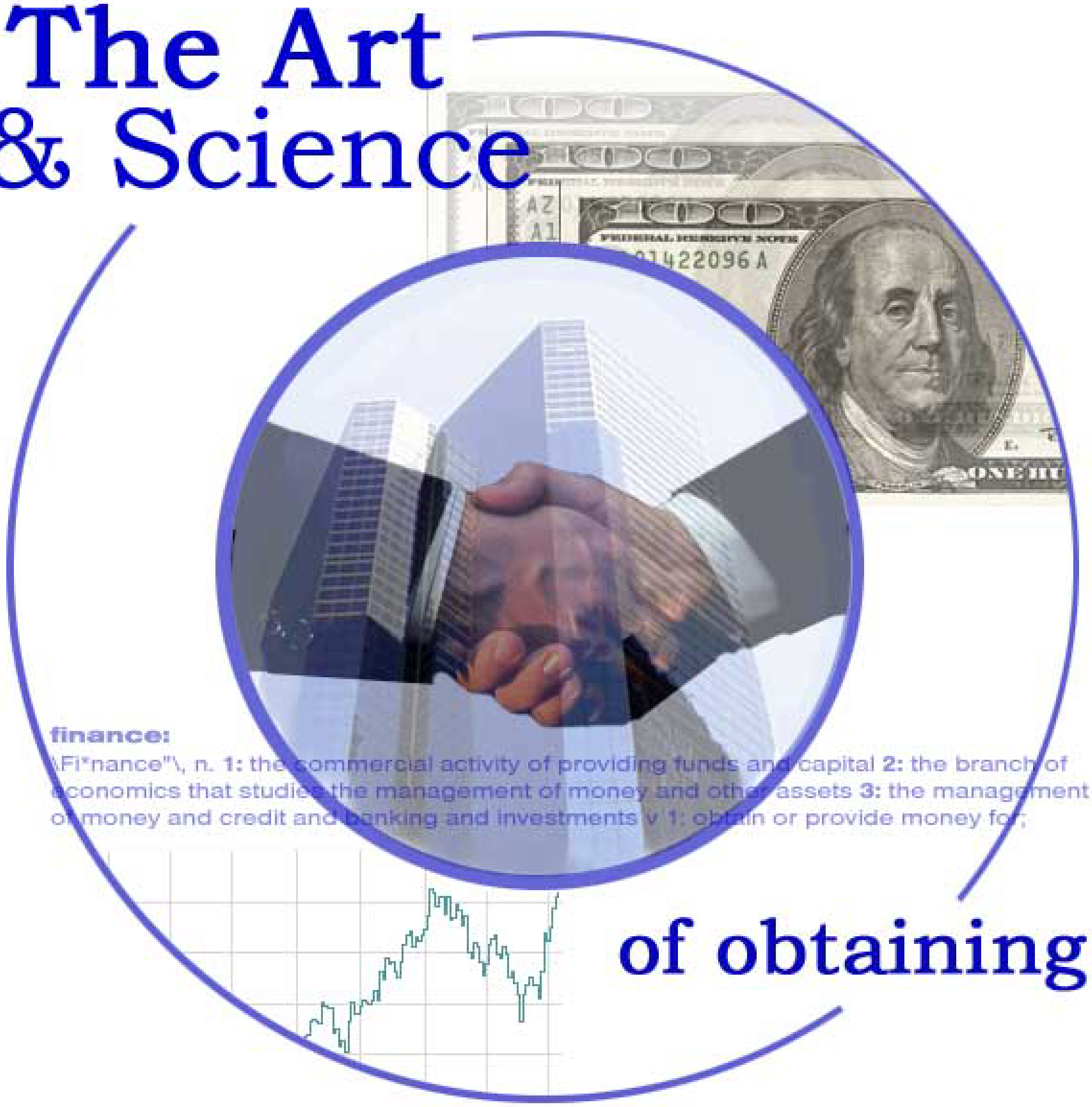
# The Art & Science

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# Venture or Angel Investor Capital

By: J. Corey Pierce

# EVERY BUSINESS NEEDS CAPITAL …
# BUT NOT NECESSARILY VENTURE CAPITAL

Successful businesses are well planned and well capitalized. Being well capitalized means having the ability to access capital when you need it, it doesn't mean that it has to be venture capture. But if venture capital is what you want, then this book will teach you how to:

- Test to see if your business can qualify for venture capital
- Find the venture capitalist that is the exact match for your need
- Know what mistakes will kill your deal before you ever have a chance
- Get that personal meeting that is vital to your opportunity to succeed
- Put on the very best presentation when you only have one shot at it

Many entrepreneurs lose valuable time and opportunities in their businesses because they are chasing something that they can never catch, why? Because they never took the time to study what they were trying to do or who they were trying to catch. Would you hunt moose in Hawaii with a BB gun? Stupid right? But how many entrepreneurs set off in search of venture capital without ever having taken the time to know if they even qualify or what firms offer even close to what they are seeking? They are completely wasting their time while the window of opportunity on their business plan closes.

Hopefully that is not a description of you. If you will take the time to go carefully through this book you will know beyond a shadow of a doubt if you qualify for venture capital and how to proceed to attempt to obtain it.

The information in this book is from methods that are proven, but you will only benefit from them if you apply them. Kind of like the difference between having a membership to the gym and actually working out. The task of obtaining venture capital is not for the faint of heart or those easily discouraged. It is only for those that seek great things for their business and have the tremendous drive that it takes to succeed.

Statistics show that 90% of all new businesses fail. I believe that is a direct result of the failure to plan. Take the opportunity to plan and complete every step in this book and along with my other book "Prepare and Present a Successful Request For Business Capital". Then use BusinessFinance.com to find the funding sources that exactly match what you need.

There is a quote that says:

***"Failing to plan, is planning to fail."***

But in the Venture Capital world it is:

***"Fail to plan and your plan is dead."***

# A NOTE FROM THE AUTHOR

Being an entrepreneur is very hard and it means that you are willing to take the risks that most people won't. Developing a business, requesting funding from strangers, and facing rejection makes it even harder. Funding your business is a science and not guess work. **Are you ready?**

My experience with business funding began with my own company during the S&L collapses of the late 1980's. My business was financed by two savings and loans that both were seized by federal regulators within seven days of each other. In a desperate search to replace the funding that I had lost, I discovered hundreds of funding sources that weren't willing to help me. After more than **300 contacts**, I finally found **one** funding source that offered what I needed. Unfortunately it had taken me over 120 days and it was too late to save my business. The $500,000 in company debt that I had personally guaranteed then forced me into bankruptcy.

Shortly thereafter I was asked to help find capital for a friend's company. Fortunately, during my own frantic search for funding I had kept very good records of those 300 funding sources who had told me NO. I had asked each of them, "If you won't fund my deal, what will you fund?" This became my first database of funding sources. Using that data along with the funding request knowledge I had acquired in my own failed attempts, I successfully found $100,000 for them.

Since that time my information has provided hundreds of millions of dollars for all types of businesses and my funding source database has grown to more than **4,000 sources**.

I founded BusinessFinance.com in 1995 and today it sees more than 10,000 requests for business capital each month. I am constantly amazed at the number of creative ways that entrepreneurs come up with for making money. I have written and give away these books:

- **The Art and Science of Obtaining Venture or Angel Investor Capital**
- **How To Prepare and Present a Successful Business Funding Request**
- **Pre-Qualify Before You Apply & How To Build Your Business Credit Profile**

to make the process of finding capital easier for as many of you as I possibly can and to help you avoid the horrible trials I went through. Try to find business funding totally on your own and you will most likely fail. It is my strongest desire that you use these books to achieve your goals, create jobs, and be successful. I implore you to read and study each of these books and then seek out the help that your business so greatly needs and deserves. **Don't go it alone!**

I will close by saying that while you are out there becoming rich and famous (or poor and infamous) remember there is much more to life than just making money. Be sure to focus on what is important; family, friends, relationships, and love of God, for without these things a man is truly poor no matter how much money he has.

Feel free to contact me if you need more help,

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***"Life is what happens while you're making other plans, so remember to have a life while making your big plans."***

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# I. REALITY CHECK – THE VENTURE CAPITAL MARKET

What really are your chances of receiving a venture capital investment?

The reality is that 99.9% of all companies who receive any capital at all for their business, do not receive "Institutional Venture Capital". Currently there are more than one million new businesses formed each year in the United States alone and at the time of this publishing there were over 1,000 U.S. based venture capital firms.

**The fact is that only 0.1% of all business investment capital comes from established Institutional Venture Capital funds.**

Most entrepreneurs make their biggest mistake by spending 100% of their valuable time chasing Venture Capital that they will never have a hope of receiving, rather than spending their time pursuing that 99.9% of the readily available capital that they have a much better chance of obtaining. The result for most is personal disappointment and business disaster.

Venture Capitalists are overrun with business plans and invention ideas. The reality is that they have a limited amount of time and resources to carefully select the businesses that they are even willing to consider. To put it in perspective, the average venture capital firm that looks at 2,000 plans a year might consider 20, perform due-diligence on 10 and actually invest in 2 or 3.

So, how do you know if you and your business plan will even get to the consideration stage?

Venture Capitalists are looking for huge returns from defendable and sustainable revenue models. They are looking for proprietary technology and large barriers to competition entry. They are looking for experienced successful management teams and they are looking for entrepreneurs who come well recommended from sources that they trust.

On the pages that follow you will find an initial qualification test that will tell you if you even have a chance of being considered for an investment. Before you run off in search of venture capital please take the time to test yourself. If you score above 80, then seeking venture capital may be right for you. If your score is less than 80, I implore you to not waste your time seeking institutional Venture Capital and proceed directly back to BusinessFinance.com to consider your other options.

Regardless of your score on the Venture Capital Qualification Test please complete this book. The information and resources in this book will be an excellent guide in your quest to plan, fund and grow your business.

