Lighthouse Consulting's

# An *Entrepreneur's* Guide to Raising Private Capital

***Strategy, Process, and Tools for Maximizing Success and Maintaining Focus***

Lighthouse Consulting

***Strategic Guidance and Advisory Service for Growth Companies.***

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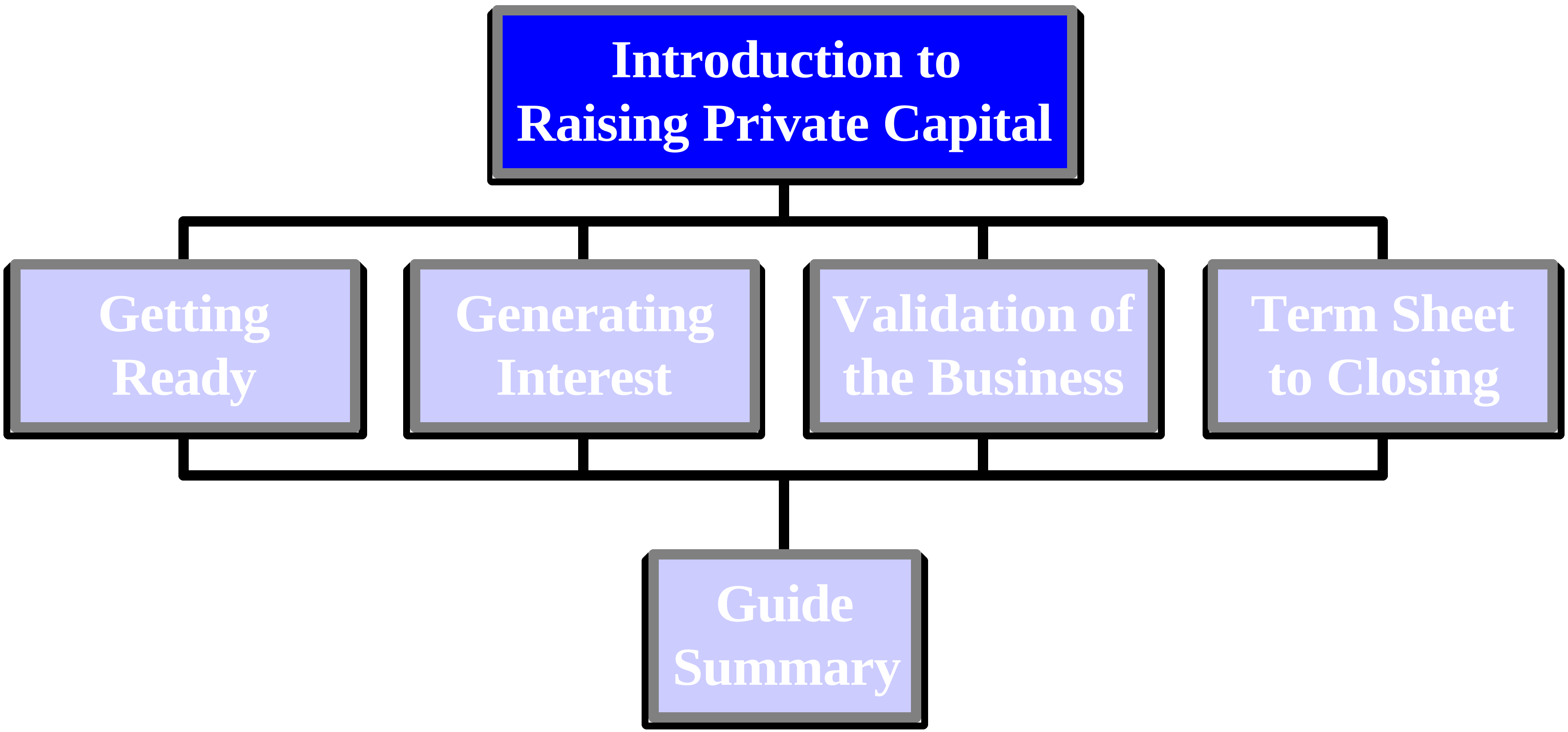
# Table of Contents



Appendices not included in the body of the guide are noted by section and may be found at netpreneur.org.

# Introduction



# Introduction

***Section Table of Contents***

# 10 Myths of Raising Capital

10. "My VCs are working on the next round."

9. "We already have $3M of our $10M soft-circled."

8. "They really seemed to like our pitch, we can probably count on them for a $1M."

7. "We have $3M committed from several interested VCs, we'll just pull in a strategic partner to fill the rest."

6. "They gave us a term sheet, the lawyers can take it from here."

# 10 Myths of Raising Capital

5. "To save time we'll use our sales presentation, throw in some financials, and start shopping it around."

4. "Our CFO is handling the next round."

3. "We better ask for a really high valuation so that when they negotiate us down, we'll still be O.K."

2. "We run out of money in November, so we need to get our Series C act together in early September."

1. "The only benefit of the fund raising process is the cash."

# Debunking the Myths

**The Capital Raising Process is:**

- A litmus test for current and future success.
- A confirmation and growth process.
- Perhaps your biggest and farthest reaching marketing campaign.
- An integral part of going to the next level in your business.
- The best source for new insights into your business and the road ahead.

