

Barriers to Raising Money

Recognize right from the beginning that fund-raising for any company prior to an initial public offering is a painfully inefficient process. However, that process can be made more efficient and a great deal less painful.

Also recognize that raising money involves a process. It is not a random walk. There is a beginning and an end and definitive steps in between. And within this process are numerous barriers and resistance points that can impede your quest to raise money.

Hubris

Number one on the list of these barriers is hubris: namely, hubris of the entrepreneur and the management team.

We hear a lot about hubris these days, especially in the political arena. Just what is hubris? Wikipedia, the free online encyclopedia, defines hubris as exaggerated self-pride or self-confidence, often resulting in fatal retribution. Well, this certainly sounds serious.

How common is hubris? It is rather common. In his book *Running the World*, author and speaker David Rothkopf parenthetically noted that "...hubris, as it turns out, is one of the most resilient organs of the human psyche and, like the tails of certain lizards, it grows back comparatively rapidly."

Hubris knows no bounds. It is non-sectarian. It is totally egalitarian. It is like a drug; it creates feelings of omniscience and insulates one from reality. It is the rare person who at some point in his or her career does not suffer from it. Some believe that hubris is a universal characteristic of entrepreneurs.

So what is the antidote for hubris? Intellectual honesty, thick skin, and something you will hear again from me again and again – the willingness to listen.

Not Knowing What You Don't Know

Let's move on to another barrier to raising funds: not knowing what you don't know. This can be a product of hubris or naiveté.

There is nothing worse than making a pitch to a seasoned investor only to have that prospective investor point out important issues, the right priorities, and key elements of your business about which you and your management team have no clue or simply are misdirected. In other words, not knowing what you don't know can kill your chances for raising money.

So how does one get smart about that which one is not so smart?

First, bury your hubris. Second, get all the advice and opinions you can. Third, listen. There is that word again – listen.

Inadequate Preparation

Here is another barrier to fundraising. The lack of preparation, or more likely inadequate preparation, is high on the list of barriers to efficient fundraising. There are two primary types of preparation, and they do have a priority.

The first is to prepare your story. I am talking about that whole, large basket that includes the manner and the means by which one communicates the story and the plan and everything related to them.

Among other subject matter or elements, included in this basket are: the traditional written plan; PowerPoint presentation; elevator pitch; discussion of the product or services offered, markets, competition, value proposition, recognized pain points addressed, payback to the customer, distinguishing characteristics, people, money sought, uses of funds, IP, and on and on and on.

I am not going to get into the details of this part of preparation. There are many others who can effectively opine about what should go into your story and plan. However, you should know that all of the material developed for the story and the plan involve a highly iterative process. There will be numerous changes as one gathers information and listens to what is being said, especially during the process of raising money.

The second element of preparation has to do with funding sources. There are numerous categories of funding sources, including among others: oneself; family and friends; individual angels; angel groups like the Tech Coast Angels; venture capital firms of all types; private equity firms, again of all types; strategic corporate investors; banks and other commercial lenders, including venture lenders; and leasing companies.

Finding and dealing with funding sources can be a difficult and confusing part of preparation. Here are a few examples of why this is so.

Right from the start, be sure you are talking with funding sources that have a genuine interest in you and your business. Qualify your funding sources early. Failure to do that can result in a huge waste of time. Verify that you are not simply a source of information for someone gathering industry or competitive data.

One often hears that the amount of money needed is a big factor as to where to go for funding. That is true most of the time, but not all of the time. It is not unheard of for a venture capital firm to invest initially an amount far below what they may advertise. Why? Because the venture firm believes there will be a follow-on need to invest a great deal more money. By putting money into the deal early, the venture capital firm will reserve a place at the table for subsequent financings.

And always keep in mind, that when it comes to investors who have their own set of investors (and this includes most venture capital firms), they are running money for others, such as endowments and pension funds. As a result, the venture capital firms have to place it with some degree of regularity and within a somewhat definitive time frame. This affects their judgment as to what comprises a suitable investment. This means that it is important for you to understand your prospective investor. Ask questions: Do they have a restricted charter as to the types of industries or technologies they may invest in? What about stage of the company (early, growth, mezzanine, late)? Are they a lead investor? Do they syndicate deals? With whom do they normally invest? Will they have the financial wherewithal to provide follow-on funds when you most need them?

