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Action Plans for Faster Access to Capital

Getting Growth Capital Faster

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Introduction

This white paper addresses the issue of finding growth capital when it is needed: a problem faced by CEOs of most growth companies at some point and for some on a recurring basis.

Raising money should follow a process.

Raising money is hard work. It is time consuming. More often than not it is accompanied by misdirection, false starts, and wasted time. The challenge for a CEO of a growth company is to find needed financing efficiently and on time.

Done properly, raising growth capital follows a process, one that combines the elements of logistics and product marketing.

It starts with a plan that has clear objectives.

The process is not random; it is based on a plan. The plan includes clear objectives, assessment, analysis, choices, targeted investors, preparation, implementation, testing, and reassessment

The objective of this white paper is to identify for a growth company CEO the key elements of what must be considered when developing a financing plan. This begins by briefly reminding ourselves of the characteristics of today's business and financial world.

There is little margin for error.

There are windows of opportunity for most businesses. Today's attractive business opportunity is tomorrow's reward…. granted to those who effectively bring resources to bear when needed. Further, we see the cycle time between opportunities getting shorter and the number of probable competitors increasing. There is little margin for making mistakes, taking the wrong path, delaying the implementation of one's business plan or failing to find capital when needed.

Within the financial markets, one sees an ever changing landscape. Investment preferences change, sometimes suddenly. These changes can occur from investor to investor or among whole classes of investors (angel investors, venture capitalists, private equity firms, commercial bankers, among others).

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Investors of all types respond to economic changes. There are periods of tight money not only with commercial bankers, commercial finance companies, and leasing companies, but also among angel, venture, and private equity investors. A misdirected effort to raise capital can result in a missed opportunity to find investors simply because conditions of the financial markets have changed.

Be aware of changes and complexities in the financial markets.

Complexity in financial markets is growing. While different investors attempt to distinguish themselves from the pack, those distinctions make the fund raising process more difficult. It has become increasingly important to know the investment market one is addressing.

Not only is there competition within one's chosen product or service market space, there is an increasing competitive environment for available investment dollars. This results in less patience among prospective investors. The importance of a good first impression is paramount.

In addition, there is a growing overlap between investment classes. Angel investors may develop a preference for deals that look like those preferred by venture capital firms. Venture capital firms may be drawn to deals that once were the exclusive purview of private equity firms, and occasionally the reverse may be true.

In other words, know the market and prepare carefully and thoroughly.

Twelve Key Words

There are twelve key words to keep in mind.

The watchword is *time*.

Time: The overriding word to keep in mind when raising money is *time*: Prepare for the best use of time. Avoid false starts. Shorten the time to capital.

Timely access to growth capital allows a company to get to market faster. This means a company may have time to test the market, develop a more effective strategy for attacking the market, and establish a foothold in the market ahead of competition.

Reduce risks and increase opportunities by avoiding delays.

In addition, having needed capital reduces anxiety within the ranks of a company. It reduces uncertainty. Capital is not only the fuel for the enterprise engine; it is also a catalyst. It is a positive motivator and raises the energy level of individuals within a company. Having capital on hand to execute against a business plan allows a company to hire the best people when they are needed.

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The risks of stretching out the time it takes to raise money are manifold: The money may never get raised. A company operates under the burden of being undercapitalized. Goals are not achieved. Milestones are missed. Competition is allowed time to catch up and perhaps prevail. There are missed opportunities to hire good people, or key people leave the company.

Take time to save time.

Given that the benefits of raising money when it is needed are so high and the risks and consequences of not getting it are so great, it is difficult to understand why one would not take the time and expend the effort to thoroughly prepare before engaging with prospective investors.

Alignment: A company must have a financial strategy. It is a strategy that addresses the current and expected future needs of a company from a financial perspective. Its elements are very pervasive, including basic dictates of a financial pro forma, capital structure, revenue recognition policies, strategic and partnering relations, use of outsourcing, timing of funding events, among others.

There must be alignment between one's growth strategy and financial strategy.

There must be alignment between a financial strategy and the growth and operating strategies of a company. One should not be raising money unless this is the case. A properly aligned financial strategy provides a reality check against growth plans. It matches needs with the attainable. Properly aligned with the growth strategy, a financial strategy is a guide that helps a company achieve its short and long-term objectives.

The consequences of running a business without a well formulated financial strategy are as dire as trying to grow a business without a marketing strategy. It is like bacon and eggs; one supports and complements the other. The lack of a financial strategy is easily and quickly exposed by seasoned prospective investors. Not only is this omission embarrassing when discovered, it can foreclose any opportunity to obtain funding from what might otherwise be an interested investor.

Structure: Money standing alone is not a capital structure. Before developing a plan for a capital structure, one must have a solid understanding of a business, its growth prospects, the risks associated with the business, and the financial strategy.

Plan a sound capital structure that is consistent with your growth expectations.