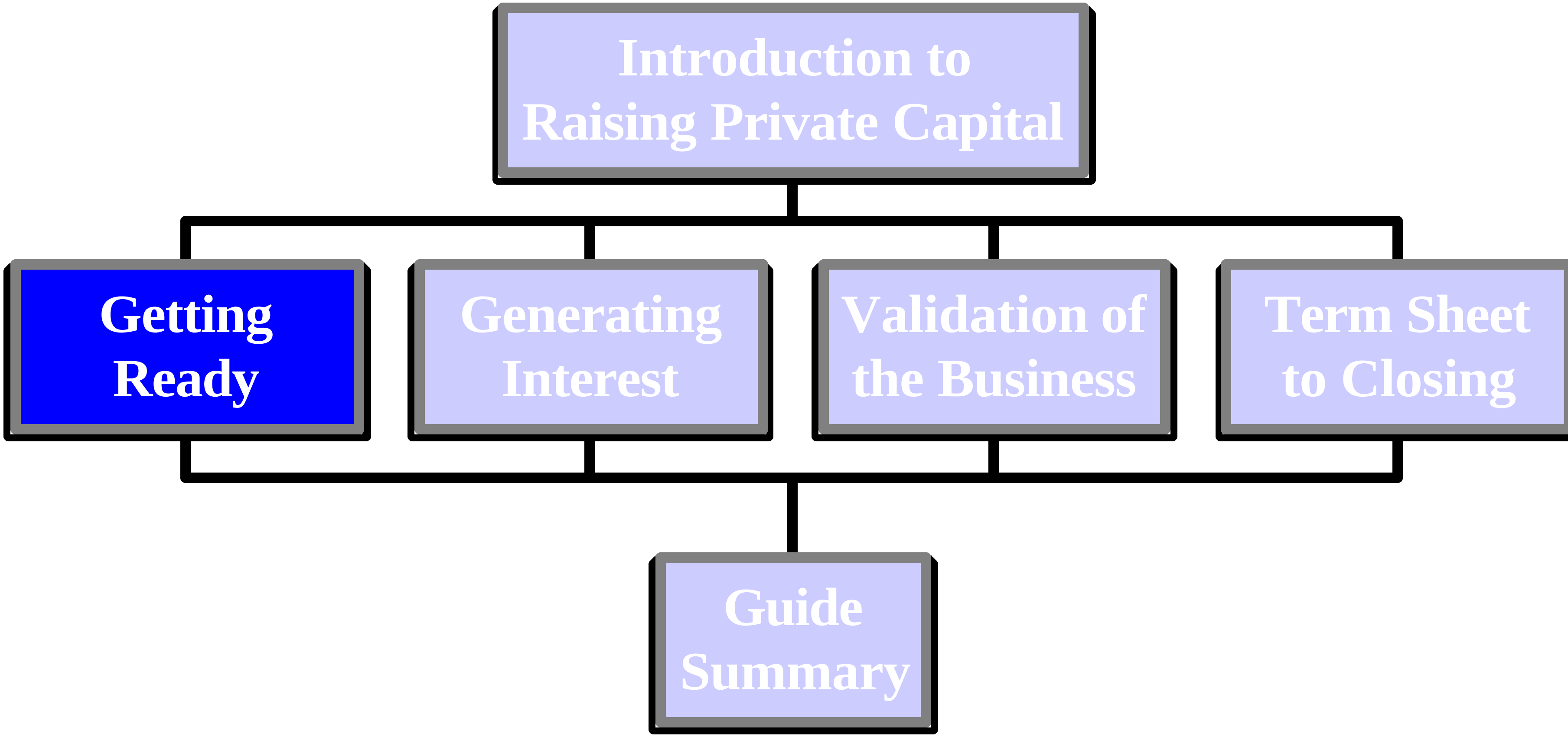
# Why the Process Often Fails

- An infrequent business exercise.
- Often a first time undertaking.
- Objectives are frequently unclear.
- Lack of skills, knowledge, preparation.
- The distraction of running a business.
- Initiated by panic.
- Failure to recognize the obvious: cash runs the business.
- Not knowing your audience: investors.

# Goals of the Guide

- ✓ Dispel the Myths.
- ✓ Increase Your Chances of Successful Fund Raising.
- ✓ Shorten the Timeline for Raising Capital.
- ✓ Keep You Focused – in the Process and in Your Business.
- ✓ Help You Grow Your Business.

# Phase 1


Introduction to
Raising Private Capital
Getting
Ready
Generating
Interest
Validation of
the Business
Term Sheet
to Closing
Guide
Summary

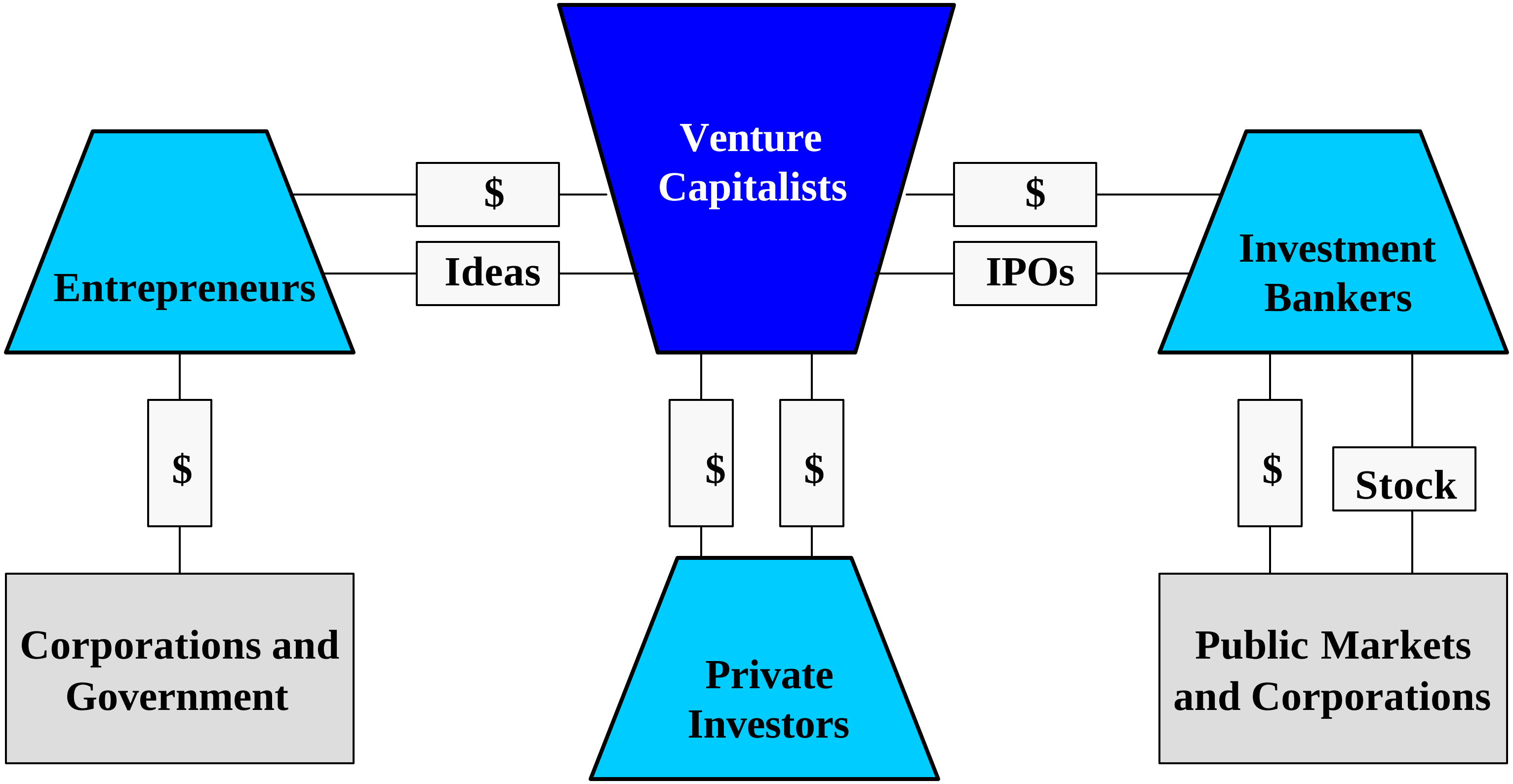
# Getting Ready

***Section Table of Contents***

# Early Stage Funding Options

| | Cash Flow | Friends/ Family | Bank | SBIC | Angel | Venture Capital | Strategic/ Corporate |
|---|---|---|---|---|---|---|---|
| **Availability** | **Low** | **Low** | **Med** | **Med** | **Low** | **Med** | **Low** |
| **Cost** | **Low** | **Hi** | **Med** | **Low** | **Med** | **Hi** | **Med** |
| **Quantity** | **Low** | **Low** | **Med** | **Med** | **Low** | **Hi** | **Med** |
| **Required Maturity** | **Med** | **Low** | **Med/Hi** | **Low** | **Low** | **Hi** | **Med** |
| **Risks** | •Typically nonexistent<br>•Not enough to fund growth<br>•Need maturity to produce it | •Hard to manage<br>•Gathered piecemeal<br>•No benefit beyond $<br>•Bad investor profile<br>•Typically supplemental | •Requires maturity<br>•Carries capital costs<br>•Stricter terms | •Must be offset by other capital<br>•Long time to apply for<br>•Does not fit all models | •Vary in sophistication<br>•Can be high maintenance<br>•Gathered piecemeal<br>•Not always in the market | •High growth, return, ownership expectations<br>•Lose some control<br>•High maturity requirements | •Less knowledgeable investor<br>•Slow investment process<br>•Informal community, activity<br>•Can limit strategy |

