Top Ten Tips On Raising Angel Financing Today

By Bob Norton

Angel Investors ("Angels") have become a much more important source of capital than ever before. Statistics show, that they have invested more than VCs in past years, and they almost always invest more in early-stage deals every year! With VCs treating early-stage deals like they have the plague, young companies had better understand and use angel financing effectively. Unfortunately, angels are nervous that follow-on financing for the round after theirs will not be there, and a good investment will go bad from a lack of available capital. This same phenomenon happened in the early 1990s. Similarly, today many companies will not be able to jump the huge gap between angel-financing and institutional financing, and will NEED to adjust their business plans to compensate for this unusual environment.

> ***If your business is a picnic, then the financing environment is like the weather. You cannot change it; you must make adjustments for it <u>in your business plan, and BEFORE you start raising money</u>. i.e. you can't beat mother nature and other forces far greater than you, you must accept and adjust. The art of business design must be applied to your business model.***

VCs and The "Series A" Deal Today

Most VCs currently are demanding <u>*many*</u> real PAYING customers (i.e. "traction"), not a Beta product with just the development risk removed. Most will also not admit this because they still want to see the deals though their rejection rate is nearly 100% right now. However, the last <u>real</u> Series A investment most VCs made was a long time ago in a galaxy far, far away. Unless you are dealing with a dyed in the wool seed stage VC you will quickly learn that product development funding, outside of the biotech and pharma areas, is very rare right now. Somehow the VCs have fooled the press on this fact with some fast razzle-dazzle called "changing the definition of a Series A deal". If you don't believe me then pin them down on this and ask for the company and CEO's name, then verify they funded product development, the definition of a Series A deal really. I see this deal flow each day from venture wire and VC Buzz, most of the institutional deals that happen and counted on a couple real Series A deal (outside biotech) in the last quarter of 2003.

Everyone knows that seed and "Series A" deals are much more risky and take longer to develop to a liquidity event than more mature companies. Since this product development funding is very difficult to get now what do you do? Effectively this requires more results

from startups, with less money! This leaves a huge gap where 'Series A' VC funding used to be. This squeeze is making it hard for all but the best teams and enterprises to make it, and is generating "virtual" companies at a much higher rate to deal with this situation. Many great ideas and companies will fail due to this environmental factor.

Today, lots of good ventures will skip the VC stage entirely, because by the time they meet the new, higher VC criteria, it is just not worth it. Most venture capitalists are in fact not currently in the "risk" business, and just like in the early 1990's, they are looking to fund growth only for somewhat proven business models, where the risk is low. Low equity market prices allow them to make their money on the way in no matter where they invest, so why not invest in lower risk deals, for the same price. Most are just not taking real calculated market and technology risks today, but instead are looking for "proven sales traction". In other words, little risk! Yes, there are some exceptions, such as where you have an investor with deep market knowledge and experience, who feels comfortable that they understand the market enough to judge the technology and/or demand for the product. Of course, in the much longer development cycle of biotech, this does not work at all. Few funds are true to their original early-stage mission and are not investing based solely on today's headlines. Who can blame them though, when they get more mature, less risky companies for the same price? However, you cannot raise funds by focusing on the very small number of early-stage funds. Companies need to push each lever they have, to position their business for the larger market of angels and raise the overall probability that they will get funding.

The Financing Landscape And Angels Today

The financing landscape has changed and angel investors are now looking at deals the way venture capitalists usually do! The "investment bar" has been raised significantly. Several angel investor groups that once did 6 to 12 deals a year only did one, or even NO new deals in 2002, and 2003 was very slow too. Angel dollars now go only to companies that meet relatively narrow and more mature criteria. If you were in their shoes you would want to move up the food chain to lower risk and same kind of stock price too! So you can't blame them for co-opting the early-stage VC investors' position of the past in the market.