**BusinessFinance.com** is dedicated to helping you find the financing that is right for your business. Check back for our resources on: government business loans, commercial lines of credit, equipment leasing, cash for your purchase orders and receivables, commercial real estate finance, unsecured lines of credit, asset sale and leasebacks, from **over 4,000 sources of capital** for your business.

## II. THE VENTURE CAPITAL SELECTION TEST

Take the test below and rate yourself from 0 to 10 on each question with “10” being if you have this question covered 100% percent and “0” meaning you don’t cover it at all. You must score an 80 or above you with a definite score of “10” on question number 10. Passing this test only determines that you “may be” a candidate for a least a Venture Capital Firm’s review process. Failing it, means you should move on.

**1. Does your business have some unique technology or service?**

What that means is do you have a unique that product or service that addresses a large market? Have you developed new software, hardware, electronics, distribution systems, medical devices, bio-med solutions, new forms of energy, modes of transportation, etc. Something new!

**2. Can your business carve out a significant and sustainable market share against existing market leaders?**

Venture capitalist will not invest in your company if you are going up against Kraft, Ford, or Xerox, unless of course you have new and proprietary technology. The risk is too great to justify the expense. That’s where your technology comes in, if you have developed something that opens up whole new markets or that will give you a significant lead in capturing the all important first mover position then you have a chance. If your products or services are just an add on or variation of an already existing technology where all the market leader has to do is make changes to their existing product, then you have little hope of being considered.

**3. How much money do you need for R&D and to reach the market?**

Risk versus reward, the typical Venture Capital fund wants to see that you require between $500,000 to $5 million. Above $5 million and most Venture Capital funds will want to bring in other funds to spread the risk and the deal gets much more complex. Venture Capital firms will want to see that you are going to maximize every penny and that you can get to market for the least amount possible.

**4. What is the ease to the market?**

Entrepreneurs and inventors are great at coming up with new products and business ideas, but will they sell? Have you considered who will sell them? What will it cost you to reach the market? Is consumer education required? Is brand awareness required? Will you have to develop your own distribution channels or are there existing channels that you can use?

**5. What level of customer support will your product require?**

Venture Capitalists won’t care if you have an outstanding product if it is going to cost $100 million to teach the public how and why to use it. Very complex products can require very expensive customer support. For example if you have developed a new type of consumer cooking device that is as fast as a microwave oven, but cooks like a convention oven … great you’ve got something. But if your device requires an expensive third party install and is difficult and complex for the consumer to use, the appeal of your investment may have gone away. The requirement for expensive customer support may not be a deal killer if your answer to number 6 is a 10.

**6. Is the market that you will serve huge?**

In our example above the Venture Capitalist may not care so much about customer support if the market is so large that it out weighs the cost to educate the consumers. Your oven may have such mass appeal that after development it can be sold to General Electric or Whirlpool for introduction into the market.

**7. Can your product produce gross margins greater than 50 percent?**

If your "margins" are below 50% than the margin for error is too low. You won't have enough to sustain you if things don't go just right and there isn't enough profit in the deal to make it worth venture capital consideration.

**8. Does your management team have the experience and skills to succeed?**

Venture Capitalists are not interested in your learning curve and they certainly aren't interested in risking their money on your education. They are interested in strong management teams with proven track records that pertain to what you plan to achieve.

**9. Are you and those now in your business committed to its' success?**

How much have you invested to get this far? Who has invested with you? Do you have Angel Investors who have believed and invested? Has your existing Board of Directors invested? Venture Capitalists hate to be the only one with "skin in the game". They are more likely to invest if they see a number of private investors already in, maybe an Angel Investor they know, maybe a law firm they have had dealings with.

**10. Can your company achieve gross annual revenues of $25 million in 3 years, and does it have the possibility to reach at least $50 million in 5 years?**

***If your business cannot reach $25 million in gross annual revenue in 3 years, then STOP RIGHT HERE. You have no hope of obtaining institutional Venture Capital.***

You must score a 10 on this question or you are wasting your time seeking venture capital. Venture capitalists are looking for investments where they can make 10 times their investment, therefore they only invest in companies with large revenue potential.

## YOUR TEST RESULTS

If you scored an 80 or above on this test and your business will achieve more than $25 million in gross annual revenue in 3 years or less, then I encourage you to seek venture capital, to use the resources in the remainder of this book. Use BusinessFinance.com to find the Venture Capital Firms that exactly match your product or service. Go For It!

## III. THE TEN "ING's" OF WHERE TO BEGIN?

If you passed the Initial Venture Capital Qualification Test, now the real work begins.

Raising venture capital is a pain staking process that must be done in a methodical and deliberate manner in order for you to maximize your opportunities for success.

I know as any good entrepreneur you are tempted to pick up the phone and begin dialing lists of venture capitalists and tell them your wonderful story **YOU'RE NOT READY YET**. Before you make that first call make sure you are prepared by completing this book.

The process of raising money from investors usually takes the following steps:

**1. Identifying your potential venture capital investors:**

This is the easy part. BusinessFinance.com has done all the research for you, you only have to enter in the criteria of your business and those VC firms that match will be instantly delivered to you. The catch is that you must know exactly what you are looking for.

The largest risk is from unscrupulous brokers who present themselves as venture capitalists. Anyone who asks you for money in advance of funding is not a venture capitalist. To determine if you're dealing with a broker ask the names and sizes of their funds. Any Venture capitalist will proudly tell you how much money they manage and the names of the funds. If they won't tell you or they say it is confidential, they are a broker. Ask for a list of companies that they have funded, if they won't tell you they are brokers.

**2. Researching your selected VCs:**

Once you have identified your most likely venture capital firms, then research all of their portfolio companies (companies they have funded). Check their websites to find out who those companies are. Then check those companies websites to find out who runs those companies (CEO, Founders, CFO, etc.) and to determine what your firm has in common with their firms and what you might do together. Venture Capitalists love to have portfolio companies with synergy. Once you have determined that, then begin to network with these companies. Attempt to get to know those that can help you. What might your two companies do together? Try to find out how they got their foot in the VC door? Who opened it for them? What you hopefully will find is a number of contacts that assisted them and may be willing to assist you. These contacts may end up being members of their board of directors, board of advisors, their private investors, or they themselves that take a liking to what you are doing and want to open a VC door.

**3. Finding the right legal and accounting firms:**

While you are researching your prospective venture capital firms and their portfolio companies also keep good notes on the legal and accounting firms they are using. One of the best ways to get the opportunity to present to your venture capital firm is by an introduction from the lawyer or accountant whom they have done business with for years. There are many professional firms that have contact lists full of venture capitalists that they have helped to close a deal or have audited the books for the due diligence.

**4. Completing your business plan and executive summary:**

If you haven't already completed your business plan, then you must. If you have completed it you need to review it and make sure it is complete, accurate, and supportable. Potential investors or advisors will immediately start asking you questions and if you don't have the answers on the tip of your tongue you are sunk. The act of writing your business plan will force you to address every issue and to know the answer to the questions that WILL come up. This book will not address your business plan. My book "How to Prepare and Present a Successful Business Funding Request" is available for free at BusinessFinance.com. "Don't present without it".

**5. Wasting your time sending your complete business plan to VCs:**

Even if they ask for it they won't read it. Instead send a two or three page executive summary with a summary of your financial projections attached. Then, when you call to follow up, use the presentation of your full business plan as the need for a personal meeting. It is extremely important for you to get in front of your potential advisors before you approach investors. I strongly suggest you practice your pitch on potential advisors first as that will allow you to perfect your pitch and bring to mind questions you hadn't thought of. It will also give you the opportunity to get experienced feedback on your plan and your presentation.

**6. Having your references ready:**

Before anyone is going to be willing to jump into business with you they are going to want to know who you are and what others think of you. Prepare a lists of business associates, partners, clients, vendors, employees, employers, accountants, lawyers, etc. who know you and respect you. Have this list typed and ready to hand out when you are asked. You would be amazed at how many entrepreneurs fail to have a simple reference list ready. What would you think of someone who couldn't give you good references.

**7. Making your first VC contact:**

Get personal introductions. Your chance of success will increase 100X if you are personally introduced by someone that knows the person you are hoping to do business with.

Why do the graduates of Harvard have more money than those of any state university? Contacts…Networking! Do your homework, find and get to know people that can make the personal introduction to those who can help you.

Here is an example: You want to get to an introduction to a venture partner at XYZ Venture Fund. You see on their website that they funded a company in the communications infrastructure industry and your company has developed a new and unique bandwidth enhancer. You request and meet with the CIO of the firm that was funded. You ask to take him and the CEO out to lunch or dinner, you explain what your two companies can do together and you ask questions about how they got funded by XYZ Venture Fund. You establish personal relationships and you eventually get the introduction you need.

**8. Closing them:**

You have ten seconds to grab their attention. All your hard work, months of research, writing a business plan, preparing a presentation, finding advisors, networking, and finally getting your foot in the door, and it comes down to ten seconds? Venture capitalists want to know that you know what your company is all about and why it will succeed, and they want to know it right now! They don't want some long winded entrepreneur rattling on for ten minutes just to get the mission statement across. The technically minded entrepreneur may offer up something like: We have developed a new polymer that decreases the thermal dynamic friction across any metallic surface. Wow, I'm asleep, how about you? But how about: Our new polymer enables cars, boats, and airplanes to travel substantially further on less fuel. Okay now you have my attention and I can easily grasp the market size and application.

Before you contact your first potential investor it is extremely important that you know how to describe what your company does in a compelling way that will make you stick in their minds.

**9. Being prepared:**

Doing all of the above steps will not guarantee your success, but failing to do them may guarantee your failure.

**10. Think this sounds like a lot of work?**

You are right it is, but if you are not willing to do this level of work to get to funding you need to succeed, then please stop right here because you will never get funded and you are wasting your time.

Maybe one out of every 10,000 companies that seeks venture capital actually gets it. Why do you think that is? Because it is extremely hard, it takes a lot of work, and it requires a level of determination that most entrepreneurs just don't have.