# How the VC Industry Works



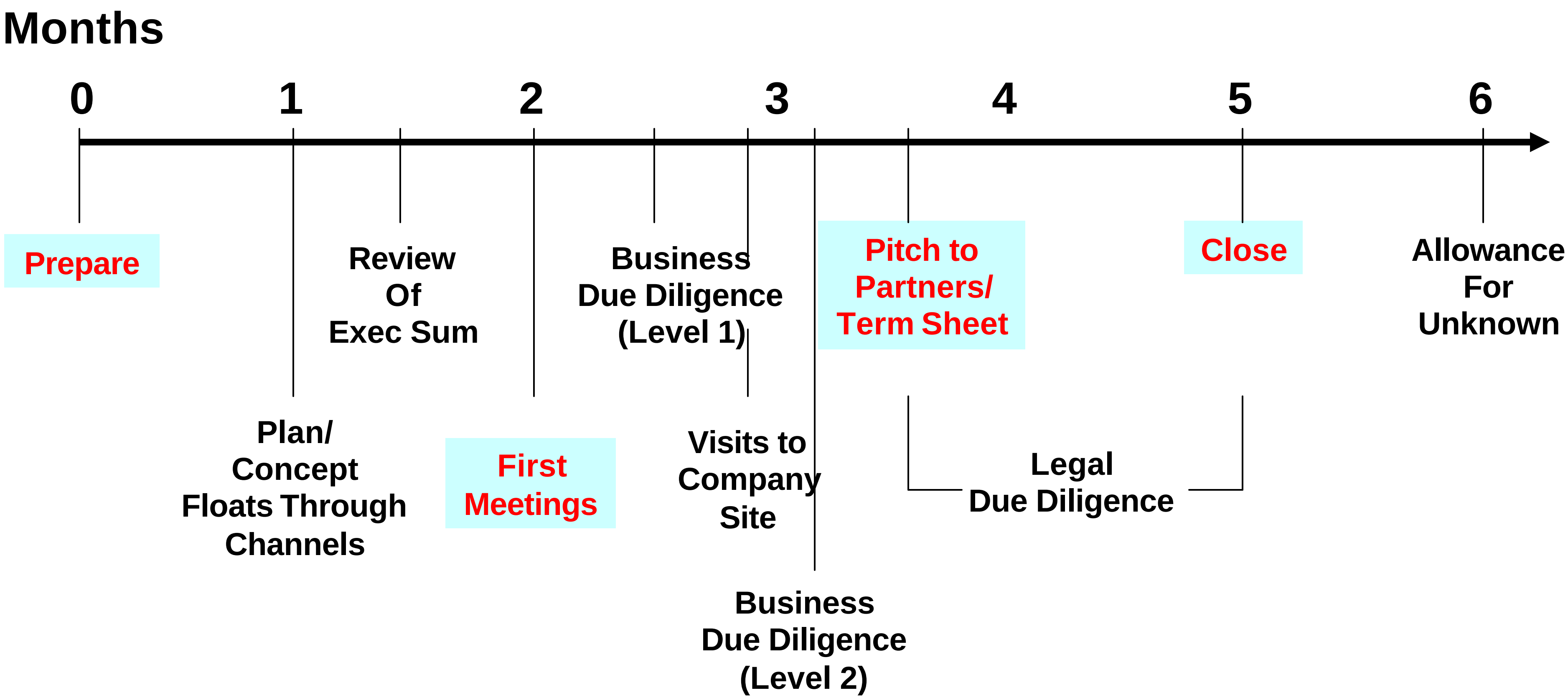

Source: Harvard Business Review

# The Capital Food Chain

| Entrepreneur | Investor |
|---|---|
| 1. Smart guy w/ a plan | – Friends, family, angels |
| 2. Smart guy w/ prototype or Beta | – Early stage VC |
| 3. Smart guy w/ proven product, team, customers | – Later Stage VC |
| 4. Smart guy w/ sustainable revenue growth, profit in 15 months | – Public Markets |
| 5. Dumb guy with broken growth trend | – Special breed private equity |
| 6. Dumb guy with seriously broken business | – Financier of last resorts – “Workout” |

# Private Equity Benchmarks
## (and Best Case Timeline)



# Readiness Assessment

## 1. Evaluating the Business Readiness

**Checklist**

- ✓ Management team maturity and completeness
- ✓ Product maturity
- ✓ Market potential, evolution, maturity
- ✓ Clear strategy
- ✓ Customer confirmation/validation
- ✓ Business model validation
- ✓ Capital status/needs assessment

# Probability of Success

| | |
|---|---|
| • Company has sufficient capital | 80% |
| • Management is capable and focused | 80% |
| • Product development goes as planned | 80% |
| • Production/sourcing goes as planned | 80% |
| • Competitors behave as expected | 80% |
| • Customers want product | 80% |
| • Pricing is forecast correctly | 80% |
| • Patents are issued and are enforceable | 80% |
| **COMBINED PROBABILITY OF SUCCESS** | **17%** |

Source: Harvard Business Review

# Readiness Assessment

## 2. Target Audience Assessment

### Checklist

- ✓ The difference between VCs
- ✓ Looking beyond capital
- ✓ The people within the firm
- ✓ Questions *you* should ask

# VCs Invest at Different Stages

**Seed Investment:**

- Concept sell
- Bootstrap funded to date
- The entrepreneur
- Technology in development

**Series ‘A’:**

- Pre-market launch
- First major funding round
- Lead entrepreneur, key support
- Beta technology developed

**Series ‘B’:**

- Market tested, ramp-up
- Marketing, sales expansion
- Full management team
- Version 1.0 in market

**Series ‘C’ to IPO:**

- Established, growing co.
- Major market expansion
- Extended staff, M&A
- New product development

# Distinguishing VCs

- Specialization/Focus
  - Industry expertise
  - Operating vs. financing experience
  - Research support
- Preferred Investment Stage
  - Seed
  - Series ‘A’
  - Series ‘B’ or later
- Typical Investment Size

- Service Offerings
  - Operating strategy support
  - Relevant network of contacts
  - Transaction expertise
  - Management/marketing support
  - Hands-on focus and resources
- Reputation and Tenure

# Entrepreneurs Should Ask …

- Do VCs have experience with similar types of investments?
- Do they take an active or passive role?
- Is there competition in their portfolio?
- Are personalities compatible?
- Does the firm have strong ties with other firms?
- Can they provide channels, staff search support?

Source: PWC Entrepreneur's Resource Center

# Readiness Assessment

## 3. Understanding the Fund Raising Process

**Checklist**

- ✓ Understanding the steps
- ✓ Learning the requirements for success
- ✓ Recognizing the time commitment
- ✓ Knowing when/where the tools fit
- ✓ The value and impact of preparation

# Readiness Assessment

## 4. Having the Right Tools

**Checklist**

- ✓ Compelling story – "elevator speech"
- ✓ Complete, concise exec. summary
- ✓ Investor presentation
- ✓ Complete business plan w/clear underlying assumptions
- ✓ Clean financials
- ✓ Organized due diligence resources

# ‘Not Ready for Market’ Red Flags

- **Business story is too complicated** (i.e. too many moving parts; lack of focus)
- **Revenue model is not one that is within immediate reach** (a stretch requiring a lot more money and time to realize)
- Business model **key success factors are not inherent** to management’s core strengths
- Leap from **entry business model to full scale is huge**
- **Management lacks VC-required maturities** (whether seeking VC money or not)
- **Splintered organizational purpose**: small private business; large public; scientific; altruistic

# The Realities of Raising Capital

- Time requirements
- Costs
- Full disclosure
- Dilution of shareholders
- Pressure for results
- Possibility of failure
- HR commitment

# Preparing to “Go to Market”

## 1. Determining Your Capital Needs

**Checklist**

- ✓ Is outside capital necessary now?
- ✓ Seeking the right amount – sanity test
- ✓ Rule of thumb: 12 months aggressive build-out, plus 90 days
- ✓ Dilution expectations

# Preparing to "Go to Market"

## 2. Preparing the Tools

**Checklist**

- ✓ What VCs are looking for
- ✓ Questions your tools must answer
- ✓ Typical business plan structure
- ✓ The importance of the exec. summary
- ✓ Typical financials
- ✓ Focusing your efforts/message

