Marketing Your Business to Investors

How to target the right investors with a focused message

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It’s a Long Shot

- CB Insights reports 3354 VC deals in 2013
- Info@CrunchBase says ~1400 Angel deals
- Some are combinations, let’s assume 4000 total
- Wikipedia estimates 1 in 400 get funded

You Are in a Serious Competition
1.6M Failed to Raise Money?
Always Remember

• This is my perspective of the competition based on my experience
• There are no rules and lots of exceptions
• Seek other opinions
• There is no secret path to success
  – Hard work
  – Consumes all your resources
  – Very low chance of success
  – Follow every piece of string
• Expect the unexpected
Plan Your Attack

• Identify your targets
• Assess their needs
• Focus your message
• Be consistent
• Be persistent

If you can sell your plan to investors they will assume you can sell your product to others
Identify Your Targets
Investment Sources

• Friends and Family
• Grants
• Strategic
• VCs
• Angels
• Philanthropic Foundations
• Angel Philanthropists
• Private Placement
• Crowd Funding

The focus here is only VCs and Angels
Venture Capital

- Venture capital is a type of private equity
- A VC firm will raise a fund from large investors called limited partners
  - Pension funds
  - Insurance companies
  - Wealthy family funds
  - Foundations
- The fund usually has a life of 10 years when the limited partners expect a large return on their investment (ROI)
- VC firms have several funds at different stages in the 10yr cycle
- Equity investments are made by the general partners
- They are under pressure to get money invested and risk spread
- Aim for 10x ROI on every deal
Good News This Year

• 2014 saw $48.39B of venture investment
  – $19.8B in software companies
  – 4356 deals

• Best year since 2000 ($105B)
  – 2013 was $29.96B

• NEA started their 15\textsuperscript{th} fund, aiming for $2.5B

• BUT

Source: National Venture Capital Association and Thomson Reuters
WBJ defines local as the DC region including Rockville, Reston, DC, McLean, Lanham, Bethesda, Potomac, Gaithersburg, Herndon and Arlington. Does not include Blacksburg and Baltimore.

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Venture Capital (cont’d)

• What should you know about a fund
  – Is it new?
  – What have they already invested in?
  – Size of investments?
  – Expertise of managers?
  – Volume of investments they can manage?
  – Where are they located?
  – What are they looking for?
    • Stage
    • Size
    • Domain
Angels

- Invest their personal wealth
- Know their domain
- Get involved
- Early stage, convertible debt
- Now hunt in packs
- Their expectations
  - 3x to 5x in 3 to 5 years
  - There is a follow-on VC or quick exit

Any seed stage investor is taking a higher risk and needs to see a plan for future success
In the 90’s

• VC’s invested at any stage
• Angels were on the periphery
• Invested big for short time and big return
• Bubble burst in 2000/2001
• All the young guns gone
• Less firms, moved up process
• Angel groups filled the void
Assess Their Needs
Finding Potential Investors

• Where do they hide?
• Buy a guide, learn, visit websites
• Web site submissions low probability
• Meet them, get recognized
• Network Network Network
• 30 second elevator pitch must work
  – Don’t tech talk
  – Do business talk
What Do They Want To Know?

• This is not about your better mousetrap
• This is not a grant or a loan
• This is about your plan to make them rich
• This is about your teams ability to run a business
• Can you take input?
• Can you pivot?
• This is about your assumptions
• They will assess your business ability
• Others will assess your technology
Investors Priorities

• The Team
  – Business experience
  – Domain experience

• The idea
  – Their comfort zone

• A new and growing market that will be big
  – Their ROI

• Barriers to entry
  – Protecting their investment

• Potential exit
  – Their ROI

Can the team deliver the business model?
Key Team Abilities

• CEO
  – An experienced leader
  – Responsible for vision and strategy
  – Chief fundraiser

• COO
  – Manages resources (cash, people, commitments)
  – Daily tactical decisions (many)

