

Venture Capital and the Internet in 2006

Christian Leybold
BV Capital

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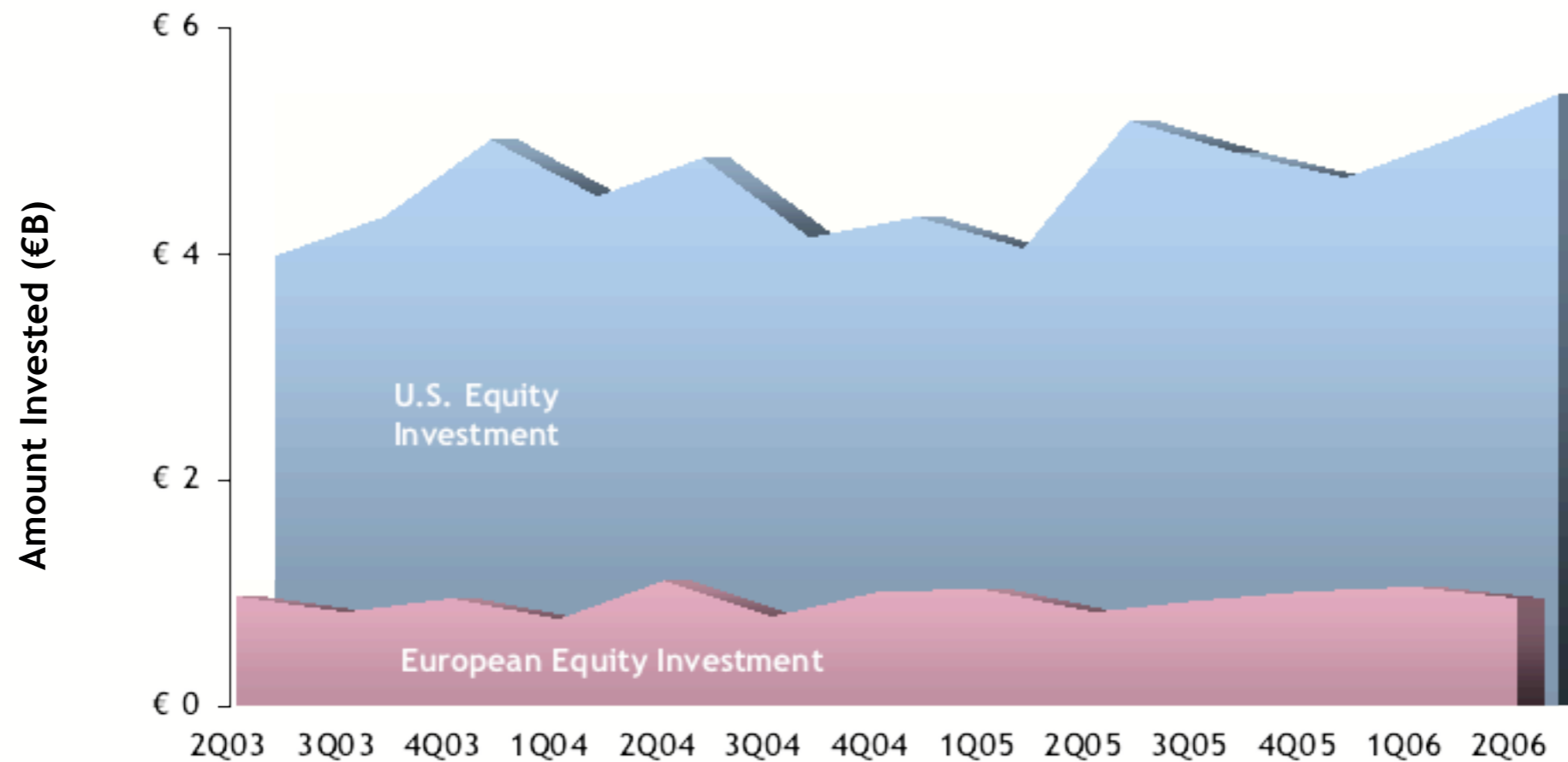
Agenda

- Current VC Market Environment
- Building an Internet Company today vs 1999
- Making money
 - Business Models
 - Focus on Communities
- Getting money (What are VCs looking for?)