# The Investor Presentation

## A Sample Outline

- **Crisp, Attention-grabbing Intro**
  - Who Co. is, location
  - What company does
  - For whom, basic "how"
  - Stage of growth
- **Problem/Opportunity Addressed**
- **Solution**
- **Product & Service Description**
- **Validation of Product & Service**
  - Market Validation
  - Technology Validation
- **The Market**
  - Size (direct, lateral)
  - Competition
- **Go-to-market Strategy**
  - Unique Space
  - Entry, distribution
  - Growth Path
- **Revenue Model, Financials**
- **Summation**
  - Strengths
  - Accomplishments
  - Unique Selling Proposition

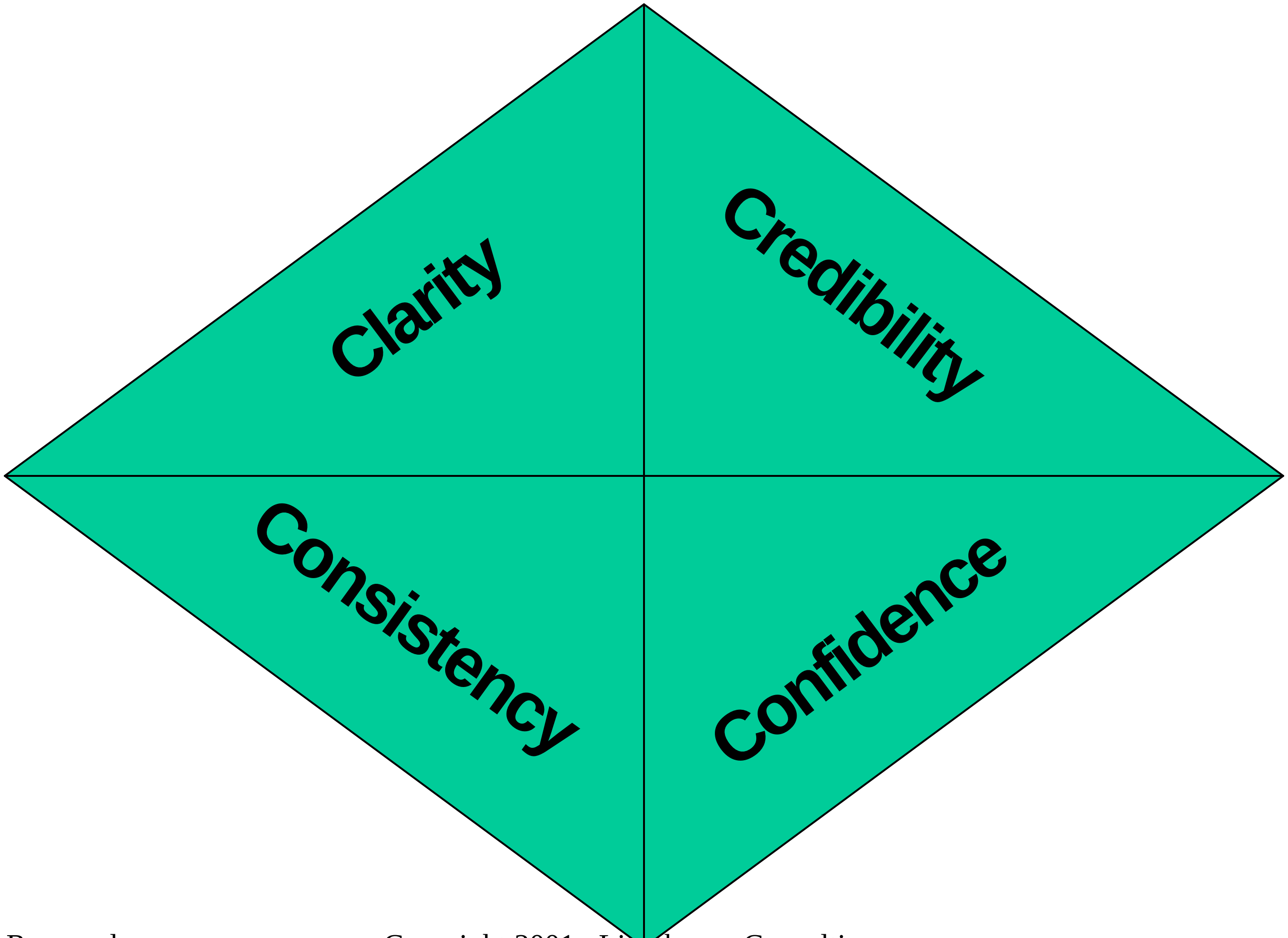
# You Should Answer …

- Is management capable of fast, successful growth?
- Have they done it before?
- Is the tech fully complete?
- Is the product unique?
- What value is being offered?

- Is the market potential large enough?
- Does the team know how to access it?
- What are the barriers to entry?
- How much money is required and for what?
- What are the exit strategy options?

Source: PWC Entrepreneur’s Resource Center

# 4 C's of Selling Success



# Components of the Elevator Speech

- A compelling reason to want to know more … in 10 seconds or less
  - The tantalizing positioning statement
    - Meaningful
    - Speaks of depth, evokes interest
    - Not the typical
  - The opportunity you're addressing/the problem you're fixing
  - Your unique strengths in the competitive dynamic
  - Your enthusiasm, confidence

# Preparing to "Go to Market"

## 3. Establishing a Fund Raising Team

**Checklist**

- ✓ Identifying a process leader
- ✓ Having a clear game plan
- ✓ Establishing a set timeline
- ✓ A complete and prepared team
  - CEO – owner
  - CFO – process driver
  - Key managers – on-call bench strength

# Dangers of Proceeding Unprepared

**No second chances with an investor.**

**Word gets around.**

**Longer timelines.**

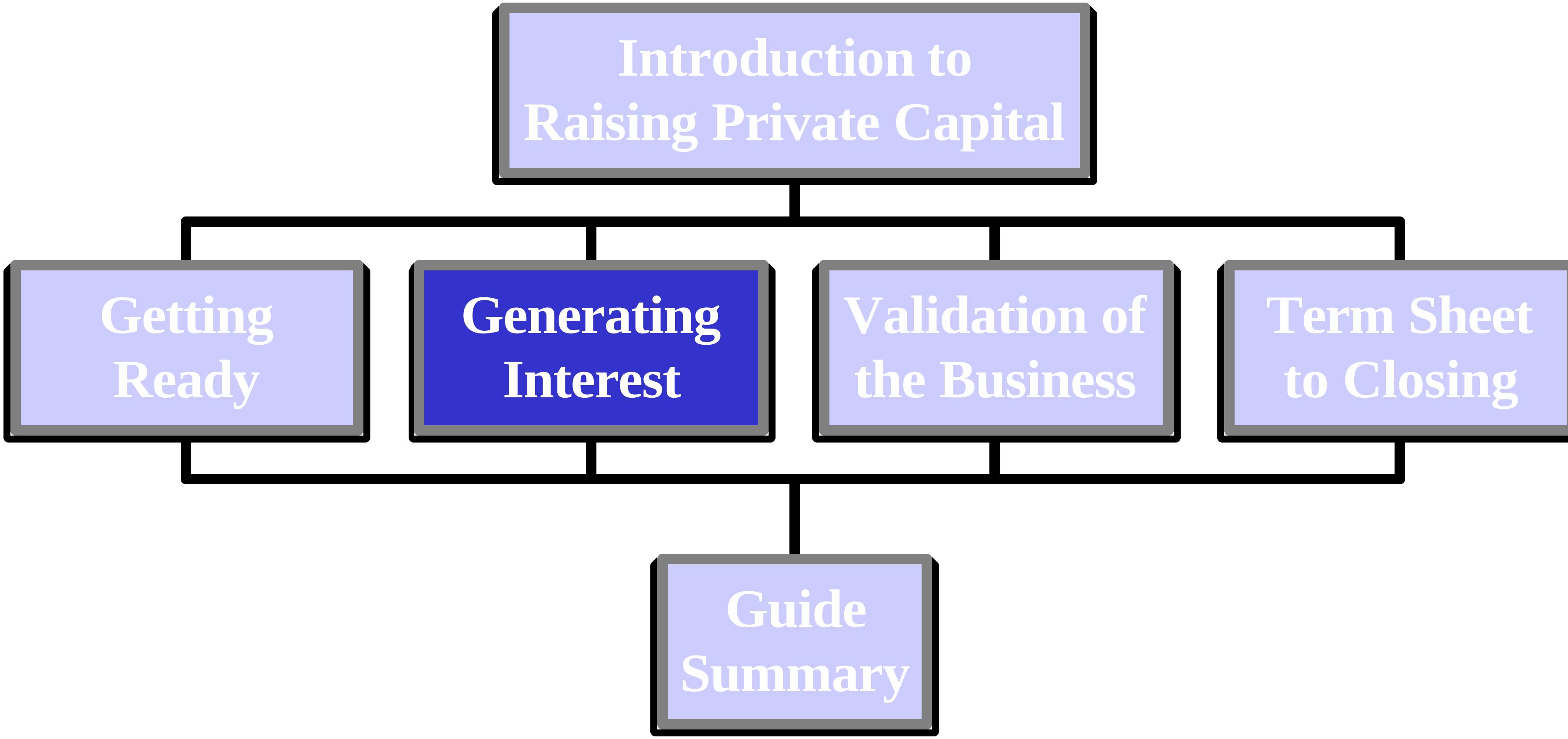
**What you don’t do now, you’ll do later.**

