out first. Then the common would split the other fifty.

It can get more complicated.

I'll touch on one other example which is called *participating preferred* which means that fifty shares of participating preferred would mean I get the $50 out and then I participate – meaning I get one third of the proceeds thereafter.

Usually that is done with a cap, meaning that I stop getting the participation after I've gotten three times my money back. The reason for that is essentially it allows the venture capitalist to agree to come up a little bit on valuation because you're getting additional proceeds if the sale isn't as high as you like and you're looking like a regular common if it steps up.

Dave Lavinsky: Got it. Now how easy or hard is it to negotiate – you said it's harder to negotiate valuations if there is only one term sheet? Is it a similar type of negotiation whether it's preferred or participating preferred?

John Babcock: Yeah. Absolutely. If you're going to get money from a real venture capitalist it's going to be preferred.

Participating preferred I would say is more common. That tends to be negotiable. That tends to get adjusted by valuation as the push off there and things like limiting the participation so at some point the venture capitalist has to decide to either get the preference or to convert to common and just get their ownership.

It's not impossible to negotiate with VCs. What I think is sort of a no-no is to try to dictate the terms when you're way up at the front of the funnel with the venture capital firm and particularly before they've indicated they really want to invest. It's just premature.

Dave Lavinsky: Agreed.

John Babcock: Depending how excited a venture capitalist is to invest you can push on that. Of course you can play the game of you may not have another term sheet but you might do actions that suggest you do, that you have some other alternative plan to taking money from the one VC who's indicated that they want to invest. Clearly it's preferable to not have a fake Plan B but a real Plan B before you step into negotiations.

Dave Lavinsky: Agreed. You can't really bluff if you don't have a Plan B.

John Babcock: Right.

Dave Lavinsky: Are there any other key terms that the first time entrepreneur may not be aware of when a venture capital transaction is done?

John Babcock: There are a dozen. Things like drag along rights and registration rights that I just counsel you to get an attorney who is experienced in venture capital who will walk you through it.

For all the hand wringing that happens on all the other terms, really I think it comes down to valuation, preference, participation. Those are the ones I'd worry about.

After those all the other terms I would do would be all the non-financial. Going back to the portfolio CEOs of ours that I talked about, talk to those guys. Is the venture capitalist engaged in his other portfolio companies or is he really

disinterested? Even worse is he a distraction in board meetings and a hindrance to the growth of the business?

I can't say that everyone in my industry has a great reputation and a track record of helping companies along. Trying to ascertain that before you take an investment is real important.

Dave Lavinsky: Can you give some examples of how a good VC would help a company along?

John Babcock: I think the simplest one is probably in recruiting. We spend a lot of time with a lot of entrepreneurs. So when you're trying to bring somebody in to add to your team, those are probably the simplest ones I've done. There's probably help on strategy in a couple of areas where I take a little bit of pride.

Though I will say I think the venture capitalist value-add I think is overstated. Every VC loves to talk about it but if I think I know how to run that business better than the CEO, I'm not investing. If I thought for a moment I'm the smartest guy in the room I'm not investing. We like to back fantastic entrepreneurs who already know their market.

Dave Lavinsky: That's a great point. I appreciate that. Just one last question which is what additional advice do you have for entrepreneurs who are seeking to raise capital for their businesses that we might not have covered yet?

John Babcock: I guess the first question is just figuring out is the business one that requires venture capital? Perhaps less so now sort of post the dotcom bust, but there's enthusiasm for using venture capital for all businesses.

There are, as I'm here in Santa Monica, looking out the window up to Brentwood Hills up there, there are a lot of really big homes owned by people who make a lot of money on businesses who never took venture capital. They don't have the

growth characteristics that we look for but they generate one and two and five million dollars a year for their individual owners. Trying to figure out if that's the business you've got, that's a pretty fine business.

I think after that trying to be realistic on what your own strengths and weaknesses are and then doing research on the venture capital firms that you're talking to.

I think it's rare that contacting thirty venture capital firms is going to be a good use of your time. Most VCs tend to have fairly narrow bands, in terms of "these are the markets that I look at," "these are the geographies that I look at," "this is the amount of capital that I deploy."

The list of guys who are going to look to invest in your company is going to end up being a pretty short one. Finding them isn't that hard right? We all have websites and describe ourselves as best we can.

You're going to find a much more receptive audience. It will save a lot of time. And I think it increases your funding having someone who comes in and knows the companies that I've invested in and has talked with the CEOs there and wants to do a deal.

Dave Lavinsky: Excellent. Extremely helpful, John. I really appreciate your time and thank you for all the information that you just talked about. I think it's going to be extremely valuable to all the entrepreneurs and business owners who listen to this call. Thanks again, John.

John Babcock: Dave, thanks.