Most venture capital hopefuls just get a name, submit a plan, and it goes directly in the round file without ever being read, some don't even get opened. In order to succeed you have to do your homework, know what you are doing and plan your success.

**Are you up to the task?**
**Most aren't, so be the exception not the rule.**

# IV. YOU'VE PEAKED THEIR INTEREST, NOW WHAT?

However you got there, if you have managed to peak the interest of a Venture Capital Firm, there will now be a process of selection versus elimination. They are going to put you and your company through an ordeal to see if your deal passes the "tests" and is deemed worthy of an investment. Below is a summary of that process:

**1. The Selected Company Investment Review**

The selected company review is normally held over the phone with an analyst for the Venture Capital Firm. It is after the Venture Capital Firm has determined an initial interest in your company. The goal of this review is to quickly see if your company aligns with the Venture Capital Firm's investment strategies and to test to see if you have the strength to proceed to the next step.

This review is of your company's products or services, industry, management, financials, use of proceeds, capital structure, other investors, and market viability. Your company will be evaluated in terms of sustainable and established revenues, your potential revenues of $25 with 3 years, $50 million or more in 5 years, a definable exit strategy, and a capital need of $500,000 to $5 million. These will be tested against your company's management strengths, attractiveness of services, and the value of proposition of your investment (what is the potential for the investment return).

In order to proceed to the next step your company will have to show strong potential and pass the "initial review test". This test is not the last test your company will have to pass and mostly serves as a go or no go tool for the Venture Capital Firm to determine if you merit further research and investigation.

| **Investment Review Test - Area Tested** | **Scoring Range** |
|---|---|
| Management ability, past successes, and broad experience | 0 – 3 |
| Product or service uniqueness and attractiveness | 0 – 2 |
| Size and growth rate of industry and competition | 0 – 2 |
| Investment value proposition of Company | 0 – 2 |
| Is the market strategy clearly defined? (Y/N) | 0 – 1 |
| Are financials audited or ready for audit? (Y/N) | 0 – 1 |
| Is the capital structure clean and well conceived? (Y/N) | 0 – 1 |
| Are the margins (gross and net) in line with VC goals? (Y/N) | 0 – 1 |
| What is the status of the current balance sheet? (+/-) | 0 – 1 |
| Is current revenue above $1 million? (Y/N) | 0 – 1 |
| Is potential revenue growth above $100 million? (Y/N) | 0 – 1 |
| Are capital needs between $500,000 and $5 million? (Y/N) | 0 – 1 |
| Is there a clear and viable exit strategy with 5 years? (Y/N) | 0 – 1 |
| Is the use of proceeds clearly defined and supported? (Y/N) | 0 – 1 |
| Was management's presentation impressive? (Y/N) | 0 – 1 |

If your company does not score a minimum of 10 on this test you will normally receive a letter that may or may not explain why you were rejected. Sometimes the Venture Capital Firm will see a potential for future investment and that your company needs time to grow or establish the opportunity. They may send you a "not at this time" letter with further instructions about their investment criteria and what milestones you need to reach before resubmitting your request. This is rare, but it does happen.

**2. The Formal Presentation**

Typically if you pass the Initial Review your company will be given the opportunity to make a formal presentation in the Venture Capital Firm's office. Your presentation is normally limited to one hour so you must be very prepared. Usually 30 minutes will be for your presentation and the 30 minutes for the Venture Capitalists questions.

By the time you get to this presentation the Venture Capital Firm will have completed some basic research on your company, the industry, any notable competitors, the investment opportunity, and the exit strategy.

Most Venture Capital Firms look for an exit strategy of:
- Going public through an Initial Public Offering (IPO)
- Selling or merging with a company that is already public
- The ability to generate significant cash flow to pay out the investors
- The company is already public and offering shares at a discount

In this presentation you must show a willing to work towards one of these exit strategies and/or have one clearly defined and supported. The formal presentation allows the Venture Capitalists assess your management along with their ability to create an impressive presentation and to handle difficult questions. If the overall impression of the Venture Capital Firm is good, your company may proceed to the next step.

**3. Term Sheet**

If your make it this far the venture capital firm will normally draft a term sheet outlining the conditions under which the venture capital firm may invest. Terms are always contingent on the completion of due diligence. The term sheet should include the initial valuation of your company based on your industry public, private and M&A comparables.

**4. Due Diligence Investigation** (See checklist beginning on page 34)

This is an extensive due diligence investigation will include your business plan, initial formation, financial information, all organizational documentation, capital and legal structure, industry and market information. They will look into manufacturing and producing processes, your research and development, all past and open contracts, any pending events, IT and HR structures, the protection of your intellectual property, compliance with all laws and regulations, and the proper insurance is available.

Extensive background checks are performed that include your company and personal credit reports. Criminal and legal background checks are run. Manager's resumes are verification. There will be SEC and NASD securities inquires of active principals and managers. Management will be required to certify that they have not been involved in any illegal activities, injunctions, suspensions or illegal proceedings.

The investigation will include possible intellectual rights problems, technology risks, key personnel losses, competitive analyses and the possible effects of the political, social, technological events. Your suppliers, customers, and banks will be questioned. Then a due diligence summary is compiled that highlights what was discovered. This summary will also include any are as that were found to be missing, or questionable.

**5. The Management Test**

Venture Capital firms will test the depth of your management team.

| The Managerial Test - Area Tested | | Scoring Range |
|---|---|---|
| History of Management Success | | 0 – 4 |
| Worked together on a previous success | (4 points) | |
| Prior individual successful venture | (3 points) | |
| Management with successful competitor | (2 point) | |
| No prior management of successful venture | (0 points) | |
| Prior Responsibility Experience | | 0 – 3 |
| Managerial and financial responsibility | (3 points) | |
| Manager responsibility only | (2 points) | |
| Financial responsibility only | (1 point) | |
| No managerial or financial responsibility | (0 points) | |
| Creating, Developing, and Launching New Products or Services | | 0 – 3 |
| Team of managers has experience | (3 points) | |
| Managers individually have experience | (2 points) | |
| Only one manager has experience | (1 point) | |
| No managers have experience | (0 points) | |
| Depth of Competition Experience | | 0 – 3 |
| Team of managers has experience | (3 points) | |
| Managers individually have experience | (2 points) | |
| Only one manager has experience | (1 point) | |
| No managers have experience | (0 points) | |
| Managers Resumes of Experience and Varity of Skills | | 0 – 2 |
| Varied experience with broad skills | (2 points) | |
| Similar experience with broad skills | (1 point) | |
| Similar experience with limited skills | (0 points) | |
| Knowledge of Capital Markets and Investor Relations | | 0 – 1 |
| Very Good | (1 point) | |
| Limited | (0 points) | |
| Cooperation and Openness During The Due Diligence Review | | 0 – 1 |
| Very Good | (1 point) | |
| Limited | (0 points) | |
| Character, Values, Morals | | 0 – 1 |
| Displays honesty, integrity and persistence | (1 point) | |
| Question in credit history or background | (0 points) | |
| Presentable To Wall Street | | 0 – 1 |
| Will yield control and values shareholders | (1 point) | |
| Any control or self serving issues | (0 points) | |
| Operational Planning and Reporting Processes | | 0 – 1 |
| Consist “Analyst Type” plans and reports | (1 point) | |
| Anything other | (0 points) | |

Here again your company must score a minimum of 10 points. As you can see this is a running test that is scored through all the other steps above. If your score is very low your company may never make it to the due diligence investigation.

**6. Due Diligence and Testing Reviews**

Once the due diligence and your test scores are completed, the venture capitalists normally meet to discuss the findings. This meeting is all about the value proposition of your company and if it makes a compelling investment.

If issues are discovered in the due diligence investigation that make investment in your company undesirable, the venture capital firm may ask to hold more meetings with you to determine if the issues can be overcome. While highly unlikely, some venture capital firms will refer you out to a consultant to resolve the issues. If the issues can be resolve the venture capital firm can move forward with the investment

**7. Final Documents**
If due diligence went well and your company proves to be a compelling investment, the venture capital firm normally calls for the drafting of final documents. This process typically involves some final negotiations regarding any outstanding issues discovered in the due diligence investigation and the final company valuation.

**8. Monthly Due Diligence Updates**

After your company has received funding most venture capitalists will require monthly and quarterly updates to key information. This will include updated financial statements, any changes to organizational documents, all new contracts or agreements, and any market information that has potential to affect the business.

**Still Think You and Your Company Have What it Takes To Get Venture Capital?**

The process presented here has many other factors that will be covered in the chapters to come. In order for you to successfully navigate your way to a venture capital investment you must study hard all that will be required of you. You will have to have an answer for every question that is raised and be able to fully support your answers with research, industry statistics, and much more.

I do not envy the task in front of you, but if you are determined to proceed with your quest to obtain venture capital then please press on and I will tell you more.

## V. THE SEVEN "NO'S" THAT WILL KILL YOUR DEAL!

Your deal may not get funded because investors saw or felt something that really wasn't there. The hard truth is that venture capitalists listen to so many pitches that only the real cream rises to the top. Here are some of the key mistakes that entrepreneurs make when presenting to venture capitalists.

### 1. No niche market focus:

To an entrepreneur, a product, service or technology that's applicable to everyone is Nirvana. Imagine the glee you'd have if you owned, say, the rights to sell oxygen. But to an investor, this sounds like trouble. The fact is, there may be many markets for a product or service, but even well capitalized giants have trouble selling in multiple markets. Thus, for start-ups or companies expanding into new markets, the critical questions on the investor's mind are: Which market will you pursue with my money? How will you do it? What does it mean if you succeed? Investors fear that, without a specific niche market focus, the company will be focusing on so many different things that it won't be able to carry out the most fundamental purpose of the business, which is to create value and wealth for its shareholders.

### 2. No clearly defined exit strategy:

How do the investors get their money back and earn a return commensurate with the risk? There are really only two exit strategies. The company is acquired, or it goes public. If an entrepreneur refuses to commit to one of these options, the investors usually walk away.