**Failure of the funding effort.**

# Tracking With the VC

| Entrepreneur Activities | Investor Activities |
| --- | --- |
| **1) Getting Ready** | **1) Build Pipeline/Networking** |
| – Readiness assessment<br>– Preparing to go to market | – Assessing trends, opportunities<br>– Building deal flow |
| | |
| | |
| | |
| | |
| | |

# Phase 2



Introduction to Raising Private Capital
Getting Ready
Generating Interest
Validation of the Business
Term Sheet to Closing
Guide Summary

# Generating Interest

***Section Table of Contents***

# Positioning the Company:
## Make it Simple

- Complexity of story
- Complexity of market or development focus
- Complexity of revenue model
- Time to profit
- Link to broader market

- Breadth of investor market
- Ease of education hurdle
- Ability of investors to get it
- Chance of shorter funding cycle

# Fund Raising Objectives

1. **Keep the process short**
2. **Target a name brand, lead investor, willing to commit 50%**
3. **Stay focused – don’t chase promises, lesser prospects**
4. **Parallel track lead investor options**
5. **Use the 6/3/1 Pipeline rule**

# Segmenting the Market

- Understanding the differences between VCs
- Finding resources to prepare for meeting VCs
- Creating your ‘A’ List criteria
- Using your contacts
- Finding a VC

# The Investor Lens

**STAGE 4**

**Suite of products.**
**Complete, proven team.**
**100+ repeat customers.**
**$4M sales/quarter.**
**Scaleable model.**
**Breakeven in sight.**

**STAGE 3**

**Mkt. validated product.**
**Core team complete.**
**10+ reference clients.**
**$1M/quarter revenues.**
**Repeatable sales model.**

**STAGE 2**

**Beta product.**
**Partial mngmt. team.**
**A few customers.**

**STAGE 1**

**Pure start-up.**
**No product.**
**Only founders.**
**No customers.**

***You are viewed through the lens of:***

- **Product maturity**
- **Team maturity.**
- **Customer maturity.**
- **Revenue maturity.**

# The Lead Investor

- ✓ Offers written agreement to do your deal
- ✓ Takes the active funding lead role (builds the syndicate)
- ✓ Does the majority of the due diligence
- ✓ Establishes the deal structure and sets price
- ✓ Knows your business
- ✓ Has a solid, relevant track record
- ✓ Actively participates in your success
- ✓ Single most important communication vehicle pre-deal, post-deal

# Techniques in Fund Raising

1. Using a kickoff date
2. Previewing the deal
3. Using your network
4. Picking a person in a fund
5. Staggering your contacts
6. Expanding support at the partner level
7. Keeping your contacts involved
8. Keeping the VC actively engaged
9. Ask *them* questions

# Starting Off on the Right Foot

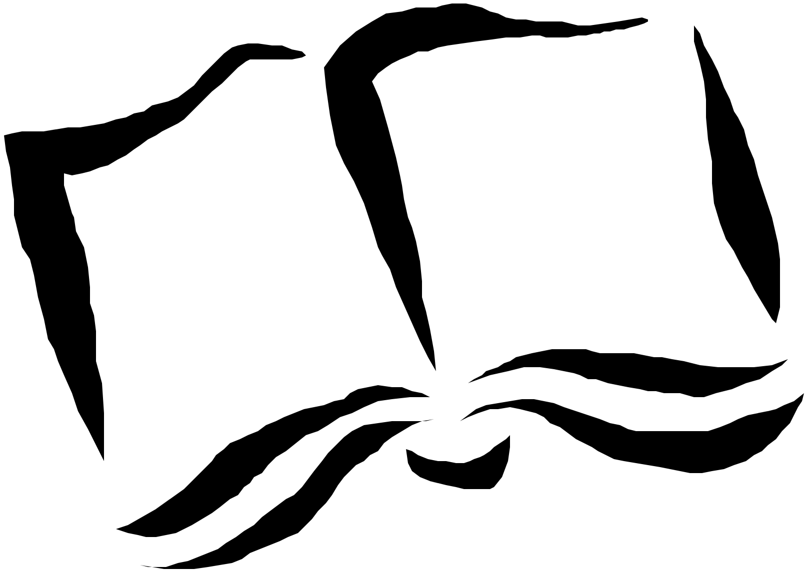
## The Importance of a Clear Date Certain:

- **The impact of a kickoff event**
- **Sending a clear message to investors**
- **Avoiding a languishing process**
- **Keeping your materials fresh**
- **Minimizing conflict with your business**
- **Avoiding burn out**

# How to Read VC Signals

## Indicators of Moving Forward to the Next Phase

- ✓ **Bringing in the technical experts**
- ✓ **Asking for customer lists/references**
- ✓ **Wanting to meet more of the team**
- ✓ **Sending out a check list**
- ✓ **Deeper questions**
- ✓ **They call *you*!**



