Equity Marketing 101:
The Art of Venture Packaging

One great mystery that confounds investors is why entrepreneurs, who spend years designing, patenting, developing and marketing their products, spend so little time learning the venture capital marketing process. Make no mistake, mastering this process can save time and money - and provide an opportunity to develop tremendous personal wealth while meeting important needs in the market. This article by Robert J. Kruse uncovers some of the critical issues entrepreneurs must be familiar with to gain venture capital.

A startup company's first sale is the sale of its restricted stock. Unfortunately, most entrepreneurs show up on a potential investor's doorstep with their widget and try to sell them on that instead. As any experienced salesman will attest, using the wrong sales strategy and tactics to the right customer can be a fatal mistake.

Raising venture capital comes down to understanding:

• exactly what it is that you are selling;

• who tends to be a buyer of the equity you are selling, how they buy it and why; and

• how to sell equity to those who wish to buy it.

This "what, why, who and how" - Marketing 101- is the Achilles heel of many an entrepreneur. What should seem obvious often isn't: the private restricted stock market is very difficult to determine because it is an insider's game. Yet, the basic tools used to sell any product apply to selling equity.

Marketing plans help sell widgets, and they will help sell equity. The "4 Ps" of marketing - product, promotion, place, and price - are the key to raising capital in record time.

Clarify the product's features

Like hard goods, equity has tangible and intangible features, advantages and benefits that appeal to different types of venture investors.

Tangible features include the terms of the deal (e.g., preferred vs. common shares), the type of deal (e.g., increasing returns vs. retail business model), capital requirements, management, the widget's marketing plan, exit strategy, and the geographic proximity to the investment.

Intangible features include the offering's ability to become a leader or be syndicated, credibility of the referral, communication mechanisms, learning curves, know how, security and comfort.

Package the deal

The most difficult step in raising capital is knowing how to package the deal and market it, so that it appeals to a specific class of investor, whether venture capitalist or private investor.

Successful packaging means, for example, creating a capital structure with equity products (convertible debt, preferred stock, warrants, etc.) that are appealing to target investors. This requires the foresight to determine any future potential products a company may offer, how the overall equity may be diluted, and what the potential Internal Rate of Return (IRR) would be for each successive round. This also requires careful accounting of shareholder positions, usually left to the lawyers, investment bankers and accounting firms when going public.

Test the water

Once the package has been assembled, it is often a good idea to send out a "red herring" to test the quality and completeness of your deal before you formally offer it for sale. Working with selected investors, advisory groups, "beta" customers and third parties before the deal is formally introduced establishes advocates early. There will, after all, be only one chance to make a first impression and winning a quick endorsement from the market is absolutely critical for success.

If it turns out that an important feature is missing from the package, it is better to stay home and preserve your one admission ticket to the game, than to damage your credibility. Trying to sell an unfinished deal is like trying to sell a laptop without a screen ñ the result could be an extended fund raising process that may never succeed.

Promotion options

Once the package is firmed up and tested, company representatives must be prepared to persuade potential buyers to get on board and

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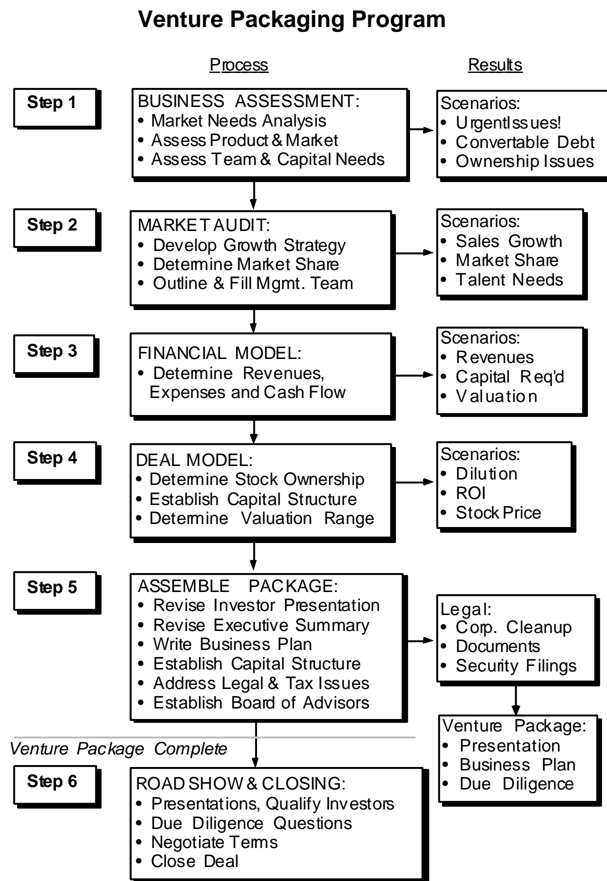
invest. This starts by developing a balanced venture package which includes a business plan, presentation, brochures, and corporate folder with articles of incorporation, bylaws, minute books, contracts, financial statements, tax returns, and testimonials. Though this may take more time to organize, a complete venture package can shave weeks off the due diligence process for a venture investor.