### 3. No willingness to surrender control:

Having a control freak at the top of the organization is a problem. It's expected that entrepreneurial genius brings with it some unique character traits, but this one can lead to disaster. If the person running the company cannot or will not surrender control, there is little likelihood they'll be able to successfully orchestrate an exit strategy for the investor. Why? "Because ultimately an exit strategy in the form of selling the company or going public is about a change of control.

### 4. No reality based business valuation:

This refers to the overall worth or dollar value an entrepreneur places on the business. Valuation is vital because it determines ownership positions for the entrepreneur and the investors. That is, if a business is valued at $10 million and the entrepreneur wants to raise $4 million in equity financing, it's likely going to cost 40 percent of the company.

All companies seeking equity financing are valued in comparison to similar publicly traded companies. When an entrepreneur sticks to a valuation that is totally out of sync with the valuation yardsticks of their peer companies, that deal becomes unfundable.

Here's an example. Suppose publicly traded restaurants, on average, are valued at 17 times their earnings. Suppose further that you have a restaurant chain that you've valued at $5 million. If your company earns $100,000, that's a multiple of 50 times earnings--way off the mark. If you stick with that figure, you'll get nothing from investors.

**5. No large market application:**

If your market isn't very big, it's hard to get outside investors fired up about chasing it with you. It's one thing if you own a storefront business or operate an enterprise within a single community, but if you're competing nationally you'll need a minimum market size of $100 million.

Consider the case of one anonymous company that had developed computed medical systems capable of scanning down to the DNA level. Unfortunately, the machines were so expensive, they were restricted to the government and Fortune 50 laboratory markets. Annual sales for the entire market were only $20 million. The company might overcome this challenge by developing products which cost considerably less, thus increasing their market potential.

**6. No strength in your business plan:**

A weak business plan may not render your deal absolutely un-fundable. After all, someone might see the genius behind the clutter. If you're going to a professional investor or an active angel investor chances are, they get inundated with business plans. If that's the case, they won't take the time to labor through your muddled presentation. There's really no excuse for poorly written business plans because there are many places to get help preparing them.

**7. No or poor financial assumptions:**

One area of a business plan that can definitely make your deal un-fundable is the financial projections. There are several ways this can happen. For established companies, a sales and earnings curve that deviates too much from historical standards isn't good. That is, the top and bottom lines have been growing at about 5 percent per year, but you're predicting they're suddenly going to accelerate to a growth rate of 50 percent per year once the company is funded.

Sometimes there are no assumptions. Other times they're just plain naive, especially regarding sales growth and selling costs. Assuming sales start at some base level and increase by 20 percent per year is just garbage. The fact is, there's nothing formulaic whatsoever about projecting future sales. It means thinking about what will happen each week, month or quarter.

Think like an investor. Is your deal un-fundable? If so, talk to your attorney, accountant or management consultant about the basic changes you can make to increase the likelihood of attracting investors.

Raising money is like running a business. You've got to make mistakes in order to learn. Once you learn how the game is played, however, success is within your reach.

## VI. THE DIFFERENCE BETWEEN ANGELS & CAPITALISTS

Moving from individual investors to institutional VCs means learning to play by a new set of rules. Before we delve into the differences between angels and institutional investors, understand that venture capital is just a certain kind of money that comes from different sources. Angels are one source. And institutional venture capitalists, or professionals who manage organized funds, are another. Now then, what are the differences between angel VCs and institutional VCs, and how do you overcome them? Just take a look.

**1. The source of the money:**

OPM? What does "Other People's Money" have to do with venture capital? Institutional venture capitalists are managing OPM and that means that they have a number of investors to answer to. It means that they will take great care not to lose their money.

The professionals are managing other people's money. Funds have investment criteria that the professionals have a fiduciary responsibility to meet. In addition, they operate with an investment committee, so if the partner you meet is unable to persuasively communicate your deal or how it matches their investment criteria to the committee, it's an insurmountable barrier.

In this respect, the best defense is a good offense. Resource guides and independent research can help you target institutional venture capitalists interested in your kind of company or industry. Just don't waste your time looking for them until you've done your homework, or you'll be in the reject pile right from the beginning.

**2. The time allowed to pitch:**

The 20-minute pitch is standard operating procedure in the world of finance, but the elevator pitch is gaining currency in the fast-paced New Economy. It refers to a sales pitch that can be delivered in the time it takes to take an elevator ride. But you need two elevator pitches: one for institutional VCs and another for angels. The institutional pitch must tell the investor how much he or she can make and how quickly he or she can get out. The angel pitch provides the same information but it leads with business issues.

It's who you know: The professionals are chasing more deals and are being chased more actively by entrepreneurs. That means they're more likely to say, "I saw one of those yesterday, no thanks." Another side effect of the high demand is getting and keeping the VC's attention. You are not given the opportunity to present your deal for an hour and a half you have about five minutes, and if you don't capture their imagination, it's over.

The solution to this is getting an introduction. Professional investors will be more courteous and more likely to offer quality time to referred opportunities than to cold ones even if it's only to stay on the good side of their own contacts.

Who you know is vital to your success. This is why you should spend time trying to expand your network of influence.

**3. The consequence of their investment:**

Individual investors believe in you and invest in you as a person, but the professionals make their living by evaluating deals and making offers. There's much less emotion and a lot more process involved, which can be a good thing because this is often good business practice. The hard part is that all this professional experience might cause investors to be rigid in their thinking about how a deal should be structured and closed.

There are a couple solutions to this dilemma, but you'll find them lukewarm at best. First, swallow hard and go with the flow. Second, try to find out beforehand how the firm structures its deals. Armed with this information, you're in a better position to take certain things off the table before they even become a part of the negotiation. A good way to find out how past deals have been structured is to contact the founders of companies that the VC has funded. You can find this information on almost any VC's Web site. You may be surprised at their willingness to talk. And when the VCs find out you've been researching their deal structures, it could be helpful to your success.

**4. The setting of different goals:**

Both sets of investors are looking for a healthy return, but the angel's required rate may be somewhat more moderate. Why? The professionals are interested in managing the fund and reporting to their investors. When professional investors ask about your previous ventures, they're only interested in the bottom line. They don't care if the companies served a purpose or that they created jobs. They judge you by your previous monetary success.

By contrast, however, individual investors often fund companies for motives that may not be purely financial. Some reasons include a desire to put something back into the industries that made them successful, to provide the resources that they wish they had starting out, a desire to be mentors, and the opportunity to relive their past successes.

The difference between these two types of investors can be the difference between an alumni booster at a football game and a nuclear power plant inspector. There's little you can do to overcome this reality except to expect it and not be offended by it.

**5. The size of the investment:**

One happy difference to keep in mind is that professional venture investors have a pool of capital set aside to make initial as well as add-on investments. When they're in, they're in. But individuals have less to invest, and their situations are often far more complex. Remember, individual investors probably already have money invested somewhere else. They may have to liquidate; if so, there are tax implications they have to consider. That means angel and individual investors are considerably less liquid and have much less tolerance for putting in more capital down the road.

As a result, your strategy with angels and individuals should be to get as much financing as you can up-front. But with professional venture investors, you shouldn't raise too much more funding than you actually need. There's plenty of money left in their till and if you succeed, you'll get it the second time around at a much better price.

## VII. VENTURE CAPITAL MYTHOLOGY

**1. They want control of my company**
VC's are in the business of investing in companies, not running them. VCs will want a fair portion of the company based on the valuation at the time of their investment. They will only want the option to consider control if your management team fails to execute.

**2. They offer unreasonable terms**
Some terms may seem unusual or unfair to an entrepreneur. For example, there may be a provision requiring the company to redeem investors' stock at a certain price after a certain period. Keep in mind that such a redemption represents a failure on the part of the VC, which will do everything possible to avoid taking this step.

**3. They are only interested in the financials**
Venture capitalists tend to be concerned with the market, your technology and management team much more than just the numbers.

**4. They have unrealistic performance expectations.**
VC's make high-risk investments and expect high rewards. Venture backed companies have proven it is possible to achieve 40 to 50 percent annual growth.

**5. They demand an early exit strategy.**
VC's expect a return on their investment in the form of cash or securities. Without an exit strategy, there is no return to their investors.

**6. Their valuations are lower than my private investors.**
VC's participate in business planning, sales strategy, key hiring decisions and links to the larger capital markets for additional investments or an IPO. In contrast, private investors tend to be less involved and therefore offer less value.

**7. They won't invest in small deals.**
VCs typically don't consider deals less than $5 million, but smaller deals can get funded if you know where to look (BusinessFinance.com).

**8. They are too quick to pull the plug.**
VCs are very concerned about the performance of their portfolio. VCs will usually try to keep a company viable if at all possible.

**9. They refuse to sign nondisclosure agreements.**
VCs see a lot of deals, it causes them too much liability to look at thousands of companies without violating someone's nondisclosure agreement.

**10. Venture capitalists are impossible to get to see.**
The right introduction is the key, without it you are faceless in a sea of business plans.

## VIII. THE FIVE C'S IT TAKES TO GET THE CASH

Since money sources are financial types, all I need is a good set of numbers, right? Lenders and investors look past the surface numbers to the intangibles of the five C's of;

**1. Character**
Is about honesty, integrity and persistence. Your credit record, work record and personal lifestyle, as reflected in your personal financial statement, are scrutinized. Never conceal debt or overvalue your assets. Order your personal and business credit reports before seeking financing. Clear up errors and put your explanation on record for any disputed items. Include in the financing proposal your explanation of any accurate negative credit information. Otherwise, when it's uncovered, you are presumed to be a liar. Past behavior is a predictor of future behavior. Have you encountered personal and business problems in the past? Did you keep your word? Meet your obligations? Applicants who fail the character test do not get funded.