Many, if not most, businesses grow without much thought given to capital structure. Although an ideal capital structure may not be attained, planning for one allows one to consider the consequences associated with the various elements that comprise a capital structure. Elements that impact capital structure include, among others:

1. Equity from organic growth v. outside investors;
2. Issues of control;
3. Stock incentive plans;

4. Cash requirements;
5. Credit and collections experience;
6. Vendor financing;
7. Prudent leveraging with debt;
8. Off balance sheet financing; and
9. Accessibility to various forms of capital, among others.

Many companies fail to consider the importance of a mix: Equity, debt (be it venture debt or standard commercial loans), and lease financing (venture or standard leasing).

Although one may have a well formulated financial strategy, without a compatible capital structure, key objectives of that financial strategy may not be attainable. For instance, a financial strategy may call for the broad use of incentive stock options to attract the kind of people needed to assure expected growth of the enterprise. Yet, the terms of an existing preferred stock may preclude the broad use of incentive stock options. Or a financial strategy may call for a high degree of leverage through the use of commercial bank debt, but the financial structure shows a thinly capitalized company making the extensive use of bank debt highly unlikely.

Form: The form of capital is the detail that comprises capital structure. The ideal form or type of capital raised is a product of a careful assessment of one's target capital structure and financial strategy done in light of the cold realities of what is feasible for one's company.

A sound capital structure may call for a certain amount of equity capital. The form of that equity capital most often is dictated by the stage of development of an enterprise. It is not uncommon for a startup enterprise to have access only to bootstrap and friends and family funding. For others, access to angel investors is the limit. On the other hand, for certain startup companies, those with an unusually strong management team and a compelling story, venture capital funding may be readily available.

Be realistic and pragmatic when executing your capital structure plan.

While a target capital structure may call for the use of leveraged financing, the alternative forms of that leverage need to be carefully assessed. Terms and conditions must also be examined. Commercial bank debt may be available but with an unacceptable condition of personal guarantees. Venture debt from a commercial bank may seem a viable alternative, but the underlying requirements for pre-existing venture capital investment do not exist.

It bears repeating: Capital structure is the objective; the actual form of capital available is determined by the realities of the financial marketplace.

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Quantity: The amount of funds one raises at any stage of development is very important. Undercapitalization can doom an enterprise from the get-go or significantly limit the upside. On the other hand, raising too much money is wastefully dilutive and often leads to a spendthrift mindset, which can be the worst of all worlds.

More often than not, the condition of undercapitalization is not a matter of choice. Funds simply may not be available to an enterprise when the need arises. On the other hand, undercapitalization can be a self-imposed condition. For instance, the principals of a business may find that maintaining majority ownership and control of a business out weighs meeting the financial needs of the enterprise. Poor planning or the lack of it may result in a shortage of needed capital. An improper assessment of the length of time it will take for a market to adopt a new technology or service may cause a company to run out of cash before it can become cash flow breakeven.

Although under-capitalization is more common, over-capitalization can often lead to disaster.

Having too much money on hand can prove to be worse than not having enough. When that condition exists, discipline often goes out the window. One only needs to recall the disastrous results of irrational amounts of money invested in Internet Bubble companies during the late 1990s to understand what can happen when too much money goes into a company. Money is spent on non-core items. An aura of invincibility and arrogance can take over management. Norman Wolfe, CEO of the strategic consulting firm, Quantum Leaders, Inc., said, "Getting too much money is like the average person winning the lottery and then going broke within a few years."

Balance is the watchword when determining the amount of money needed. Although creativity often comes from being resource constrained, opportunities may be missed if those constraints are too severe.

Investors: Raising money is all about selling….selling an investment opportunity. Before beginning to talk to prospective investors, a careful analysis must be done to ensure the correct investor group or groups are targeted. One would not expect to sell snow blowers to Hawaiian residents. That is an obvious waste of time and resources. Likewise, a great deal of time is easily wasted if one targets the wrong category of investors. It makes no sense to spend time talking to commercial bankers if ones company does not qualify for a line of credit.

Targeting the wrong investor group is a huge waste of time. Select your prospective investors carefully.

Similarly, randomly sending out business plans to venture capital investors is akin to buying a lottery ticket. One may harbor delusions of striking it rich or finding a receptive investor, but the chances are so remote that the exercise amounts to a gross waste of time. Based on an analysis done by the author of this paper and a former colleague, the chances

are less than one in 5000 of finding an investor via the route of randomly sending out a business plan.

Just as with selling a product or service, when looking for capital, one must know the market. One must know the composition of the financial markets and the individual investment objectives of the participants in those markets. This is not an easy task, but the hard work of good preparation will pay huge rewards.

Messaging: Raising money is like selling soap. Know your product. Know your target market. Craft your message to link the two.

Your story is the investment world's perception of your company. The sum total of all of the elements of that story, including its format and presentation, will determine how effective you are.

Nothing is more important than your story and how you tell it.

This is show time! You want a Broadway hit. The amount of thought, creativity, preparation, rewriting, and rehearsal for your presentations to prospective investors is not much different from that which goes into a Broadway hit production. For you the stakes are just as great. If you do not resonate with your audience, no matter how ingenious or clever your business concept may be, you will not get the money you need to sustain and grow your enterprise.