In the past, most angels wanted a good concept and a good feeling about the entrepreneur. They bet with their gut in areas that they understood and would let the management team be filled out later. They were very willing to take product development risk, market risk, financing risk and incomplete management team risk. They could count on the VC firms being there, if the seed money was spent well, and a product was developed and team filled out pretty well. They could keep costs down and focus on creating product value, figuring out the market and finding the right people. This is far from the case today! However, who can blame them, as they can now secure more mature, lower risk deals for less money. The VCs have created a void and when this happens, the angels can step into the gap. Everybody moves up the food chain one or two notches. This is clearly the case today.

Top Ten Things Companies Need To Do Now To Survive And Raise Angel Funding:

1. BOOTSTRAP, BOOTSTRAP, BOOTSTRAP - Companies must pinch every dollar, when possible! Some ways to do this include: A) Get individual contributors to work for stock/free If they are unemployed and have a spouse earning money then they can stick with the company for a while. If this is not sustainable for a year or whatever needed to finish the product development phase then you can't depend on them and need an alternative. . B) Pay upon performance of a sale, C) Do everything you can that does not cost real money before taking on expenses, but is a function of your time (i.e. market research, business plan, vision development). Unfortunately, the best people, and more senior people do not need to work for free, and neither do the better sales people. So you must pay for quality, when that position is critical to getting to your next milestone TODAY. The older "Virtual Company" model, where almost everything is outsourced except the company's core value, is coming back to fill this need. You do not need to have all full-time people, so you can pay a little higher hourly rate, but in total, save a fortune because you are only purchasing 10% of someone's time. Work from home, barter, use stock, and look for services and/or consulting revenue to help build the product. However, you must buy what is necessary to get to the next level and to save time. You cannot possibly have all the skills on your core team to be successful, if you did you brun rate would kill you. Many entrepreneurs forget that it is costing them whatever the monthly burn rate is, to be there – so there are many cases where NOT spending money can cost you even more. Knowing the difference, requires experience and good judgment with very clear priorities and vision. This means a well thought out financing plan and timeline.

2. CLARIFY YOUR ENTIRE VISION FOR THE COMPANY - Flush out your vision more clearly. Most entrepreneurs have a good "product vision" and/or "market vision", but not a very clear vision of how to design and run the business in operations, financing, sales, and marketing. This is what the founder needs to be working on early on and adjusting as more information becomes available. There are eleven key elements to a complete vision and most entrepreneurs I see, have five or fewer worked out properly. Some have only one or two. Each major area of the business requires a strategy and tactical plan that will evolve with the company, and any one of them can bring your company crashing down. The reality is, that ideas ultimately get only 2% to 5% of the business's value (as in a patent royalty), while most of the value will go to the team that gets it to the market and to the investors who take the capital risk by funding it. The best way to preserve equity is to see #1 (Bootstrap). A vision consists of short-term plans that can realistically evolve into longer-term plans and strategies that can only be validated by experience.

3. **HAVE A FOCUSED LAUNCH STRATEGY** - This means ideally ONLY ONE market niche as the initial target. Companies should do little more than list and size other markets; with no significant resources going into selling to them at this stage. Acknowledge them as "future market opportunities" with 'future', being the key word. Almost no startup has the resources to go after multiple markets on day one. Startups need to be a small fish in a small pond. This means developing a very specific customer profile and probably an actual list of ALL the target customers. You need to have some unfair advantage over the competitive

solutions for this group of customers. The customer profile should include metrics for size, geography, and several other market specific attributes that contribute to making the company a high-probability prospect **sooner**, not **later**. If companies don't know what these factors are, odds are, that they are not ready to look for any investors yet, because they do not understand their market, niche or "sweet spot".

4. BE PREPARED TO DELIVER ANY SIZE PITCH – Companies need to condense, focus, polish and practice their elevator pitch and presentation about the company before they give it even once. You will not have a lot of chances, and need to go into every single meeting prepared. Anything else is like an actor showing up on opening night of a live play without any rehearsal. Several experienced people should first review everything, as well as speak to people who have raised money from angels before. It amazes me, how many companies still cannot state what their company does in a few clear sentences! If you cannot articulate your Unique Selling Proposition (USP), you are not ready. Why will someone be compelled towards your product over alternative solutions? Who specifically will NEED it most? To replace an entrenched player you need to be twice as good, at half the price! Companies also benefit from a good tag-line (3 to 7 words). Send people an executive summary before any meeting, but if possible, first set the meeting date and time. Deliver it just-in-time, when possible, so it is fresh in their minds when you meet. You do not want to waste much time covering basics and you want to leave plenty of time for feedback. "TELLING IS NOT SELLING". You are selling yourself, your concept, your team and your stock to everyone you meet, so treat it like any complex sales-process and be prepared.