**2. Capacity**
Is about what you can do. What skills, education, experience, drive and contacts are needed to enable repayment of a loan or achieve company growth such that investors can capture a 35 percent-plus return? Does your track record, education and training show that you and your management team have these skills? Investors specialize in selected industries because they know what to look for in management.

**3. Conditions**
Are external factors impacting your business in ways that you cannot control but to which you must respond. They can be threats or opportunities such as technology, competition, regulation, and economic or social changes. Your response to judgmental conditions should be strategic planning. You must include an analysis of competitors and how you create and maintain a competitive advantage.

**4. Collateral**
Loan collateral includes identifiable business and personal assets, such as your land and building, vehicles, and machinery. Investor collateral is having control of your company. If you can't pay, the banker can take your assets and sell them. If you don't hit your projections, the investor can take over your company. Venture investors tend to select one of two ownership control concepts. They either take a minority interest in the company that can increase if profitability targets aren't met, or they start with a controlling interest that declines as financial targets are met.

**5. Capital**
Equity capital measures how much the owners have risked in the company. Equity is a cushion to absorb losses. Debt capital must be repaid in good and bad times. The more debt a company has relative to equity, the riskier the loan. New companies are expected to have more capital. It is nearly impossible to get bank financing if, after the loan, there is $4 of total debt for every $1 of owners' equity. Not all dollars are equal to investors. You've spent dollars and sweat equity in product development, but if you can't get to market without investor money, your dollars are without value. Investors argue their dollars should buy a larger share of your company than your dollars. Most investments fail over this issue.

## IX. NETWORKING SECRETS THAT OPEN DOORS

You can greatly increase your chances of success with some advance planning. First, scout out local networking organizations to determine which events you want to attend. Then ask organizers whether investors are attending the events, and make it your objective to meet those investors.

Be careful not to push too hard for information about attendees, though, as well-connected organizers tend to react by politely feigning ignorance. No organizer wants to get calls from investors that begin with “Why did you sic that nut job on me?”

It helps to decide how many investors you want to meet. With a number in mind you’ll work the room with more purpose. Try to get the names of at least three investors but not many more than five because to be effective you’ll need to follow up fast.

Not everyone is adept at striking up conversations with total strangers. But if you’re serious about networking to raise capital, you’ll have to. **Don’t be shy**, take responsibility for reaching out to potential investors and getting them to hear your story. At networking events, it’s perfectly acceptable to walk up to strangers and introduce yourself. But after you’ve gone over the basics, what brought you here, your thoughts on the speaker it’s time to take the conversation in a new direction by asking “What do you do?” it’s an important question, because the same question will come back to you just a few minutes later. And you’ve got to be able to respond with a memorable introduction of yourself. It should be short, no more than 15 seconds, which is ample time to get a compelling message across. For example: I’ve founded a company that I hope will change the face of publishing by producing mystery books that rely on Web-based content for clues. Now I’m looking for $5 million to put several titles into print.

**Here are some networking tips:**

1. Recognize that there is more to networking than greeting people. Develop a step-by-step plan for how you'll build relationships and how you can effectively tell your story.

2. Zero in on specific groups of people. Who are the ideal prospects for your business? Do they live nearby? What activities do they participate in?

3. Determine where you'll be most likely to find your ideal prospects. Do they belong to specific organizations or associations? Do they frequent particular events, performances or recreational facilities?

4. Identify organizations, events, professional groups and social clubs whose members meet your profile characteristics, and get involved. Get to know people, and let them know what you do. Volunteer for committees, attend conferences, and maximize opportunities that might spin off from the formal sessions.

5. Work on your ability to make small talk. Have some prepared topics in mind--current events, sports, vacation plans. And be sure to ask open-ended questions of the other person like "What is it you enjoy most about your work . . . or where you live . . . or your free time?" Remember, too, that having a good conversation depends greatly on being an active, courteous listener.

6. Explore organizations dedicated to business networking. Chambers of commerce, tenant associations and networking clubs offer opportunities for you to meet and greet.

7. Look for partners. Specifically, look for other businesses that complement what you do and might be a good source of referrals. Align with non-competitors that call on the same prospects and share your business relationships.

8. Don't look at networking as a sales opportunity. Instead, look at it as a reconnaissance mission--a chance for you to learn something and enjoy the scenery. There is a proper time and place for sales calls.

9. Make a habit of being patient, polite and friendly to people, whether or not you're in an "orchestrated" setting. One day, I was snapped at by a frazzled airport ticket agent. Instead of getting angry and formulating a counterattack, I said, "You must be exhausted; so many people are flying this weekend." A woman behind me commented on my remark and asked if I was in the clergy. I laughed and told her what I did, and thus began an enjoyable business relationship.

10. Don't do anything to extremes. What constitutes anything? You name it: drinking alcohol, eating, talking, laughing or whispering.

11. Timing is everything. If you're working the room and getting results, stay as long as you can. If you're in a dead zone, cut your losses, get out early, go home and get a good night's sleep.

12. When you meet with someone and it’s clicking, capitalize on that with a rapid follow-up. There were two ways to go: to the top of the pile or into the abyss of nameless faces that they met the night before.

Referrals, introductions and contacts that simply come by chance are like gifts. Be sure to thank anyone who helps you network. Your ability to be seen as a giver rather than a taker will spread the word that you are someone with whom people want to do business.

## X. DOES YOUR BUSINESS PLAN SAY SUCCESS?

Why is a business plan so vital to the health of your business?

A business plan is a written description of your business's future. That's all there is to it. It is a document that describes what you plan to do and how you plan to do it. If you jot down a paragraph on the back of an envelope describing your business strategy, you've written a plan, or at least the seed of a plan.

Business plans can help perform a number of tasks for those who write and read them. They're used by investment seeking entrepreneurs to convey their vision to potential investors.

So what's included in a business plan, and how do you put one together? Simply stated, a business plan conveys your business goals, the strategies you'll use to meet them, potential problems that may confront your business and ways to solve them, the organizational structure of your business (including titles and responsibilities), and finally, the amount of capital required to finance your venture and keep it going until it breaks even.

Sound impressive? It can be, if put together properly. A good business plan follows generally accepted guidelines for both form and content. There are three primary parts to a business plan:

1. The business concept, where you discuss the industry, your business structure, your particular product or service, and how you plan to make your business a success.
2. The marketplace section, in which you describe and analyze potential customers: who and where they are, what makes them buy and so on. Here, you also describe the competition and how you'll position yourself to beat it.
3. The financial section contains your income and cash flow statement, balance sheet and other financial ratios, such as break-even analyses. This part may require help from your accountant and a good spreadsheet software program.

**A business plan consists of seven key components:**

1. Executive summary
2. Business description
3. Market strategies
4. Competitive analysis
5. Design and development plan
6. Operations and management plan
7. Financial factors

In addition to these, a business plan should also have an impressive cover, a descriptive title page and a compelling table of contents.

**How Long Should Your Business Plan Be?**
A typical business plan runs 15 to 20 pages, in the case of an especially detailed plan describing a complex enterprise, more than 100 pages, but there's room for wide variation from that norm.

Most venture capitalists say that plans over 50 pages tend to end up in the round file, but remember it is the introduction to the VC that counts and if you have their attention before you present your plan, then if you need 100 pages to convey the “Big Picture” it won’t be the kiss of death. It will depend on the nature of your business. If you have a simple concept, you may be able to express it in very few words. if you’re proposing a new kind of business or even a new industry, it may require quite a few more pages.

**What type of plan should you use?**
The reason that plan selection is so important is that it has a powerful effect on the overall impact of your plan. You want your plan to present you and your business in the best, most accurate light. That’s true no matter what you intend to use your plan for, whether it’s destined for presentation at a venture capital conference, or will never leave your own office or be seen outside internal strategy sessions.

When you select clothing for an important occasion, odds are you try to pick items that will play up your best features. Think about your plan the same way. You want to reveal any positives that your business may have and make sure they receive due consideration.

So viewing your plan as a fund-raising tool is just the beginning of the story. You’ll use the plan for so much more for managing yourself, for operating the business and for recruiting. Before deciding to skip your planning phase, consider all the implications and what they mean for your future success.  If you skip the plan you have no hope of obtaining venture capital … period. Clear enough?

**Presenting persuasive pro-forma financials**
Your pro forma is what gets investors interested. Make sure you do it right.

Investors will be persuaded by the actual numbers (a $100,000-a-year business is a very different investment than a $55 million business), but most sophisticated investors will be even more concerned with the thinking behind the projections.

Your revenue projection should reflect your business assumptions and dynamics. That way, you can play with your assumptions—which correspond to your actual business structure—and see how they impact your revenue.

I highly recommend not inflating your numbers to meet your investors' needs. Only ask for an investor's money if you truly believe you can give them a good return. Otherwise, you'll end up beholden to a group of people you've disappointed.

To clearly develop your business plan before you attempt to present to potential investors get my book “How To Prepare and Present A Successful Business Funding Request” at BusinessFinance.com.

## XI. WILL YOUR FIGURES STAND UP TO VC ANALYSIS?

Want to know what investors are looking for in the numbers of your financial statements?

Most investors usually look at the income statement first to see whether gross, operating and net income margins are in line with industry averages. If not, it's a negative. Then again, it doesn't have to be the kiss of death. Many companies have not reached the critical mass on sales that will reduce the effects of fixed costs, or may be experiencing high costs because they're growing.

Next most equity investors examine the composition of revenues. They are looking to see if the revenues have gravitated to the higher margin business and will probe the degree to which revenues are recurring in nature. Revenues which occur over and over again without the stimulus and cost of sales promotion are ideal because they increase the company's overall profitability.

On the expense side ideally there will be operating leverage which means that as the business grows, expenses as a percentage of revenues will level off or go down. The absence of operating leverage does not mean the business will be unattractive to all investors, but it could be a defining characteristic. Some investors shy away from companies that cannot achieve operating leverage.

The balance sheet provides a snapshot of the business's assets, liabilities and owner's equity for a given time.