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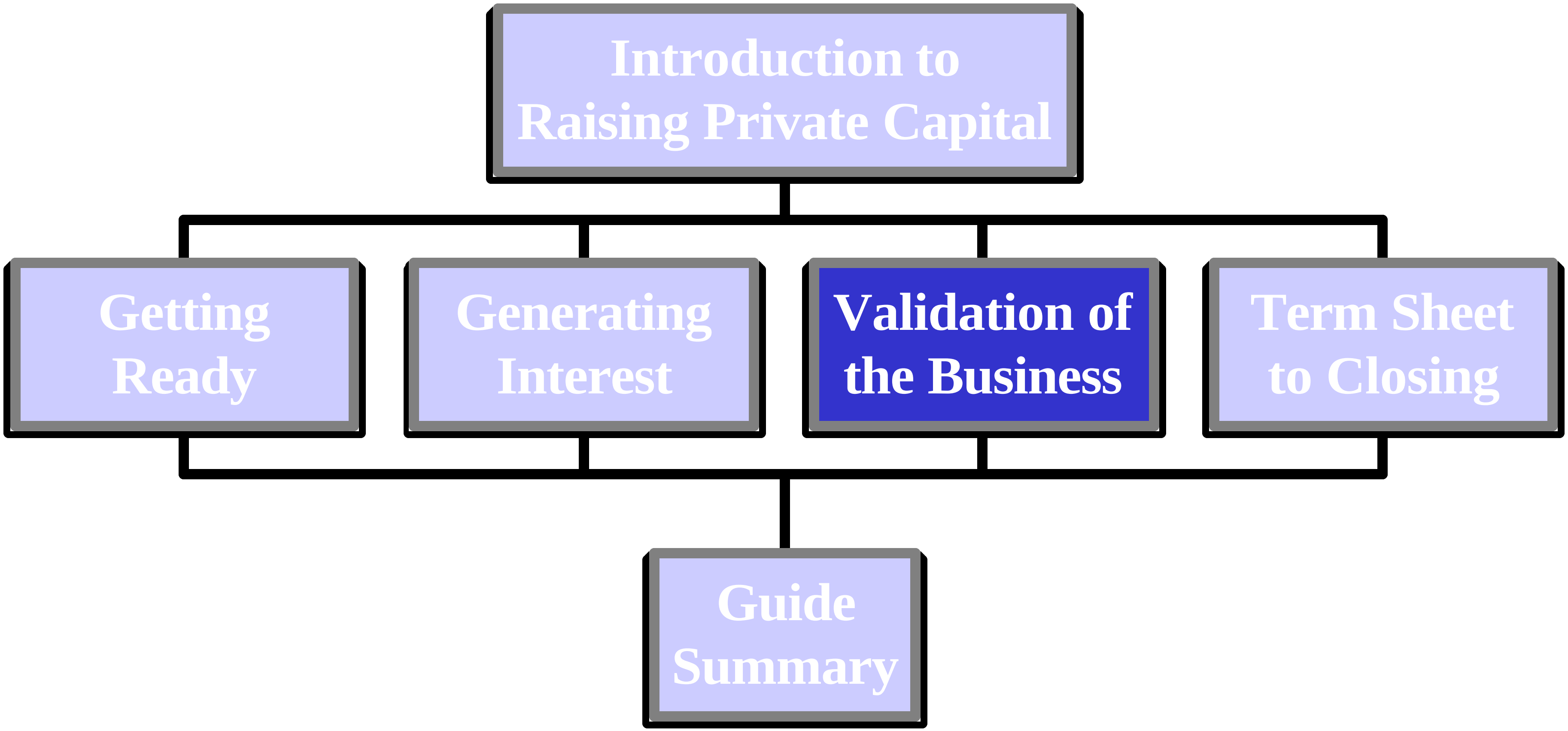
# Phase 3


Introduction to
Raising Private Capital
Getting
Ready
Generating
Interest
Validation of
the Business
Term Sheet
to Closing
Guide
Summary

# Validation of the Business

***Section Table of Contents***

# Market Validation

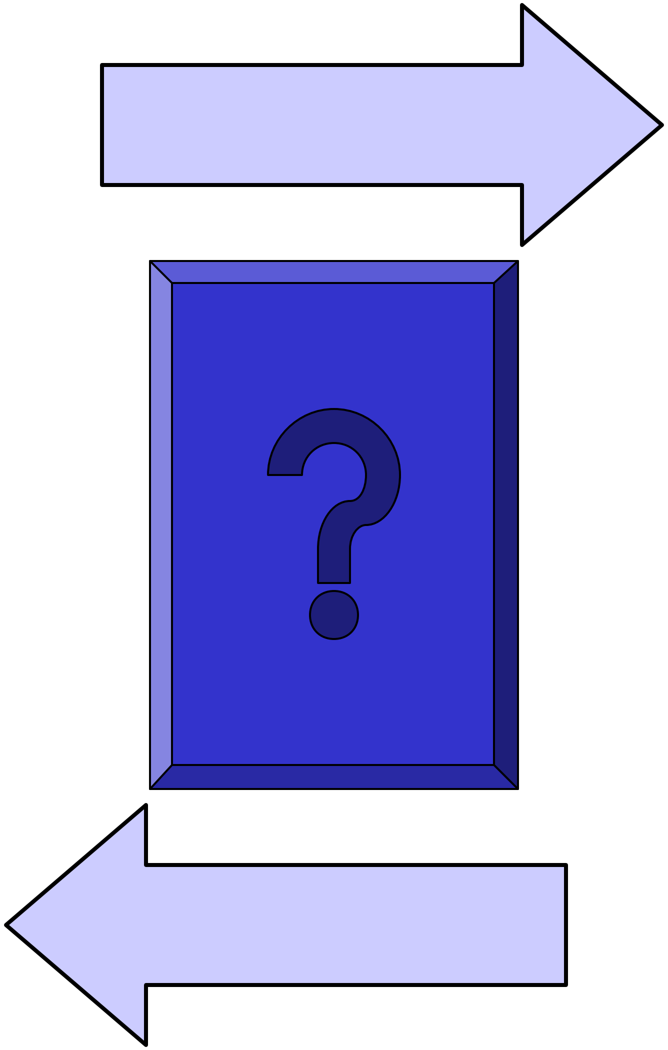
## A Deeper Business Sell:

- The value and danger of a known space
- Landscaping the market for investors
- Real competitive intelligence
- The benefit of the familiar analogy
- The revenue model
- Clear tactical roads to certain revenue

# I.D. the Dark Side Questions

- **Tracking the line of questioning**
- **Noting a lack of questions or contact**
- **Looking for the questions behind the questions**
- **Being direct – asking for the issues**
- **Listening to *them* tell your story**



# Most Important Questions to VCs

- Can you tell me about other companies like mine that you've worked with and your **value add**?
- **Where are we** in the process, **what remains**, how can we help?
- **How can you help me** build my business?
- Where are you in **this fund**, life cycle of funds?
- Give me a sense of **your level of interaction** with your portfolio companies.

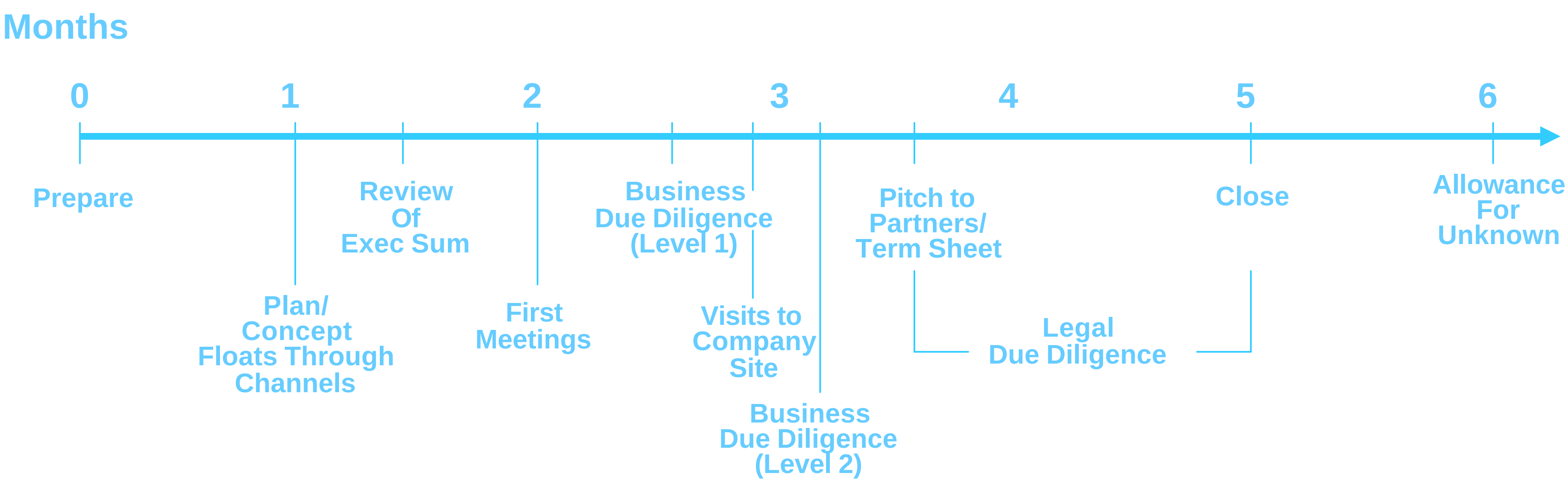
# Process Tracking Signals

## Signals You're Off Track:

- Can't even get networked callbacks
- People don't get your story
- No further contact, post visit
- Due Diligence Scramble
- Off timeline significantly