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EU vs US Venture Investment



Source: Dow Jones VentureOne/Ernst & Young

- US strongly dominates the venture capital investment market compared to Europe
- Solid investment pace showing moderate acceleration

Internet Investment Highlights

- Strong acquisition activity makes VCs money
 - But: Mostly category leaders get acquired by a limited set of players (Google, Yahoo, News Corp...)
 - Nowhere near the public market frenzy of the late 90s
- Recently, the market is getting crowded
 - Valuations and amounts raised increase
 - Multiple competitors get funded in one segment
 - Acquisition interest in very young companies

Consumer Internet companies have come back as attractive investment targets for VCs

On the Internet, EU is catching up to US

- Internet usage
 - EU at ~50% vs US at ~70% online population, broadband dominating access form
- eCommerce, online ad spending still much smaller than US but all growing very strongly
- EU Internet investment activity on the rise, solid M&A, tech IPOs back on track with rich multiples
- Eastern Europe emerging
- But: Large US players still dominate the market and M&A scene

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Building an Internet Company Today

- The Internet is growing up
 - High Broadband penetration
 - Basic usage patterns solidified (email, IM, ecommerce)
 - Lots of early adopters (“heat seekers”) open to new technology
- Cost of starting a company has gone down dramatically (open source software, server cost)
- Great developer talent is available globally
- Viral and Internet marketing allows to build audience (almost) independently of startup’s location

The framework changed a lot since 1999!

What does this mean for entrepreneurs?

- Bootstrapping is in
- Angel money takes the right idea pretty far
- BUT: You will be copied quickly

What does this mean for VCs?

- There is life outside of Silicon Valley.
- The VC needs to find the deals globally, versus the deals finding the VC locally.

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The per user business model*

$$\text{CLTV} = \text{LT} * \text{Gross margin/month} - \text{CAC}$$

How much is each customer worth? How much do I make on each customer? How much does a new customer cost?

- CLTV= customer lifetime value
- LT = customer's lifetime in months
- CAC=customer acquisition cost

* simplified, not accounting for discount rate, retention cost etc.

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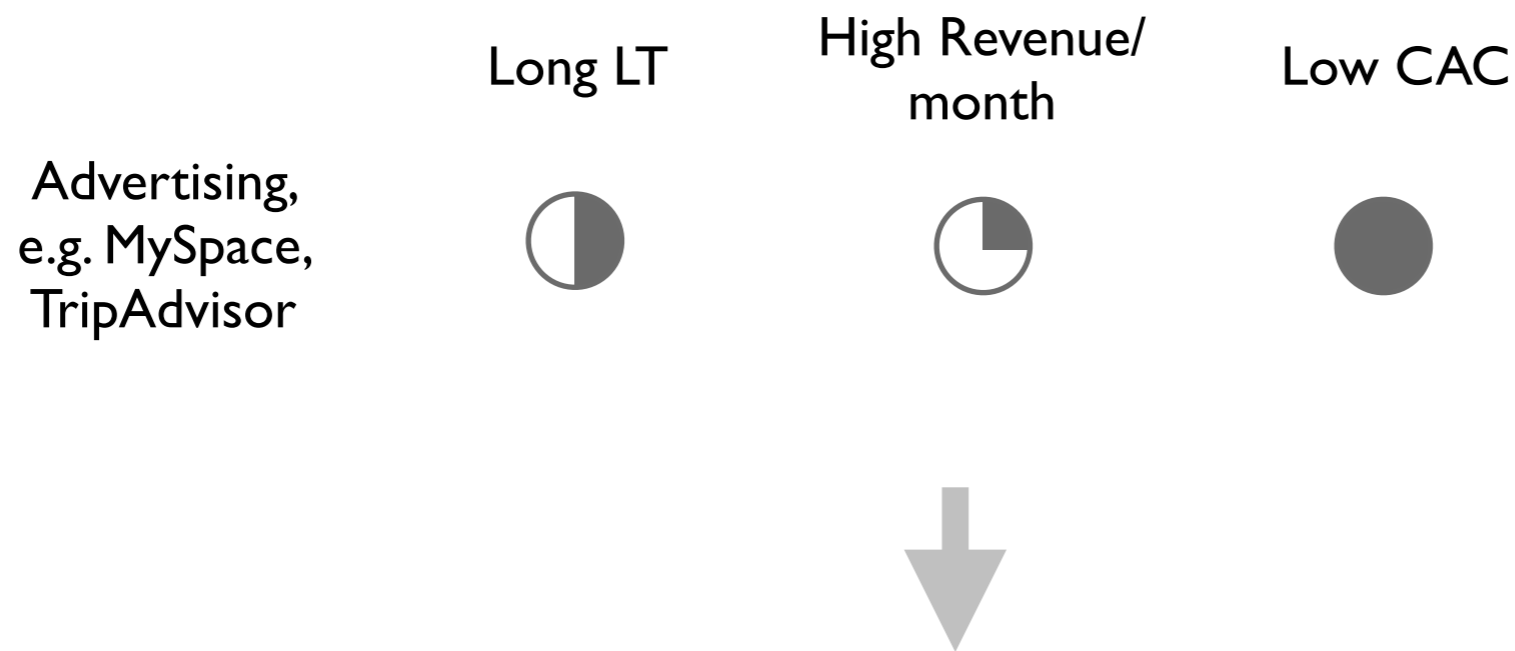
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Enterprise Value strongly driven by
CLTV * number of users (and growth...)