Working capital is one of the most difficult financial concepts to understand for the small-business owner. In fact, the term means a lot of different things to a lot of different people. By definition, working capital is the amount by which current assets exceed current liabilities. However, if you simply run this calculation each period to try to analyze working capital, you won't accomplish much in figuring out what your working capital needs are and how to meet them.

A useful tool for the small-business owner is the operating cycle. The operating cycle analyzes the accounts receivable, inventory and accounts payable cycles in terms of days. In other words, accounts receivable are analyzed by the average number of days it takes to collect an account. Inventory is analyzed by the average number of days it takes to turn over the sale of a product (from the point it comes in your door to the point it is converted to cash or an account receivable). Accounts payable are analyzed by the average number of days it takes to pay a supplier invoice.

Most businesses need short-term working capital at some point in their operations. For instance, retailers must find working capital to fund seasonal inventory buildup between September and November for Christmas sales. But even a business that is not seasonal occasionally experiences peak months when orders are unusually high. This creates a need for working capital to fund the resulting inventory and accounts receivable buildup.

Some small businesses have enough cash reserves to fund seasonal working capital needs. However, this is very rare for a new business. If your new venture experiences a need for short-term working capital during its first few years of operation, you will have several potential sources of funding. The important thing is to plan ahead. If you get caught off guard, you might miss out on the one big order that could have put your business over the hump.

**The five most common sources of short-term working capital financing:**

Investors will look very closely at how effectively you use these.

1. Equity: If your business is in its first year of operation and has not yet become profitable, then you might have to rely on equity funds for short-term working capital needs. These funds might be injected from your own personal resources or from a family member, friend or third-party investor.

2. Trade Creditors: If you have a particularly good relationship established with your trade creditors, you might be able to solicit their help in providing short-term working capital. If you have paid on time in the past, a trade creditor may be willing to extend terms to enable you to meet a big order. For instance, if you receive a big order that you can fulfill, ship out and collect in 60 days, you could obtain 60-day terms from your supplier if 30-day terms are normally given. The trade creditor will want proof of the order and may want to file a lien on it as security, but if it enables you to proceed, that shouldn't be a problem.

3. Factoring: Factoring is another resource for short-term working capital financing. Once you have filled an order, a factoring company buys your account receivable and then handles the collection. This type of financing is more expensive than conventional bank financing but is often used by new businesses.

4. Line of credit: Lines of credit are not often given by banks to new businesses. However, if your new business is well-capitalized by equity and you have good collateral, your business might qualify for one. A line of credit allows you to borrow funds for short-term needs when they arise. The funds are repaid once you collect the accounts receivable that resulted from the short-term sales peak. Lines of credit typically are made for one year at a time and are expected to be paid off for 30 to 60 consecutive days sometime during the year to ensure that the funds are used for short-term needs only.

5. Short-term loan: While your new business may not qualify for a line of credit from a bank, you might have success in obtaining a one-time short-term loan (less than a year) to finance your temporary working capital needs. If you have established a good banking relationship with a banker, he or she might be willing to provide a short-term note for one order or for a seasonal inventory and/or accounts receivable buildup.

## Fortune Telling

In every company's life, there comes a time when it must look into the future and try to imagine what its financial prospects are. Often this occurs right at the point when the product or service is fully developed but not yet launched. It's at this moment that most entrepreneurs faced with the enormity and cost of evolving from a product development company to a sales and marketing giant seek outside financing.

Naturally, the first question would-be investors ask is "What do your financial projections look like?" The reason investors ask this question is simple: Companies are valued in relationship to their earnings. Hence the future value of the investment depends on how the company performs down the road. As a result, access to growth capital depends in large measure on the entrepreneur's ability to paint a credible and compelling picture of his or her company's financial prospects through a projected income statement.

But how to do so effectively? It's naive to simply start with baseline sales and apply a formula that increases them by 20 percent per year. It's probably even more naive to suggest that the market is a certain size and the penetration will increase a certain number of percentage points each year. The fact is there's nothing formulaic about projecting future sales. It requires going through a spreadsheet cell by cell and thinking about each quarter.

When investors get close to doing a deal, they'll want to examine every single detail of your projections. But at first pass, they'll look at just five items: sales; cost of sales; gross margins; selling, general and administrative costs; and operating income. So what should each of these items include, and how should they be structured to avoid immediate rejection?

Sales: The most effective sales projections for pre-revenue-stage companies rely on original market research or test marketing conducted by the company's founders. Neither of these activities needs to be exhaustive or expensive. But they are important because empirical data will move the projections out of the realm of fantasy and into the world of reality.

For instance, an entrepreneur offering pet-grooming services can test potential customer response through a direct-mail campaign even though he or she is not yet in business. Once the response rate is determined, projected sales are figured as a percentage of that response. This approach also begins to lend some credibility to the expense side of the equation since you now have hard facts to base your projections on.

Cost of goods sold: Compared to sales, the cost of goods sold is much easier to determine. After all, while projected sales require the entrepreneur to consider where, when, and how long it will take to open new stores, the cost of goods is a fait accompli because much of it relies on the calculations behind projected sales. When sales are known, the cost of goods sold is mostly just a case of plugging in the right figures.

But you can only plug in the right numbers if unit costs are known with some degree of certainty, which for many companies is the fly in the ointment. Pinpointing unit costs requires you to do some homework to determine the cost of materials and time that go into producing the unit or service, as well as any other expenses involved. These estimates are sometimes referred to as cost schedules.

If an entrepreneur is unwilling or unable to make detailed supporting schedules for the cost of products or services, it can be the kiss of death. After all, who would invest in a company where not even the founder is sure what it will cost to produce the product or provide the service?

Gross margins: Gross margin is defined as sales less cost of goods sold, and the investor usually looks at it as a percentage. So what must the gross margin say or not say?

First, the gross margin should not be too far out of kilter with the average for the industry. (For industry figures, contact a trade association.) For instance, according to statistics maintained by the National Restaurant Association in Washington, DC, gross margins for the full menu table service establishments are about 36 percent. If you're opening a restaurant and your financial projections show a 25 percent gross margin, up goes the red flag. If your projections show a 45 percent gross margin, up it goes again.

While the former deviation is a tough sell, the latter is possible to overcome with a plausible explanation. In fact, with a really good explanation, it's a selling point. After all, breakthroughs in technology, manufacturing techniques, or management styles can change the economics of doing business and create exciting investment opportunities. So if you've got it, flaunt it. But be prepared to offer lots of evidence that illustrates why your operation breaks the mold.

Another important strategy for computing the gross margin is to pull it back a bit from what might be suggested by the numbers alone. For instance, if your actual projected gross margin is 45 percent, it's wise to increase the cost of goods sold so that the gross margin in the projections you show investors is a more realistic 40 percent. "Most of the time when you're talking about gross margins you're talking about utopia with no stock-outs, absenteeism, shrinkage or teamsters strikes.

Selling, general and administrative costs: If ever there were a place in the projections to simply let costs increase each year by a set factor, general and administrative costs are it. Supplies are not expensive. Calculating the cost of running centralized operations is fairly straightforward.

Estimating selling costs, on the other hand, can be a bear if the entrepreneur is uncertain how products will be distributed. And if the entrepreneur suggests too many different types of selling methods in the financial projections, investors will know he or she is clueless about how to sell his or her product or service.

Specifically, if the selling costs include advertising, trade shows, manufacturer's representatives, sales staff and telemarketing, it could be an indication that the distribution channels are unknown and thus overstated. There are legitimate instances where the precise distribution channel is unknown and as a result, so are the precise selling costs. But the burden of selecting the most likely channel, based on experience or due diligence, rests with the entrepreneur, not the investor. When the financial projections indicate a shotgun approach to selling, the entrepreneur is saying, in effect "I'm going to try all these things to see which works," which often prompts the investor's response "Not with my money, you're not."

Operating income: As far as financial projections go, operating income or the operating margin, which is defined as gross sales less selling, general and administrative costs, is the bottom line. Many of the guidelines for projected gross margins apply to operating margins as well. For instance, be conservative rather than extreme in your estimates so you leave yourself room to exceed the projections rather than fall short of them. Where operating margins exceed industry averages, provide a tenable explanation. In the same way technology, management style and manufacturing techniques can cause a breakthrough on gross margins, so too can they have a healthy effect on operating margins.

Another important aspect of the operating margin is its absolute value. In general, a small operating margin, as a percentage of sales, is a turn-off for most investors; it leaves little room for error, and it's harder to create the kind of profits that offer an opportunity for investors to cash out.

For many businesses, however, thin margins are just part of the territory. Where they can undermine a small business is when projected operating margins are thin because of a low-cost pricing strategy. If the underlying assumption is that profits come with volume the question becomes, does the organization have the skill to generate the required volume?

More important, what kind of cash is going to get eaten in inventory purchases (if there are any) and in carrying a large balance of accounts receivable that come part and parcel with a large sales volume? You have to question the wisdom of an entrepreneur who is using a low-cost approach because it's not really dependable or maintainable on an ongoing basis without becoming costly to the business.

A complete financial forecast includes projected income statements, cash flow statements, and balance sheets. Conventional wisdom says that if the projected income statement is right, everything else will fall into place. But the flip side is that if the projected income statement is off, it's unlikely financing will ever get off the ground.

This has been a brief overview of what investors look at in your financial statements.  To be fully prepared get my book “How To Prepare and Present A Successful Business Funding Request” at BusinessFinance.com.  It will give you very clear specifics on the creation of your financial projections.

## XII. IT’S TIME TO PRESENT, DO YOU KNOW HOW?

In addition to a business plan, be prepared with a business summary focusing on the management team, profit projections, market position and exit strategy. Also put together marketing materials and due diligence analyses on the company, management and industry.

Take these materials along with your product, if you have one to your meeting to help the venture capitalist fully understand your product or service. Focus on your business plan. No “blue sky” plans or dreams, no mention of products or services not covered in the business plan.

