Money

Where to find investors

Strategies to get the money to build your business.

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(Money Magazine) -- **Q:** How do I get investors to help take my company to the next level? *-Michael Solovy, Eden Prairie, Minn.*

A: The first thing to figure out is how much help you need. This will aid you in determining whom to go to. If you're looking for less than $500,000, focus on angel investors - typically wealthy people who use their own money to help build small companies (usually less than $1 million in revenue).

If you need more money and are in a high-growth field, look to venture-capital firms, which generally put down stakes of $1 million or more. Be forewarned, though: Both types of investors will want an equity stake in your company and some involvement in how it is run, with VCs often requiring a say in big decisions and some angels taking a hand in day-to-day operations. (Given these parameters, you may want to consider whether you could raise capital from friends and family instead.)

Whether you approach VCs or angels, you'll need to prepare a strong case for why they should buy into your business. Lawrence Gelburd, an entrepreneurship lecturer at the University of Pennsylvania's Wharton School, advises writing up a two-page executive summary, which you can elaborate on in an in-person pitch. Include a clear, concise mission statement; a detailed description of your product or service; its points of differentiation from competitors; the company's projected revenue; and your past, present and anticipated financial needs. Find examples at springboardenterprises.org.

The best way to locate an interested investor is by networking, so see if the Angel Capital Association or the National Venture Capital Association hosts events in your area. Also search online to find angels or VC firms that specialize in your field. Your local business incubator or trade association may be able to help too.

Once you have a name in mind, don't cold-call, warns Kay Koplovitz of Koplovitz & Co., a New York City media and investment advisory firm. Angels and VCs typically pay attention only to proposals that come to them through a known source. "So use people you know - like bankers, lawyers or fellow entrepreneurs - to make the introduction," she says. --*Emily Maltby*

Q: What are the pros and cons of working with venture capitalists? --*Ashish Singh, Mumbai, India*

A: Venture capital has facilitated the start-up and development of countless successful businesses. (Ever hear of Amazon.com or Starbucks?) And the benefits go beyond a much needed infusion of cash for your fledgling company: You get access to the VC firm's business-building expertise. You share the risk, so that if the business fails, you don't absorb all the loss. Plus, you may get automatic customers, as many VC firms encourage clients to treat one another as preferred suppliers, says Peter Ireland, who coaches entrepreneurs on getting investors via AntiVentureCapital.com. Another pro: The VC can help get other investors onboard if needed.

Working with VCs does have drawbacks, however. For one thing, the process of securing funding can be lengthy and difficult. Fewer than one in 10,000 businesses receive initial funding from VCs,

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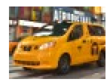

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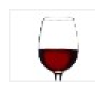

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according to a report from Babson College and the London Business School. Thus new entrepreneurs can expect to go through several rounds of rejections; even those who meet all the typical venture-capital criteria (see the next page) usually have to pitch for six months to a year before they have money in the bank, says Akira Hirai, managing director of Cayenne Consulting in Phoenix, which helps entrepreneurs develop business plans and financial forecasts.

If a firm does buy in, be prepared to lose a substantial degree of autonomy. "Almost every VC will take a seat on the board of directors to have some voting authority," says Hirai. So before you accept a dime, make sure your investors believe in the direction you want to take the company.

Understand also that you'll be pushed hard for fast results. The reason: VCs usually don't get any return on investment or even recoup what they've put in until you sell the company or it goes public. There can be an advantage to this. "If your concepts convert to quick sales, you'll build a stronger company faster," says Patrick Thean, a serial entrepreneur and co-chairman of MIT's Entrepreneur Masters Program. "But if not, the VC will have to invest further to keep operations running, and you'll have to give up more equity."

To find out if an investor group's approach to business is compatible with yours, visit TheFunded.com, where entrepreneurs rate and discuss their experiences with various venture-capital firms. *--Hibah Yousuf*

Q: I'm looking to bring in partners and investors. What percentage of the company is typically given away in such cases? *--Victor, Las Vegas*

A: With professional investors, the percentage of equity you have to give up is generally a factor of your company's value and the amount of money they bring to the table, says Richard Honen, an Albany, N.Y. lawyer specializing in angel and venture capital. For example, if your start-up is valued at $3 million and someone contributes $1 million, that investor might expect around a third of the company. Fewer rules apply to friend-and-family investors, who probably care less about their exact share and more about your success, Honen says.

As for partners, these are usually experienced executives whom you can't afford to pay a market salary, so you offer a package that includes a stake in the company, be it stock or options. In general they should fill a critical need - say, a skill set you lack.

That expertise and their roles in the firm should influence how much they get. Typically, Honen says, you might offer 2% to 5% for a top executive position like CEO or CFO but less than 1% to other high-level managers. Overall, owners of fledgling companies usually allocate between 10% and 15% of their shares to employee compensation plans.

Don't forget, you might need two or three rounds of funding, Honen says. After the first you want to retain at least 51% of the company, a majority vote; Honen says 67% is better, as many states require a two-thirds vote to sell the company. After the second there's no accepted metric; it depends on the exit strategy. If the plan is an IPO, even 5% is substantial.

Granted, those goals are not always realistic, says Sheldon Frankel, a business law professor at Seattle University School of Law. "If it's a single untried idea, the founder might have to give up control entirely to lure an investor," he says. If you can offer less risk and greater reward (for example, a more developed idea reinforced by a patent and interest from a buyer), you'll likely have better financing options and be able to keep more control. Otherwise, you might want to stick with friends and family as investors. *--Kathleen Ryan O'Connor*

Make yourself a VC's dream

Your idea will be more appealing to a venture-capital firm if you:

Play up the trendiness factor. VCs tend to hop on bandwagons, says Emily Mendell of the National Venture Capitalist Association. Historically, software and biotech have been popular industries; now green technologies are hot. You'll have a better chance of getting financing if you show that your company is in on the ground floor of something big.

Document your experience. VCs prefer entrepreneurs who have built successful companies before, says Peter Ireland of AntiVentureCapital.com, who counsels small businesses on securing funds. If you haven't, highlight other management and industry expertise, and emphasize a commitment to fast growth.

Show off your advantage. VCs want to make sure it won't be easy for potential competitors to knock you out of the marketplace. In your executive summary, lay out who else is in the market and why you're better.

Underline the bottom line. VCs prefer to put a stake in markets with the potential for at least $1 billion in sales a year and companies that can capture 5% to 10% of that revenue, says Ireland. But don't inflate projections in your sales pitch - VCs will replace management teams that don't meet sales targets.

Have an exit strategy. From the moment they think about investing, VCs are contemplating the most profitable route to cash out. Investors are looking for businesses that demonstrate a strong potential for a buyout or an IPO within about five years, says Ireland. --*Hibah Yousuf*

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