The most common mistake entrepreneurs make raising angel money today is going out to their best networking contacts BEFORE they are ready. They burn their best chances for money and all other contacts further down that chain of referral contacts. C Level Enterprises will provide a "Financing Readiness Review", including a full review of your presentation and executive summary that is guaranteed to greatly increase your chances of success for only $650. How many months of effort does it take to get your company and presenationa ready? What is it worth not to blow that chance because of silly things you do not know? It is CRAZY not to get your presentation reviewed by an expert before getting in front of any investor! Call (617) 571-7591

5. CASH BREAKEVEN IN 6-12 MONTHS, MAXIMUM - This was not the case most times in the past, but today it is required. Tune your plan to get to cash breakeven in 6-12 months, on no more than $1 million! This is usually a difficult, but possible task with good

bootstrapping practices. Ultimately, you will have more company equity left for the team at the end of the day doing it like this anyway. One way to do this is to offer services while building your product, and essentially get development funded along the way on consulting contracts. But there are many ways to bring your capital requirement down. Work your financial model hard, strip down the product features to the Unique Selling Proposition (USP) you need on day 'one', use virtual employees, charge a higher price, get paid faster or upfront, get financing from vendors who will benefit from your success, the list is endless so use your advisors to revamp a plan to this time-frame and cash requirement.

6. INVOLVE THE BEST MANAGEMENT-TEAM YOU CAN GET, EARLY - You need a broader management team than angels wanted in the past (a virtual team most likely). Many new entrepreneurs are going to be seen as a "techie with an idea", not someone who can pull this off alone. Get used to it! As in most cases, this is the reality. The people with the ideas are generally not experienced enough to develop a business around the idea because the ideas come from a different level of working directly with customers and technology. Maybe one out of every million people can take a company from startup to $200MM in revenue. When this happens, it is mostly because they have done it, or most parts of it due to very broad business experience. I can count on my hands and toes the people who have grown a company from $0 to over $1 billion, such as Bill Gates, Ken Olsen, and Michael Dell (all with serious bootstrapping stories), without this past track record. Although lack of a management team was acceptable in the past, for the product development phase, there is no better formula for disaster than not having an experienced management team and/or CEO somehow very involved early on, today. I have seen millions go down the tube because virtually all resources went to product development – the founder's area of expertise of course and not to other critical areas. Today you need to tap experienced people who have "done it before", in each major discipline earlier on. People with experience in all the key facets of launching a business into the market place! Anyone can hang the name "President" on their door, but this is the equivalent of allowing someone to do brain surgery on you who has just graduated medical school (or not). They might have "Surgeon" on their door, but I would not let them near anyone I know, on the operating table without some "adult supervision" or more experience. Don't fool yourself on this -- virtually no real money is going to new grads or techies with an idea and no team. Surprisingly, many VCs learned this lesson the hard way all over again during the Internet bubble - trying to emulate that one-in-a-million shot of Netscape.

7. A FINANCIAL BUFFER – The odds are, that you will probably need some friends and family money first, to get to the point of being "angel ready". I recommend a year's worth of personal expenses in the bank, plus the largest home equity line of credit you can get, as a safety net before you give up your full-time job. Don't pay yourself, as that just might allow the same money to be taxed twice in some scenarios. Without a financial buffer, you have no leverage and will certainly get a worse deal than if you have the time and money to make more progress first. Work your plan and product, nights and weekends as far as you can before leaving your full-time job. Pre-sell friends and family many months in advance by telling them you will be looking for money later and have something to show first.