Occasionally you may run into a situation like this: A venture capital firm hears your pitch, says it likes what it hears and wants to think about it. This goes on for awhile. What is going on? Well maybe that firm is out looking for money itself and wants your deal in its backlog. Most venture firms will be very upfront about this, others much less so.

Also, within venture capital firms, investment appetites change and are not always advertised. Perhaps a new partner comes on the scene and develops an investment thesis that is new to that firm. Maybe the venture capital firm suddenly finds itself up to its ears in problems with a large number of its portfolio companies. Does one think that a firm is going to advertise to the world that it is not doing deals because of portfolio problems?

There is also the fashion aspect that exists within the venture capital business. If one starts a company in a space that is out of fashion, finding a willing funding source will be very, very difficult. On the other hand, if one is in a favored space, raising money is much easier.

Everyone knows that angel investing groups put money into very early stage companies. Right? Well, that is much less so today than in the past.

As part of your preparation, know with whom you are talking, what their status is, and what their current investment appetite is. It pays to ask. It helps avoid misunderstandings as to what a funding source is looking for and when they indeed will be looking for it. It will help you avoid a false sense of expectation. Always drive to a definite answer. Remember that “no” is the second best answer one can get. A fast “no” will save you a great deal of time. “Maybe” is the worst answer.

Finding investors is okay, but finding investors that add needed value is outstanding. Is there a match between the strategic and tactical needs of your company and what an investor brings to the table other than money? Run reference checks on your prospective investors. Do they in fact provide the kind of help they purport to? Do they support their portfolio companies or do they head for the hills at the first sign of difficulty? Do they have time to provide help when it is needed?

The investment community is like a kaleidoscope. It is multi-faceted and ever changing.

The following will no doubt add to the confusion and difficulty of courting prospective sources of capital. Do not go directly to funding sources. First, court referral sources that can get you an introduction to qualified venture capital firms or other sophisticated investors.

Rarely, very rarely, does a pitch made without a referral lead to a funding event. Based on an analysis done by one of my partners at Timeline Ventures and me, the odds are worse than 1 in 5000 that one will get funding without a referral. (Unless, of course, one is a recognized, successful, serial entrepreneur.)

Good referral sources will be of great help, and more than likely they are essential to the funding process. And, yes, that was referral sources, as in more than one. The whole prospect sounds exhausting doesn't it? Preparation is a lot of work!

The best referral sources are those who can vet your company and your plan and who have a reputation among funding sources for referring viable deals. Included among these types are (1) other entrepreneurs who are successful in their own right, (2) venture capital firms who want to take a lead in your deal, and (3) service providers who have a sense of what constitutes a viable business and attractive investment opportunity and who are willing to tell the entrepreneur when things don't quite hang together.

A referral source does no one any favors by simply passing off an entrepreneur via a referral when the entrepreneur's idea needs work before it can get funded. In other words, be discriminating in selecting your referral sources.

Not Helping Your Champion

And here is yet another barrier to fund-raising: not helping your champion.

When one makes a pitch to a prospective investor, be it an angel investor, who may be part of a group like the Tech Coast Angels, or a venture capitalist, who is part of a firm, that presentation will be to one or two people. Unquestionably the initial reaction of your one or two-person audience will be visceral - positive or negative. If it is positive, you have made a small advancement toward your goal of raising money.

Everything you present should assist in reinforcing that positive response. Ask yourself: Is there an easy-to-grasp, easy-to-articulate story and rationale supporting a positive investment decision? Seasoned investors are skeptical people by nature. Smooth the way to overcome cognitive dissonance.

Next, keep in mind that this champion of yours must convince his or her colleagues that this is a deal that will make lots of money for investors. And the best way

to do this is to make your story very, very simple and easy to articulate. In other words, give your champion exactly the right story needed to be an effective proponent for you.

Failure to Get to the Next Meeting

Closely related to supporting your champion is getting to the next meeting with your prospective investor. The primary objectives of any meeting with a likely investor are to get to the next meeting and determining if a next meeting is appropriate.