• Founders
  – Created the original idea
  – They are the source of the passion

Very rare to find all these attributes in one person
At Grotech, we seek out companies that have the potential to make a massive impact," said Fredrick. "The founders of White Ops are well known for the considerable positive effect they've had -- and continue to have -- on the security industry. In a very short time, they've developed the 'Go-To' solution for ad industry players to combat fraud, while becoming an authoritative voice and an integral resource for setting direction in the advertising industry as a whole. This combination of influence and innovation enables the company to fundamentally change the game in online fraud."
Focus Your Message
Message Delivery

• 30 second “Elevator Pitch”
• Executive Summary
• Short form business plan
• Full business plan
• 10 minute PowerPoint
• 45 minute PowerPoint

Your business plan (of any size) is an explanation of your Pro-Forma Income Statement
Pro-Forma Income Statement

• Captures your business model
• What are you going to do with their money?
• Your view of the future
• Assumptions
• Embodies your strategy
• Reveals your team’s thinking and abilities

It is a strategic look at the future not a financial statement
Your pro-forma income statement should answer the investor’s question........

“What will you do with my money and how will it make me rich?”

If it doesn’t, it is a big red flag
How To Build a Pro-Forma

• Start with the product development timeline
• When will beta product be ready?
• Release 1 features and price (minimum viable product)
• Release 2 features and price, etc.
• Number of developers and expense
• When to begin marketing product?
• When to add sales resources
• How much sales expense to create revenues?

It must all link together
Be Consistent
**Pro-Forma Income Statement**

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- This is a forecast
- It illustrates your plans
- It is based on your best assumptions
- It is a test of consistency
- It is not meant to meet accounting rules
## Pro-Forma Plus Cash

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Additional lines convey important information about CASH
Sales

• Most important line, no sales, no business
• Sales of products and/or services
• License income, royalties
• Grants, investments etc. are not sales
• No top down numbers (e.g. % market share goals)
• Explain bottom up assumptions
  – Who will buy it and why?
  – What/who are you competing with?
  – How will you get first sale?
    • Beta customers, reference accounts
  – How will you grow annually?
• How did you set your price?

Are Sales Consistent With Product/Feature Availability and Price?
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Cost of Sales

• Costs to manufacture, deliver, install etc.
  – s/w product can include server costs (delivery)
• Can include warranty provisions
• Cost of goods not sold but obsolete/scraped
• Do you understand your costs

Caution: You will have to incur the costs well ahead of being paid for the product
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Gross Margin

- $sales – $cost of sales = $margin
- ($margin/$sales) x 100 = %margin
- Key metric, the product margin funds your operating expenses
- Margins change over time
  - Competition drives price down
  - Premium features can raise price
  - Costs can drop due to volume
  - Costs can rise if you have product reliability issues
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SG&A
R&D
Operating Earnings
Operating Margin %

Capital Spend
Investment
Cash on hand
Selling, General and Admin (SG&A)

- Salaries and benefits of all but R&D team
- Trade shows, advertising, marketing collateral
- Rent
- Lap-tops, desk-tops
- Phone, internet
- Legal costs
- Bank charges
- Etc.

Is your spending on sales and marketing consistent with revenue growth?
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Research and Development (R&D)

- Salaries and benefits of R&D team
- Include non-capitalized lab tools/eqpt
- Include contract work

Is your R&D spend consistent with the new features required to stay ahead of competition and sell at a competitive price?
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Operating Earnings

- \( \$\text{Gross margin} - \$\text{SG&A} - \$\text{R&D} = \text{Operating Earnings} \)
- Operating Margin\% is a key metric
  - Operating Margin\% = \( \left( \frac{\text{Op’g Earnings}}{\text{sales}} \right) \times 100 \)
- Typical errors
  - Huge margins
  - Insufficient spending to stay ahead of market and competition
  - Rapid revenue growth, despite being “conservative”
  - Better earnings than any large corporation
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<tr>
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Capital Spend
Investment
Cash on hand
# Reality Check

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<thead>
<tr>
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<th>Apple</th>
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<tr>
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<td>28.7%</td>
<td>27.3%</td>
<td>35.6%</td>
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</table>

Source: Yahoo Finance

- Is your pro-forma consistent with similar businesses?
- Compare industry
- Direct sales vs. distributor sales vs. licensing etc.
Capital Spending

• For the purposes of this exercise capital spending is money spent on buying, not renting, assets needed to produce the product.