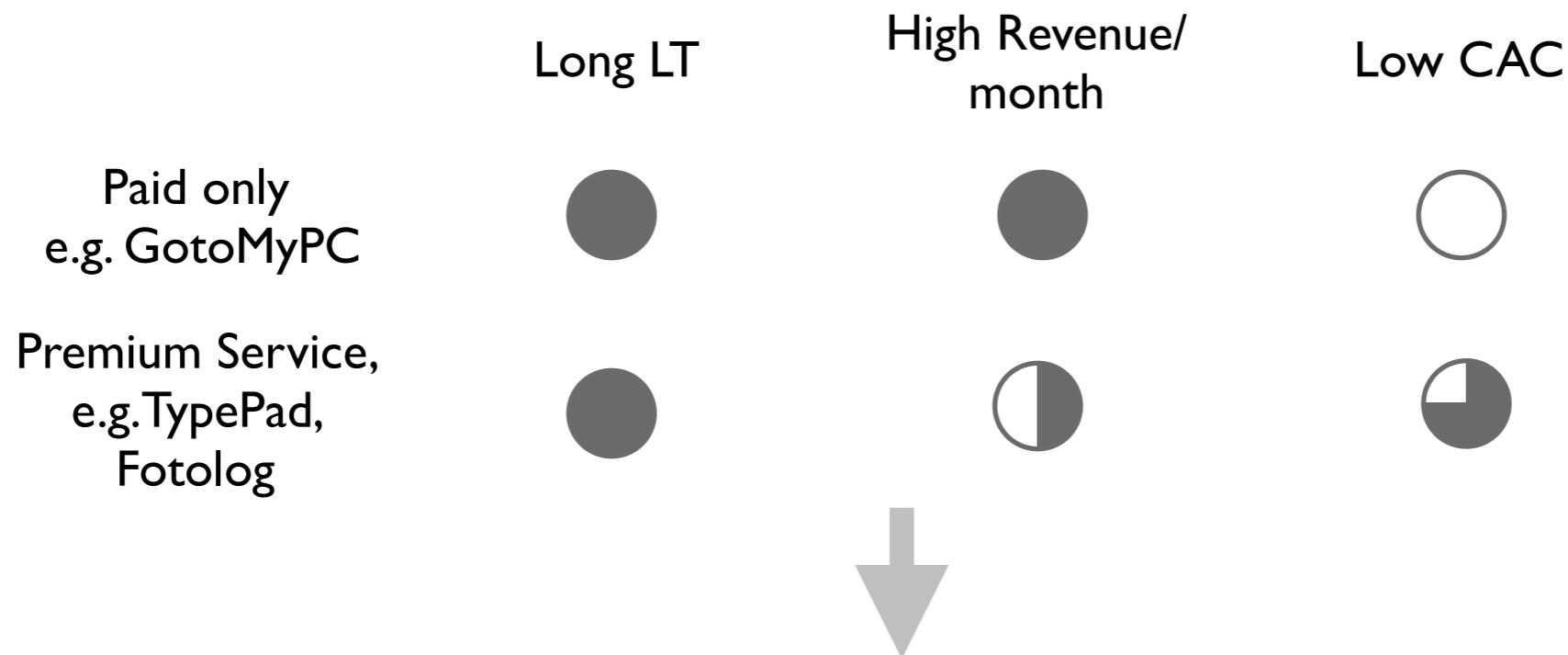
Current models: Advertising



Advertising:

- Sites should exhibit significant customer LT and low CAC since monthly revenues per customers are typically small
- Works best for sites that are geographically, demographically or content targeted, otherwise revenues will suffer
- SCALE is king

Current models: Subscription









Paid-only subscription services:

- Work best for long LT services with significant monthly fees (strongly differentiated, unique services) since CAC tends to be high
- Can be very profitable and scale excellently, but takes time & money to grow

Premium models:

- Great way to lower CAC by getting users “hooked” on the free model, but monthly fees tend to be limited
- Conversion to paying user can be a challenge
 - Difficult to do introduce paid service when service was initially free
 - Can be VERY different in different regions of the world

Current models: Transactions

<i>Virtual Goods ONLY</i>	Long LT	High Revenue/month	Low CAC
MMORPGs*, e.g. Knight Online			
Virtual Gifts, e.g. CyWorld			



Transaction:

- Significant customer lifetime required and/or CAC needs to be low unless transactions are very high margin
- Begins to replace paid-only or premium services especially in gaming sector (“free to play”, but that laser sword will cost you dearly)

* MMORPG = Massively Multiplayer Online Role Playing Games

What is key to an Internet community?

Useful **T**ool



Example:

 del.icio.us

- Efficient way of managing your large collection of bookmarks

Useful **C**ontent



Example:



- Great way of discovering good restaurants

Useful **N**etwork



Example:

 flickr



- Sharing and discovering pictures

Internet communities combine a useful service with content and networking.

Business Models for Communities

Useful **Tool**



Premium Service

Typically:

- more storage
- more bandwidth