## Signals You're On Track:

- Active interest, scheduling
- Clear understanding, clear fit
- Stated active steps
- Generally on timeline



# The Reality of the Term Sheet

- What the term sheet means differs by VC
- The typical serious term sheet
- Without it you're nowhere
- The signal that the negotiation has begun
- With it you move to the final phase

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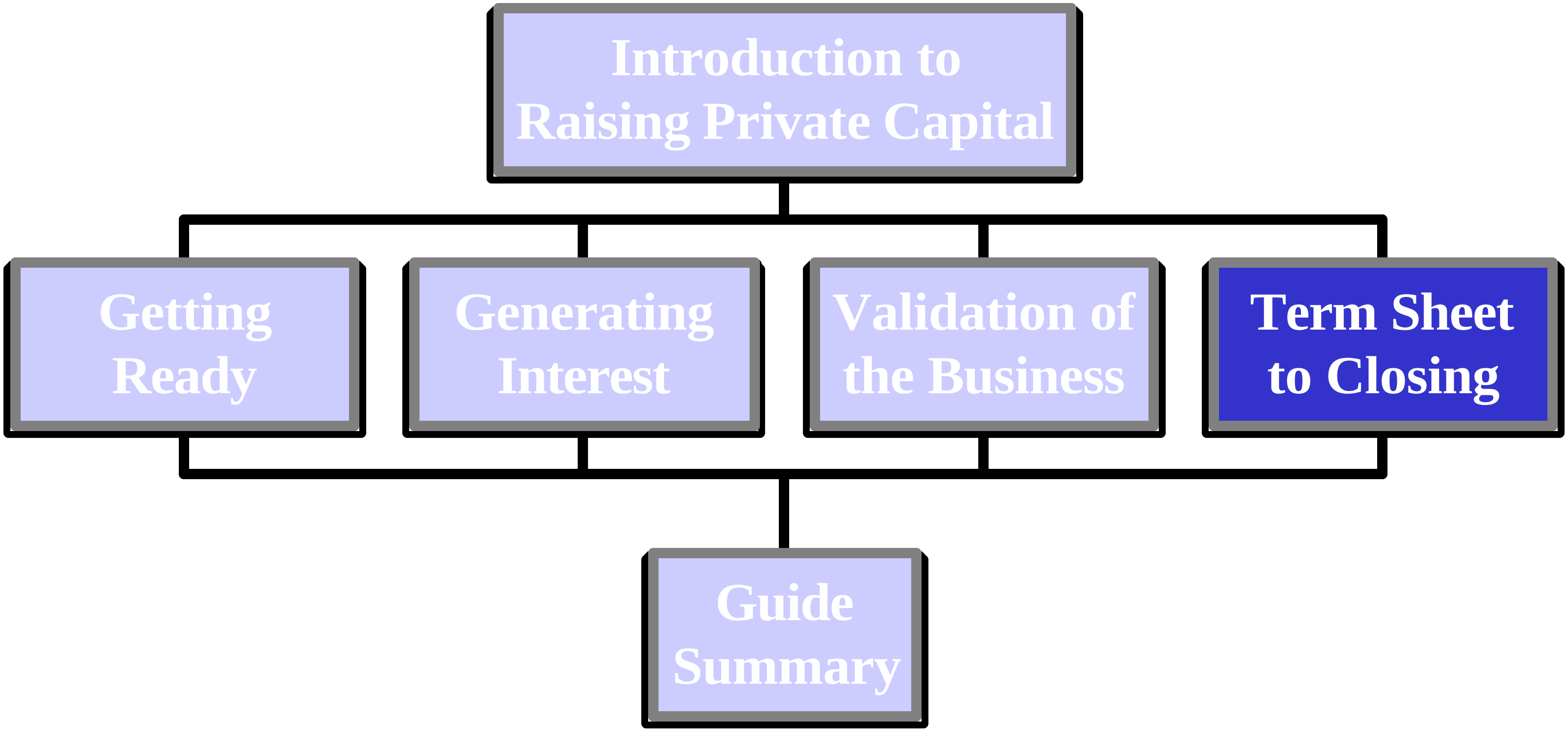
# Phase 4


Introduction to Raising Private Capital
Getting Ready
Generating Interest
Validation of the Business
Term Sheet to Closing
Guide Summary

# Term Sheet to Closing

***Section Table of Contents***

# Understanding the Term Sheet

## The Term Sheet

- Sample term sheet
- Glossary of terms
- Major pressure points

## Staying Focused

- Principals own the term sheet
- Selecting the right counsel early
- Directing counsel

# Term Sheet Pressure Points

**Valuation**

**Board Composition**

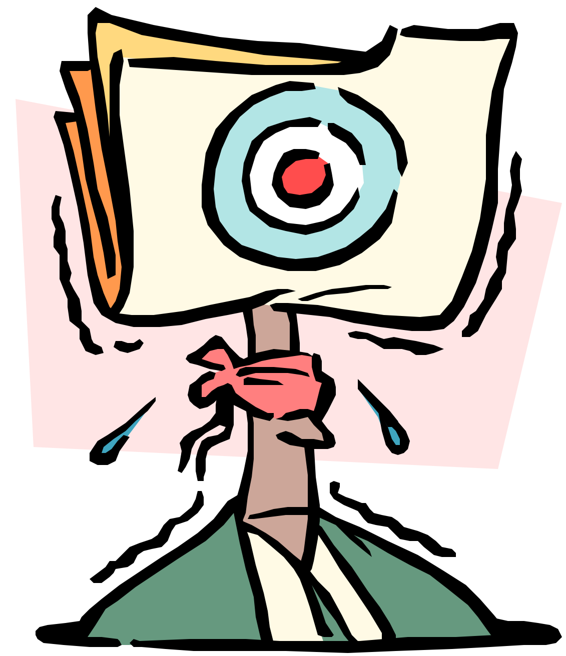
**The Option Pool**

**Key Rights and Preferences**

**Structure and Performance Hurdles**

# How Do I Value My Company?

**Generally:**

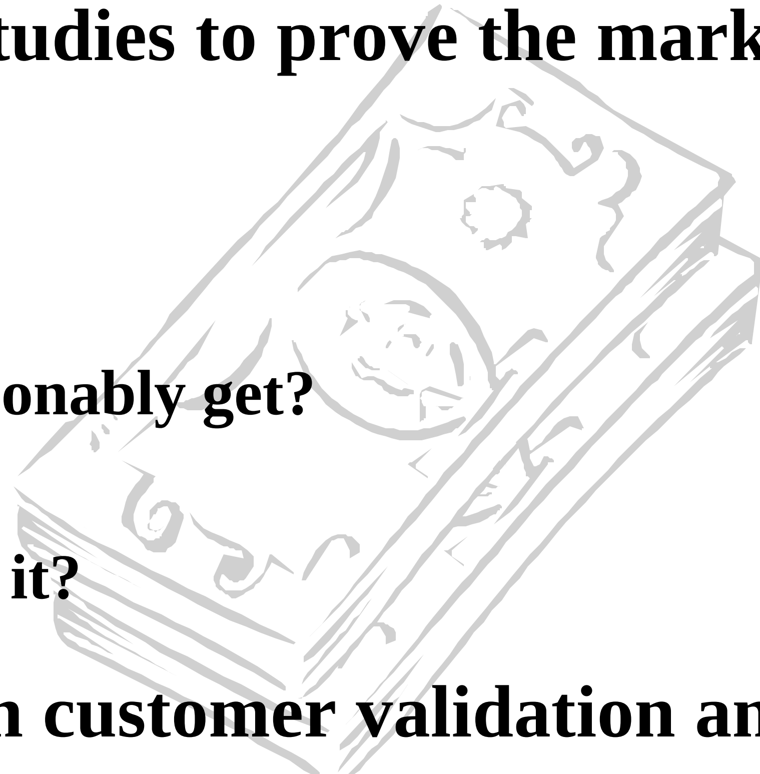


- Typical methods:
  - Comparable private (direct or indirect)
  - Known multiples (cash flow; revenue, other)
  - Comparable public (direct or indirect)
- Should be built sale-by-sale, from ground up
- Must be evidenced and validated in detail