• Could be any equipment or machinery that will be depreciated over time.

• Could also be buildings, vehicles etc. if necessary

Caution: Capital equipment needs to be purchased, delivered, installed and commissioned before you can make anything.
<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
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Cash On Hand

• You will always need some cash on hand
  – Payroll
  – Raw materials

• Suppliers don’t give start-ups credit

• If Operating Earnings + Capital Spend is negative you need investment money.

• Total investment required before the business is self supporting is an important metric for your investors.
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Investment Required

• Looks like $6M investment required
  – For the purposes of this exercise there is no such thing as negative cash
• Do monthly analysis to make sure
• At least $2M needed for first year
• Ask for 18 months to 2 years runway
• Try two raises of $3M each
  – Could go for $6M in two tranches
• A slower start might attract angel seed money
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<td>350</td>
<td>1130</td>
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Pro-Forma Result

If you have put all the initial effort into a well thought out pro-forma then writing a business plan of any size or a PowerPoint of any length will be easy.

Follow the business plan template NOT the pro-forma sequence.
Investor’s Opportunity

• How does this make the investor rich?
  – Growth?
  – Earnings?
  – Team?
  – Product?
  – Customer base?
  – Portfolio match?

• Will someone buy the business, or
• IPO, or
• Organic growth?
Be Persistent
Go On The Offensive

• Attend panel discussions, conferences, trade shows, any gathering where investors might be.
• Talk to them
• Make sure your 30 second pitch is about your business – NOT YOUR WIDGET (10secs max)
• Get a business card
  – Research who you met, keep a log
• Ask if you can follow up with more info
Don’t

• Go as a group and stick together
  – Split up and hunt independently
  – Make sure you all have the same pitch
• Hide in a corner and avoid eye contact
• Waste time talking to someone who is nice but no help
• Say you have no competition
• Mumble
• Leave early
What Now?

• You have an interested investor

• They will start due diligence
  – Your product/service IP
  – The market
  – Your team (quality, background, alignment)
  – Your corporate documents
  – Your cap table
  – Etc.

• Valuation

Any suspicious issues will spook them and they don’t have time for complicated analysis
Valuation

• A pre-money valuation is what the investor determines your business is worth before they invest (call this value X)
  – Depends on your stage of development and revenues
  – Depends on comparable deals they will find
  – Get opinionated

• Post-money value is pre-money value plus their investment (assume investment Y)

• Their ownership is $Y/(X+Y)$

Early investors don’t want their ownership % to demotivate the founders
Term Sheet

• If due diligence is looking good you will get a term sheet
• A summary of all the terms that will be in the equity agreement
• Can be very complex
• You should already have a lawyer who has done this before
  – Interview several
  – They are worth every penny
• The check is NOT in the mail
Summary

• You are competing with others for the funds
• All deals are different, there are no rules
• Expect the unexpected
• Get advice from anyone that has been through this, ignore hearsay
• Network, network, network
• The process can be long and very stressful
• Take input after every encounter and adjust

What will you do with my money and how will it make me rich?
Something to think about

• You can improve your chances by being the right person in the right place at the right time.
• Are you the right person?
• Are you ever in a place to be discovered?
• How much time do you make available to be discovered?
Where to Look

• www.crunchbase.com
• http://thomsonreuters.com/pratts-guide/
• www.pitchbook.com
• www.mattermark.com
• www.cbinsights.com
• www.massinvestor.com
• www.potomactechwire.com
• http://citybizlist.com
• www.mava.org
• https://dc.tie.org
• www.meetup.com/TechBreakfast/
• http://tedco.md