**Don't:**

- Dodge any questions
- Hide significant problems
- Give vague answers
- Expect immediate decisions
- Fixate on valuation
- Stretch facts or projections
- Bring your lawyer

**Do:**

- Prepare all materials before soliciting any firms
- Send a business plan and cover letter first
- Solicit several firms
- Keep phone conversations brief
- Remain positive and enthusiastic about your company, product, and service
- Know your minimum deal and walk away if necessary
- Negotiate a deal you can live with
- Investigate the venture capitalist's previous deals and current portfolio structure

**Keeping It Real**

What you say and how it is perceived is very important to your presentation success. Let’s explore some common statements that entrepreneurs make and VCs have heard thousands of times.

Entrepreneurs say: “Our patents provide a significant barrier to entry.”
Investors think: We risk our capital on your ability to execute, not your attorney's ability to win in court.
Successful version: “Our patents will buy some valuable time to establish ourselves in a very viable marketplace.”

Entrepreneurs say: “The brand-name companies are too big and slow to threaten us.”
Investors think: The entrepreneur is arrogant or naive. Today's giants got to be where they are by being aggressive. They're lean, they're mean, and they deserve respect.
Successful version: "We understand that Brand X might enter our market, but if we establish a reputation for quality early on, they will see us as an acquisition candidate.”

Entrepreneurs say: "We're doing a deal with Microsoft (AOL, SUN, Oracle, etc.)"
Investors think: With a big company and a large deal, marketing and development resources can dither away your very limited resources even when they're attempting to be your ally.
Successful version: "We may have an agreement with the world's largest player in this arena. It's important, but it's not the destiny of this company. Our idea will succeed regardless of whether we are in partnership with them."

Entrepreneurs say: “Our financial projections are conservative."
Investor think: Every plan is right on, they show next year's expenses and last year's revenues. Investors know you aren't going to make the numbers. But they pay close attention to the projections because it gives them a window to what you're thinking, where you want to take the company, what you think it will take to get there, and how well you understand what it takes to sell in your industry.
Successful version: "These projections are our best estimate of what the future could look like. And there are some developments underway that make us feel very good about these numbers."

**Stay away from these in your presentation**

Here are some observations on areas where entrepreneurs frequently go wrong in pitching to investors.

1. Suspicious numbers
Many times, entrepreneurs present profit histories that, upon further and perhaps more conservative examination, might actually show a loss. Others present growth curves that look like a hockey stick. When outrageous numbers show up on the overheads investors leave the room."

2. Droning on about technology
Entrepreneurs who are scientists or engineers are prone to making this error. And once you lose an investor's attention, it can be hard to get it back. Yes, the technical aspects of your company's product or service are important as they deliver competitive advantages, open new markets or change the balance of power in an existing market but to investors, technology is not important in and of itself. Spend no more than three to five minutes discussing technology. Any more time spent on science is less time devoted to selling the deal.

3. Lack of audio/visual support
Making a presentation with no visual support is difficult for all but the most gifted of speakers. Without a visual outline, if investors get distracted for even a moment, they may lose the context of the speaker's remarks. The most effective presentations are accompanied by 10 to 15 slides, overhead projections or handouts that punctuate your remarks and give the listener a constant source of context. Don't get too obsessed with visual aids, however.

4. No flowery corporate videos
It's a mistake to let a corporate video run for more than five minutes. After that amount of time, it starts to give investors the impression that management is trying to hide something or has nothing important to say.

5. Poor timing
Entrepreneurs frequently say too much or don't say enough. Either extreme is deadly. When the presentation is too long, it puts investors to sleep, indicates the entrepreneur is unsophisticated about the rules of engagement and is uncertain about what information is important. When the presentation is too short, the entrepreneur appears to be unwilling to share information. The optimal length of time to get across the history and potential is 30 minutes.

6. Weak live demonstrations
Live demonstrations are almost always a failure, particularly for technology products. The most successful presentations do not involve demonstrations of our software. For product demonstrations, which can be extremely effective sales tools, use a video for a perfect pitch every time.

7. Poor response to questions
Many entrepreneurs err on the inevitable question and-answer part of the program. The most damaging is when the entrepreneur gives the impression that they are smarter than the person asking the question and compounds that error by throwing too much technical jargon into the answer.

8. Poor listening skills
Often entrepreneurs blow responses to questions by failing to listen. It's dissatisfying to an investor when they ask a question and the answer isn't even relevant, In fact, it's as close to the kiss of death as there is.

9. Inappropriate follow-up.
When raising capital, particularly from individual investors, the old rule is that yes comes fast, and no takes forever. Still, many investors test the mettle of the business owner by seeing how long it takes him or her to follow up. If it's not forthcoming, even for reasons of perceived courtesy, many investors get turned off. On the other side of the coin, calling every day doesn't work, either. Follow up within a few days of the presentation but no more than three times. Then wait. If you haven't gotten an answer in two weeks, kiss that investor goodbye. But do it nicely, so you can get the names of at least three more investors before you move on.

10. Burned bridges.
Raising money often takes a long time. Sometimes the things that initially turn investors off; an underdeveloped product, no sales, incomplete management team, correct themselves during the fund-raising process. Contacts made early on may at some point become fertile ground for raising capital unless, of course, the entrepreneur hasn't kept in touch or, worse yet, was less than gracious when the investor said “no thank you” the first time.

## XIII. TEST YOUR METTLE AT VENTURE CAPITAL FORUMS

You need tons of money. You have no financial contacts. Where can you turn? Many entrepreneurs have found what they need in venture forums.

Any entrepreneur who's ever chased venture capital dollars can tell you the process is often a brutal, soul-stripping experience. For those without Ivy League connections or friends and family in the right places, finding someone to quickly scan your executive summary or listen to your "elevator" pitch can take months.

This need of entrepreneurs who have potentially fundable ideas to be connected to investors has given rise to the quite recent venture forum phenomenon. Although these entities have been in existence for decades, the past five years have seen the number of forums grow significantly.

There are about 100 active forums nationwide. They range from relatively small, highly selective groups to forums that let just about anyone with a business plan make a pitch.

Most forums charge an application fee and offer brief one-day workshops geared toward helping selected candidates refine their presentations. Presentations range between seven and 15 minutes and are typically followed by a question and answer period, when angels and venture capitalists ask for more details about the company, its management team, the market and more.

But don't expect investors to be so dazzled by your presentation that they rush to get their checkbooks. Venture forums are long shots that require lots of follow-up and perseverance. But are a great place to help entrepreneurs get exposure, refine their business models, and sharpen their pitches.

Venture Forums can help review your business plan, to ensure you have a good presentation plan and, most important, to help develop a strategy to locate investors.

Most entrepreneurs tend to focus all their energy on finding the financial resources to fuel their dreams. Consequently, they become frustrated and impatient when the questions are raised like "What do you and your team want out of the business?"

Venture Forums can help entrepreneurs understand how such ancillary issues will affect their search for funding and the development of their business.

In addition to polishing your presentation, the forums allow you the opportunity to network with individuals who might know the right investors.

Most entrepreneurs don't succeed at their first venture forum. But there's never a quick fix to capital needs. Don't forget: If you want to raise money, you usually have to do a lot of homework and even more legwork.

**Things to keep in mind when looking for the right venture forum**

Attend a small forum to help you better learn the process. But keep in mind the following tips for evaluating venture forums:

1. If the application process is highly selective, chances are the number of potential investors present could be substantially higher.

2. A larger application fee sometimes translates into more investors.

3. When you call to get more information on a forum, find out the ratio of investors to service providers.

4. Will there be more angels than venture capital firms attending? Angels tend to make smaller investments.

**Scared stiff by public speaking?**

More people say they're afraid of public speaking than say they're afraid of death! But ask top entrepreneurs what has helped propel them and their businesses to the forefront, and they'll tell you their ability to motivate groups of people has been instrumental in their success.

When planning a presentation, start by considering what your audience wishes to gain from your talk. Then create a speech that presents relevant facts and reasonable solutions. Structure your presentation so it flows logically, and incorporate visuals to add interest. Leave time for questions and audience interaction to build rapport and demonstrate your expertise.

Typically, content and structure are less of a problem for presenters than is the issue of style. You can produce an eye-catching and comprehensive multimedia presentation using a presentation graphics package, such as Microsoft PowerPoint, in combination with a computer and a projector or monitor. Programs allow you to incorporate bulleted points, images, and audio and video clips. Whether you use the latest equipment or simple flip charts, make sure your presentation is visually appealing and never dull.

Most important, keep your presentation free of negative behavior. Eliminate anything that detracts from communicating solid, benefit oriented information in an engaging manner.

Here are just a few of the most common types. See if you can spot a problem you need to work on.

The Slow Talker
Who speaks at an unnaturally halting rate that makes the audience want to jump out of their seats with impatience.

The Low Talker
Who speaks quietly, generally with eyes cast down. This awkward shyness eventually makes the audience so uncomfortable, they forget what's being said and concentrate on the speaker's embarrassment instead.

The Double Talker
Who presents few substantiated facts and tends to over promise. His or her proposals sound too good to be true.

The Droner
Who just doesn't know when to stop. The presentation goes on endlessly, with no respect for the audience's time.

The Techie
Who presents too many details and little bottom line content. Techies often get bogged down with charts and graphs that are difficult to read and understand.

The Stiff
Who stands behind the podium with hands folded, reading from a script, making few if any gestures, and simply bores the audience to death.

The Apologizer
Who destroys his or her credibility by making excuses, often right at the outset, which can sabotage the entire presentation.

The Twitcher
Who is a nervous presenter who may repeatedly grin, grimace or make other repetitious motions, such as pointing a finger in the air for emphasis or swaying from one foot to the other.

The Show-off
Who gives more glitz than substance, offering few relevant facts or solutions.

**AND THE BEST PRESENTER:**

**The Straight Shooter**
Who makes eye contact with the audience, uses natural body movement, and may even move around the room instead of standing stiffly in one spot. The Straight Shooter uses direct language so everything is understandable and clear.