**But remember:**

- More than one valuation method, so usually expressed as a range
- Valuation rises or falls in a range based on a company's maturities (management, product, market, financial)
- Recognize that valuation is negotiated – be prepared
- Different company stages = different valuation parameters/scores

# Preparation for Valuation



- **Build market and model data from the bottom up**
- **Don't rely on market studies to prove the market**
- **Know:**
  - **How big is the market?**
  - **How much can you reasonably get?**
  - **How long will it take?**
  - **What does it take to get it?**
- **Back up your facts with customer validation and support**

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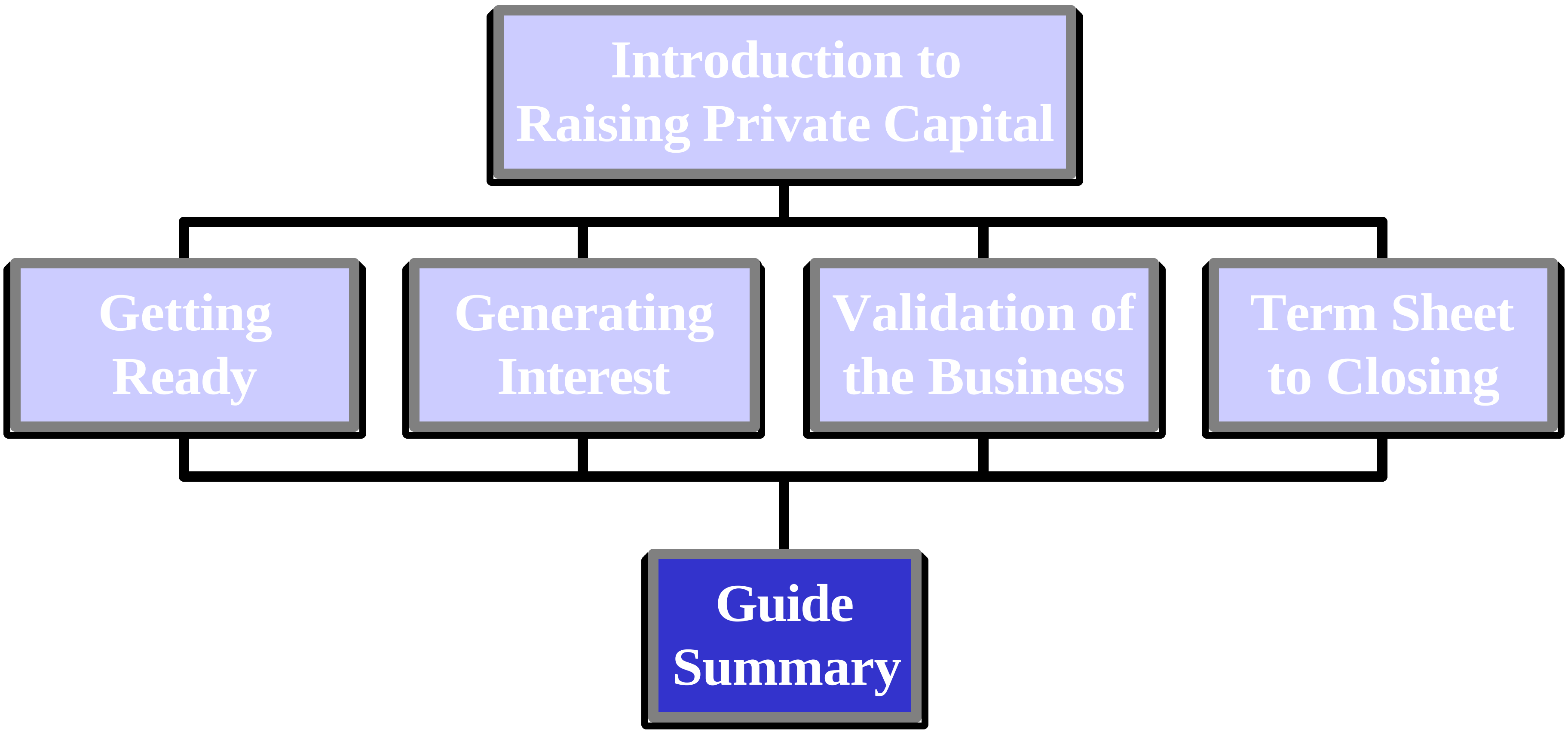
| **4) Term Sheet to Closing** | **4) Negotiate and Close Deal** |
| – Understanding the terms<br>– Focus and preparation | – Present term sheet<br>– Work to close |

# Guide Summary and Resources



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# Avoid the 'Hot Spots'

**Event – Potential Conflict - Solution**

| | Networking/ Pipeline Build | Investment Fit | Deeper Due Diligence | Negotiate and Close |
|---|---|---|---|---|
| **Getting Ready** | Identify right target<br>Don't know VC market<br>Learn,segment,network | Predicted time to $<br>Unnecessary selling<br>Know the deal, investor | Due diligence review<br>A good start goes bad<br>Understand expectations | Finding the right deal<br>You don't get funded<br>Assess needs, market upfront |
| **Generating Interest** | Setting the stage<br>VC unaware of you/deal<br>Preview the deal | Shopping the deal<br>Wrong investor targets<br>Segment,target market | Due diligence review<br>Falling off the radar<br>Be ready before VC | Qualifying your leads<br>Don't find right investor<br>Sell only to appropriate fit investors |
| **Validating the Business** | Anticipating investors<br>Funding drags or dies<br>Formalize an investment team, be serious | Getting to due diligence<br>VC sees weaknesses<br>Declare weakness and solution approach | Due diligence review<br>VC kills deal too early<br>Plan ahead for review | Getting fully funded<br>Interest but no deal<br>Find, secure a lead investor |
| **Term Sheet to Closing** | Anticipating terms<br>Shock at terms<br>See a term sheet, get a qualified lawyer | Investment fit<br>Term goals don't match<br>Know VC's criteria, parameters, history | Term sheet presented<br>Your lawyer kills deal<br>Prepare, consult early | Coming to terms<br>Term gap too wide<br>Be informed/realistic |

# Summary

- Raising capital must fit within the context of what's right for your business.
- There are more failed fund raising efforts than successful ones – but there are also clear reasons why.
- There are 4 distinct phases to the process, each is critical.
- The success and length of the process is driven largely by your preparation and understanding.
- The process is about much more than raising money.
- Though you seek short-term capital, the goal is sustained long-term growth.
- *Ready, Fire, Aim* is a one time, losing approach.

 

# Resource Guide

## Web Sites:

- **Netpreneur *(netpreneur.com)***
- **PWC Entrepreneur Resource Center *(pwcerc.com)***
- **Forbes Small Business *(fsb.com)***
- **The Wall Street Transcript *(twst.com)***
- **Venture Expert *(venturexpert.com)***

## Books/Guides:

- **Beyond Entrepreneurship *(Collins/Lazier)***
- **Growing a Business *(Paul Hawkin)***
- **3 Keys to Obtaining Venture Capital *(PWC)***
- **Going Public *(Grant Thornton LLP)***

# Additional Resources

**Lighthouse Consulting**

***Strategic Guidance and Advisory Services for Growth Companies.***

**www.lighthouse-consulting.com**

*Appendices organized by sections of the guide can be found under "Funding and Finance" at:*

netpreneur.org