Within the investment community, you are competing for mindshare and allocation of investment dollars. The effectiveness of your story told to a properly targeted investor will determine the competitive outcome.

Valuation: A compelling story and a well-conceived financial strategy and target capital structure can be rendered almost useless if one fails to properly value an enterprise. More often than not, principals have an overblown perception of the value of their companies. Incorrectly valuing an enterprise may result in the loss of an audience of target investors. Or if one over-values a company in an early round of financing, facing a subsequent down-round becomes a very unpleasant likelihood.

The market sets the price for your company. Don't presume to know more than the market.

The financial markets always determine the price that will be paid for a company's stock. Initially, the principals of a company need not see eye-to-eye with investors as to valuation. Within reason, investors will look past an over-valuation. However, there must be an underlying acceptable rationale for any proposed valuation. Fundamentally it must be subject to review and discussion. For instance, if a valuation proposed is determined by issues of control, it is almost a certainty that common ground will not be found and a financing will not happen. Irrespective of one's points of view, one should not become fixated as to any particular notion of valuation.

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Finding a correct valuation for a financing has long-term consequences. It is not like negotiating the best price for buying a car or a house. A valuation for a round of financing must be fair for the company and its investors. If entrepreneurs have imposed upon them an unfairly low valuation, the "great deal" done by the investors will ultimately prove hollow when key talent moves on to other opportunities. On the other hand, if management holds out and somehow gets an unsupportable valuation, subsequent rounds of financing may not be available except through a highly dilutive down round.

Insight: No set of managers or principals has answers to all questions faced as a business plan unfolds. However, failure to seek to know what one does not know is foolish and doubly so when embarking on a quest for funds.

It is very dangerous to not know what you don't know. And it is very embarrassing to have a prospective investor point that out to you.

Business plans are built on assumptions, some are explicit and some implicit. Lurking within those assumptions are the realities of fact and fiction. Carefully identify what you know in fact, what you believe and need to verify, and equally important what you don't know. Some of what you don't know may fall within the category of unknowable and should be identified as such. To the extent feasible, unknowns should be identified and coupled with an action plan to get the answers. Seasoned investors will ferret out what you don't know. If you have not anticipated this, likely you will lose your audience of prospective investors.

Identifying business unknowns is a difficult task. It begins with an equally and at times more difficult task of listing the assumptions underlying a business plan. One must then test those assumptions. From this overall assessment, unknowns will appear. This process requires discipline and a mindset that is open to challenge and the occasional conclusion that runs counter to long-held beliefs. Rarely can this type of assessment be successfully undertaken without the use of an objective advisor.

Added perspective exposes hidden problems and new opportunities.

Perspective: Multi-discipline, multi-functional experience covering a broad range of businesses over several decades provides the perspective needed to prepare for a money-raising campaign. Perspective is a collection of mental vantage points that allow a company to achieve insights essential to understanding the key elements of an enterprise, its growth prospects, and the challenges that must be overcome before success is attained. "Perspective is the wide-angle lens of a business," so noted venture capitalist and entrepreneur Dev Purkayastha.

Most management teams can benefit from supplementary and complementary perspectives. These will help assure realistic assessments, broaden the range of options, and expand horizons. Perspective allows management to see beyond the

range of the highly focused attention required for the successful execution of most business plans.

Objectivity: To claim objectivity as to one's own enterprise is certainly an oxymoron. Passionate enthusiasm, an essential characteristic of successful management teams, interferes with objective assessment and analysis. Objectivity is essential. It gives one the ability to see the world as it is.

There is no substitute for objectivity.

Investors seek to overcome their own enthusiasm and that of management through the due diligence process. It is important for companies that are about to raise money to anticipate due diligence by investors. This is best done by seeking the assistance of an advisor that can operate as an objective sounding board to test thinking, raise otherwise unseen issues, and propose alternative plans of action. Karen Gifford, founder of Gifford Management, observed, "The most objective advisors are those who have no tie to the economic outcome."

Seeking objective input is difficult. It requires one to recognize the limits of one's own view of the world. It requires one to accept information and points of view that at times can be difficult to receive.

Reception: Presenting to a prospective investor is one of those instances where making a good first impression is vitally important, and as with all first impressions, one gets only a single chance. To achieve a favorable reception among investors, one must do a great deal of preparation, planning, and target analysis.

Your primary goal is to get a second meeting with a prospective investor.

The objective of the first meeting is to get a second meeting. If you achieve that, you have made a good first impression and have placed yourself in the top five percent of those companies looking for money.

There is no substitute for saving time when raising money. There is no better way to save time than to carefully plan a money-raising campaign. And there is no better way to effect that plan than to address the twelve key factors discussed above.

Take the test.

Test your level of preparedness at www.timelineadvisers.com/evaluation.html.

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Mike Kucha is the founding Managing Director of Timeline Advisers, LLC, a consulting firm that helps early stage and middle market growth companies lay a foundation and establish processes for faster access to needed financial capital. Mike, an honors graduate in engineering and law, has over thirty years of experience with public and private companies as a CEO, board member, corporate lawyer, venture capital investor, and business owner and adviser.

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