To eliminate negative behaviors from your own presentations, set up a video camera and tape a rehearsal or two. Watch the tape critically. Some of the most common negative behaviors are the easiest to spot, so with just a bit of practice, you can smooth out the rough edges and create a presentation style you'll be proud of.

## XIV. FIND YOUR FUNDING SOURCE

***"BusinessFinance.com knows where The Money is"***

Connecting entrepreneurs who are searching for capital, directly to Funding Sources with capital available to place. That's really the whole point, isn't it?

BusinessFinance.com matches your specific funding request with the lending or investing criteria of Funding Sources who have capital to place. Don't waste your valuable time talking to sources that can't help you. Get your request in front of those Funding Sources that are pre-qualified to match your specific funding request.

At the time of this edition (December 2002) BusinessFinance.com had categorized the lending and investing criteria of more than 4,000 funding sources nationwide.

### BusinessFinance.com has categorized sources for:

**Commercial Finance (781 Sources)**
Commercial Lending is normally renewable short term loans to finance the working capital needs of a business. Qualifying for this type of capital typically involves the pledging of some form of asset, like equipment or receivables.

**Investment Banks (142 Sources)**
Many sources for Investment in you business. If you are searching for equity capital or some type of offering, it can be found in the directory.

**Equipment Finance (633 Sources)**
Is equipment acquisition a major part of your need for business capital? All the equipment finance and leasing sources you will ever need are in the directory.

**Government Loans (590 Sources)**
Our Government is one of the major sources of small business capital. We have listed those Funding Sources that are outlets for U.S. Government programs.

**Commercial Real Estate Finance (475 Sources)**
Need Funding for a Real Estate project? You can find Funding Sources for every type of real estate project under the sun.

**Venture Capital (1,062 Sources)**
Investments are normally starting at $250,000 and placed in industries and businesses that exhibit more than $25 Million gross annual revenue potential.

And a variety of non-categorized funding sources such as sources for unsecured lines of credit, asset sale and leasebacks, operational leases that can include set-up, software, installation, and training fees. And many more.

***"Looking for money is like searching for the Holy Grail.<br>It would be easier if someone just told you where it was."***

***It's at http://www.businessfinance.com***

## XV. GETTING FUNDED ON YOUR OWN, A DIFFICULT TASK

There are over 4,000 institutional sources of business capital in the United States and each one has different criteria for funding a deal. Each one of these sources will tell you NO for just "one thing". By yourself how can you possibly know what that "one thing" might be?

Less than 3% of businesses that attempt to receive funding on their own ever do! The bottom line is that you are foolish for going it on your own. If you apply at multiple places without pre-qualifying, you will damage your credit and may destroy your chances of receiving funding from the sources who would have done your deal.

**So now it is decision time for you.**
BusinessFinance.com will pre-qualify you before you apply for free or you can apply everywhere and be a real danger to yourself. So the choice is yours, ignore all the warnings and go it on your own, or use BusinessFinance.com and get the help you need. Let us help and we will:

- Assign you a "Funding Coach" to guide you step-by-step through the process.
- Allow you to see which funding programs that you pre-qualify for right now.
- Show you exactly what you need to improve on in order to pre-qualify for more.
- Prepare and present your funding requesting to the funding source's requirements.
- Help you to build a good Business Credit Profile separate from your personal credit.

**ALL FREE OF CHARGE!!!**

There are "business credit services" that charge over $1,000 to help you build your business credit profile. Dun and Bradstreet charges $399 just to set up a business credit file. Professional services charge $1,000 to $5,000 to package your funding request. None of these pre-qualifies you before you apply. All these are FREE on BusinessFinance.com with your "Funding Coach".

You have accessed your **Business Funding Coach** or you wouldn't be reading this book. Your coach's only job is to get your business funding. Let's look at the steps to funding after you have used your business funding coach to pre-qualified for a funding program:

1. Your application is forwarded for the funding program you selected.
2. The information you provided is verified; credit, banking, taxes, etc.
3. "Conditions" to funding are issued; copies of invoices, appraisals, etc.
4. After verification/conditions are complete, you're request is funded.

In order to verify of the information on your application for funding, there is a "one-time" fee of $299 for third party verification. This verification fee is <u>only paid once</u> and covers you for however many funding programs you pre-qualify for and choose to apply for in the future. This verification fee is non-refundable and does not guarantee you business funding. It is only to determine that the information you have provided is accurate and factual.

BusinessFinance.com puts you on the path to more funding opportunities for your business. You will always know exactly what it takes to reach your goal and just what steps to get there.

***"We're lost, but we're making really good time"***
***When you want excellent directions they are at:***
***http://www.businessfinance.com***

# V. THE VENTURE CAPITAL DUE DILIGENCE CHECKLIST

Below is a sample of the extensive amount of information that venture capital firms are going to require in order to **"just consider"** funding your capital request. The burden of providing all this information is going to be on you and your management team. Having been through this process a few times myself, I can tell you from personal experience that it is very painful and extremely time consuming. You will end up putting your business on hold while you proceed through this maze. Can you afford it?

### 1. Corporate Documents:

Articles of Incorporation
Bylaws and operating agreements
Shareholder agreements
Minutes of Board of Directors and Shareholder meetings
All documents furnished to shareholders and directors
Certificates from all states and jurisdictions where the company does business

### 2. Previous Securities Issuance:

Copies of stock certificates, warrants and option agreements
Complete Stockholder contact information
Number of outstanding shares, dates of issuance, and percent ownership
All outstanding preferred stock, including covenants
All outstanding options, warrants or convertible securities
Employee stock benefit programs; stock options, stock purchases or others

### 3. Financial Information

Audited financial statements since inception
Income statements, balance sheets, cash flow statements
Records of all changes in equity position
Accounting methods and practices
Company prepared monthly or quarterly statements
A three year budget and financial projections
A complete and current business plan
Accounts receivable aging and accounts payable aging
Product or service pricing plans and policies
Revenue and gross margins by product or service
Extraordinary income or expense details
Explanation of any material write-downs or write-offs
A summary of all bad debt experiences
Details of any outstanding contingent liabilities
Accountant report on the company's financial condition

## 4. Tax Status

Federal and state income tax returns for the last three years
Detail of any tax audits

## 5. Contracts and Agreements

List of Bank and non-Bank lenders
Joint venture and partnership agreements
License agreements
Purchase agreements
Liens, equipment leases, mortgages or any other outstanding loans
Insurance contracts and agreements
Contracts with suppliers, vendors and customers
Any additional agreements or contracts relevant to the business of the company

## 6. Governmental Regulations

Copies of all permits and licenses
Copies of reports made to government agencies
Detail of any inquiries made by any local, state or federal agencies

## 7. Litigation

Description of any current litigation including potential damages
Description of any potential litigation including potential damages
Settlement documentation

## 8. Products and Services

Detail of product offering including market share by product line
Inventory analysis including turnover, obsolescence and valuation policies
Backlog analysis by product line including analysis of seasonal issues
List of all major suppliers including dollar amount purchased per year

## 9. Marketing

List of competitors and detail of market share
List of major clients
Analysis of pricing strategy
Current brochures and marketing materials
Sales commission structure
Sales projections by product line
Any pertinent marketing studies conducted by outside parties

**10. Management and Personnel**

Management organizational chart and bios of senior personnel
Detail of any labor disputes
Employee compensation plans including pension, options, profit sharing, deferred compensation and retirement
Management incentive plans including pension, option, profit sharing, deferred compensation, retirement and any non-cash compensation
Employee confidentiality Agreements
Listing of any consulting Agreements
Number of employees, turnover, absentee problems and hiring projections
Employee HR, benefits, and insurance manuals
List of Company's Directors
Pinkerton investigation report on all principals, managers, and directors
Credit history report on all principals, managers, and directors
Resume verification on all principals, managers, and directors

**11. Property and Equipment**

An appraisal of all equipment and fixed assets
List of all real property owned by the company
Copies of titles, mortgages, and deeds of trust
Detail of any easements or other encumbrances
Leases and sub-leases
Company space expansion plans
Patents, trademarks and other intangible assets

**12. Research & Development**

Detail all research and development in progress
Commercial analysis of R&D efforts
Documentation policies including examples

**13. Other Company Information**

Copies of all past and planned company press releases
Existing articles relating to the company and its industry
Company newsletters and any investor relations material

**14. The Kitchen Sink**

Any other information that might be pertinent to full disclosure of all company issues

## XVI. SAY THANK YOU TO THOSE WHO HELPED

Remember along your entrepreneurial journey to take the time to thank those who help you. If you will treat others the way you would like to be treated, you will find that people will go out of their way to help you. I have tried my best to give you the benefit of my knowledge and experience. I sincerely hope I have helped you.

In 1995 I founded BusinessFinance.com to help business owners just like you. Our mission statement is "To Help Businesses Grow and Succeed". Today I am still the CEO and it is my strongest desire to give business owners like you every opportunity to make their dreams come true. Along the way I have had lots of help.

**With that said I would like to thank my:**

Father and Mother, who have invested in me my whole life and who have always shown me love whether I failed or succeeded.

Sister and Brother-in-law, who have always been there for me when I needed a shoulder to lean on or someone to just listen.

Children, who are the joy and blessing of my life and who give me the wonderful gift of unconditional love to begin every day.

Business partners, who believed in me and in my wild dreams and who have come along side to lighten my load.

Lord and Savior, Jesus Christ, who by his will I can do all things. He reminds that life is short and not all about riches in this world, for my eternal life is in the next.

The material presented in this book is designed to help you plan for your business success and to locate the funding that your business will need to grow and succeed.

Remember to keep your priorities straight and that money cannot buy happiness…but that is a whole other book.

I would love to hear from you if you thought my book helped you in any way. I am always willing to answer your questions if you ask (by e-mail please).

I wish you all the success in the world in your search to fund your business.

**Corey Pierce**
corey@businessfinance.com

Food for thought:

***"For what does it profit a man if he gains the whole world, yet loses his eternal soul." Mark 8:36***