8. CORPORATE PAPERWORK - You need to get your "corporate" house in order with written agreements on ownership that are fair and equitable from the INVESTOR'S perspective. You need a cap table and several more boilerplate documents from an attorney. If these are not clean, you can scare off investors who want to take a closer look and you will have to start all over again. You do not need everything legally bulletproof, customized or covering every possible scenario; that always costs too much and takes too much time. However, you do need written understandings that are solid and cover the most likely scenarios, such as what happens when any individual leaves. This is why some vesting of founder's stock is REQUIRED, before angel dollar one comes into the company! No one wants to invest in a company and have a founder leave, still owning a big piece of the company, which is actually going to be needed to compensate and motivate their replacement. This is a common avoidable disaster that kills many companies. The founders are part of the value but only if they stay. Typically, founders' shares must be restricted and it must be required that the founders be an ongoing participant for about three to four years, at the minimum. If a "founder" is passive, not working full-time or just waiting for the funding to come in while checking in occasionally, they are really not earning much equity during that period, as compared to people who are working full-time. Their equity needs to be tuned to their time and other contributions, based on individual market-value for different roles; that is what shares and options are for; flat percentages many companies use, do not take into account this large variance in contribution due to time and market value. Working this all out early is easy, and it gets much harder over time.

9. NETWORK AND LEARN - Attend many entrepreneurial workshops, such as MIT Enterprise Forum, and WPI, regularly for a couple of years, preferably before you found a company. This helps you to learn how to run business models in your head better and see how investors react to holes in plans etc. Whether right or wrong, these reactions are real market feedback and must be dealt with somehow. LEARN SOME MORE - Read at least a book a month that is business related. Some of the best that I recommend are: Mike Porter's Competitive Strategy, Sun Tsu and the Art of War, and Entrepreneur America. There are also many valuable short articles at www.CLevelEnterprises.com that can help you avoid common traps and develop some higher level executive skills and perspective.

10. GET A MENTOR - If the person in charge has not grown a company from $0 to at least $25 million in revenue, then at a minimum get a mentor CEO who is willing to help you regularly, until you can afford a full-time or part-time "done it before CEO". Company style must shift gears radically several times during the first few years. You cannot afford to learn by trial and error here. Typically, an advisory board and board of directors, though helpful, cannot cover this need due to both lack of time and breadth of experience. You need someone available for at least two to four hours every week to review all major decisions. Even if this is a once a month review, you will save yourself lots of pain. Only a seasoned, successful, startup CEO can help here. I see many companies who think they are saving money, but spend months and months of extra time burning cash while making simple to avoid mistakes. They could save a small fortune with a little trusted advice. They save a $1,000 in consulting fees to spend and extra three months and $30,000 figuring out how to do something right they could easily learn from someone else because they do not know how to select a trusted advisor and follow that advice. The predictable result is, they run out of

money, never getting to the next level, where capital could have become available. KNOW WHAT YOU DON'T KNOW AND COMPENSATE BY HIRING A FEW TRUSTED ADVISORS! This does not have to be expensive, but does have to be done unless you have done it all before well. (in which case you would probably not need other people's money and would have investors chasing you). The mentor(s) must be someone who has successfully launched a startup business before. I do not mean a sandwich shop or dry cleaner, but a business with a similar structure and/or industry that your vision calls for. This will be the best time and money you will ever spend, because it is highly leveraged. An hour or two a month will save you tens or even hundreds of thousands of dollars in errors, will generate sales faster, and will get you to critical milestones months earlier. At the end of the day, this means more company left for the team, so don't be "penny wise and pound foolish". This will be the best money you ever spend because it will save far more than it costs.

Doing all these things can increase your chances of building a successful company and getting angel financing from one in a thousand to as high as 50%. The rest is the reality of the idea's potential, the team and real market potential. There are few guarantees in life, but hang this top ten list on the wall and review it every month and I guarantee you will improve your chances greatly!

This whitepaper is the chapter of the ebook "How To Raise Venture Financing In Any Market" from the Secrets Of A Serial Entrepreneur Series. This book is will be available in May or June, 2004. To order the book you can go to http://www.CLevelEnterprises.com/ and enter your email address in the newsletter subscription box and you will be notified when the book is available for download.

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