- no advertising

Useful **Content**



Monetize by Advertising

Typically:

- contextual ads
- Lead Generation:
Pay-per-click
Pay-per-call

Useful **Network**



Premium Service

Typically:

- Social features
 - Reputation
 - Virtual Gifts

Key Business Model Take-Aways

- A number of Internet business models have emerged that have been proven in multiple categories
- The fundamental types of business models (advertising, subscription, transaction) remain, but their efficiency has improved significantly
- Advertising works for audience-rich sites in Web 2.0, but is clearly not the only way to make money

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So what gets you funded these days?

- **Key venture truths still hold:**
 - Strong team
 - Large growing market and strong business model
 - An innovation that has the power to dislocate existing market leaders
 - Barriers to entry
- **But**
 - On the Internet, barriers are often audience or content rather than technology
 - Audience is valued highly again - maybe too highly!?

What do VCs spend time on today?

- Relevance: New wave of content requires new search ways to drive relevance (collab. filtering, algorithmic etc.)
- Communications: Has exploded with the Internet (Phone -> Email, IM, VoIP...) and is at the center of convergence and viral business models
- Community: Well who isn't spending time on this? It's where most of the audience hangs out...
- Advertising: As ad spending moves online, keyword advertising can't be the end of it
- Games: Not only Koreans love them (MMORPG...)
- Content: Moving online faster than we can watch...
- P2P: The only way bandwidth growth can keep up with content growth
- Personalization: The web becomes your web. And if you are in the middle of it, why not make money?

Thank you!

christian@bvcapital.com

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