As for getting to the next meeting, pitch enough to set the hook and create further interest in you and your business. As for determining if a next meeting is appropriate, ask as many questions as you are asked. Constantly qualify that prospective investor, and listen to what is said. Do you really want them as an investor? Are they asking the right questions? Are you learning from them?

Defensiveness and Fear

Let's move on to another resistance point to fund-raising. This one is defensiveness. It is similar to hubris, but it is different.

Chances are ones story and plan, no matter how well thought through, have holes, defects, elements of misdirection, misanalysis, etc. In other words, they are less than perfect. Of course, it is natural for one to feel defensive about such a well conceived and well formulated story and plan when they are attacked and criticized.

Fear can yield the same problem. Fear of rejection. Fear of failure. Fear that one will need to go back to the drawing board.

Help yourself. Put aside your fear and defensiveness and go on the offense and solicit the criticism and opinions of others before you get criticism in spades from prospective investors. Think like Kim Edwards, a former CEO of Iomega, who in the 1990's took the concept for a disk drive and turned it into the Zip Drive. He did this by relentlessly getting input from those outside of Iomega as to what was wrong with this product idea that ultimately became the Zip Drive.

What was the result of getting all this information and criticism? Huge changes in the form factor, absolutely huge. And what was the result of the changes made to the product idea that was so lovingly conceived within the bowels of Iomega? A billion-dollar annual revenue company.

So what does one need to do? Seek advise and opinion and listen, listen, listen. (There is that word yet again – listen.)

Over-Priced Deals and Presumption of Valuation

Here are two barriers to fundraising that are very, very common: namely over-pricing a deal at the front end and making presumptions about the value of the company.

Fairly valuing a company is an art form and a condition that is absolutely essential to building a proper foundation for staged fundraising as a company grows and prospers. Over-pricing a company early in a company's history is a major barrier to obtaining funding at a later stage.

Always keep in mind that there should be a community of interest among all stakeholders in a company. The imperative here is fairness, and that fairness applies to valuation. If one obtains funding from friends and family or unsophisticated angel investors at a valuation that is too high, when it comes time to bring in sophisticated investors, either they will walk away from the deal or force one to face the reality of having to re-price the initial round. And that will not sit well with the initial investors.

Here is another bit of advice about valuing a company: Never tell a sophisticated investor what your company is worth. Let the market price the deal.

Raising too Much or too Little Money

Trying to raise too much money in an early round can be a major barrier to obtaining funding. Likewise, raising too little an amount can have the same effect.

This gets into issues of staging fund-raising, of proving part of the story before going out for larger sums of money. It also addresses the reality of who is investing and in what size chunks. Part of this reality is tied to the needs of ones business and part is tied to the changing landscape within the investment community.

Need for Control

If an entrepreneur or management team must be in control, that can be an insurmountable barrier to funding, particularly when it comes to dealing with sophisticated investors. Most investors will not seek control; however, if they sense that an entrepreneur must have control, that can kill a deal in short order.

Keep in mind that the second to last thing an investor wants to do is run your company, so don't worry about control. On the other hand, the last thing an investor wants to do is lose its money. In this event, worry about control if you may reach your level of incompetence and being at the helm is important to you even if the ship is sinking.

This leads me to my next and final point.

Lack of Community of Interest

Right from the get-go, look for a community of interest as between you and your prospective investors. If a community of interest exists, the process of completing a funding will be much more certain and much faster.

What are the component parts of a community of interest? There is no precise answer, but if one seeks to verify that a community of interest exists, the components will become apparent. Look for alignment of objectives. Choosing the right first group of investors or lead investor is vitally important to the long-term success of your company.

Conclusion

Raising money follows a process. It is within your power to control that process and make it far more efficient than it might otherwise be. Most of the barriers to raising money are self-imposed by those seeking funding. Objectivity and planning will help immensely in overcoming those barriers. Remember to bury your hubris, seek advice, and listen at every opportunity.

Michael J. Kucha
Managing Director
Timeline Advisers, LLC
mike@timelineadvisers.com
858-945-5647