The all-important presentation

To sell equity, the marketing and sales plan for the eventual product must be well thought out. Technology entrepreneurs need to apply the 4 Ps of marketing to their widgets as well, because most venture investors prefer "painkillers" not "vitamins" - they prefer to fund the development of products that fill a critical need. If this critical need is not clearly stated up front, venture capitalists generally cut to the point by asking, "Who cares?" before the presentation is over.



The seller's challenge, therefore, is to drive home the product's bottom-line and measurable benefits: savings of time and money; excellent productivity; promising market share; safety, environmental impact and sustainability advantages. And the story's background - needs, features, benefits, competitors, market sizing and growth - should be clearly expressed as well. At the end of the sales presentation, an investor's only thought should be, "Wow!"

When it comes to discussing the product's marketing plan, there must also be a thoughtful discussion of the "how". This includes describing the strategy, sales methods, core competencies, sustainable competitive advantages, and partnering opportunities that will land the widgets in the laps of those who care. Investors need to be convinced that they are looking not only at a "wow" situation, but at a team (on-board or within reach) capable of seeing it through. The business model must make sense.

The entrepreneur's final challenge is to tell this gripping story of sizzle and execution in a 10 - 20 minute presentation.

Own up to your strengths and weaknesses

An entrepreneur who "doesn't know what he doesn't know" about raising capital and building a company is the investor's greatest risk. Professional investors respect entrepreneurs who know their blind spots and lay plans to mitigate risk- especially when it comes to hiring the right CEO. References and reputations sell products!

Dynamic positioning key to success

Few leading deals are perfectly in tune with the market when they first come out. Instead they are modified and altered once they meet the investor market. After hearing the story, an interested investor may suggest modifications to make the deal fit their needs. Obviously, an ability to adapt rapidly to early investor needs- flexibility- is critical for success. In other words, dynamic positioning of a product is always required.

Corporate positioning supercedes, and can validate, a company's market positioning and its product positioning. Just as product positioning gives individual products a unique presence in the

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market, corporate positioning provides a unique presence for an entire company. A corporate position is hard to achieve and even harder to regain if it should slip. One of the most important factors in corporate positioning is financial success - every other corporate strength, no matter how remarkable, may be insufficient to secure a superior corporate position of credibility.

When a deal wins over potential investors, it picks up momentum in the broader marketplace and success builds on itself. On the other hand, if the market sticks a "loser" label on a product or the deal (it has been over-shopped), the company will have a tough time overcoming its unfavorable reputation and may have to undergo a total restart. While companies have little direct control over the word on the street about their deals, understanding how the market works and who are the key players can help build credibility.

Building credibility is a slow and difficult but extremely important process. Credibility is established by using word of mouth, developing communications among the investor network infrastructure, forming strategic relationships and selling the deal to the right customers (investors).

A strategic word-of-mouth campaign avoids "shopping" the deal, and focuses instead on creating demand for it and favorable momentum in the marketplace. Undoubtedly, this is the most powerful way to communicate in the business world. Venture capitalists, who prefer to deal directly with the entrepreneur over broker-dealers, rely heavily on it. It is able to work miracles because face-to-face communication is the best way to spark commitment, support and understanding- a product heard about through word of mouth is more likely to be remembered and accepted.

Entrepreneurs seeking venture capital should also be wary of intermediaries who fail to add meaningful value to a venture package. Therefore, entrepreneurs should only consider working with law firms, accountants, broker/dealers, consultants, investors and other intermediates who have relevant and successful experience in navigating the process.

All great deals are dynamically positioned: they roll with the punches of investor needs and build up momentum in a market. In other words, they are well enough placed to survive the turbulent changes of the real-world investor marketplace.

Figure out who might be interested

Ironically, finding investors is often the least difficult part of the process! Word of a good deal travels quickly among the private, international networks of professional and nascent investors, despite the use of confidentiality agreements. When faced with the task of qualifying venture investors, it is helpful to classify them in terms of three primary factors: active vs. passive, seasoned vs. nascent, and the amount they tend to invest per deal. Arranging them on a corresponding grid helps identify the most appropriate potential investors for a particular deal.

Hitting the road

Once the venture package has been refined, tested, and positioned, word of mouth has started, and the investor market segmented, it is finally time to begin the formal road show. Armed with the valuable knowledge that investors only give you one shot, you should:

- craft a strategic direct marketing plan to minimize unwanted deal-shopping effects;
- have a succinct, targeted and focused presentation;
- be prepared to face the grilling due diligence process and
- be confident, flexible, and firm when negotiating the deal. The goal is to price on value but charge what the market will bear.

Admission: 1

DEAL SHOPPING

You really only get one chance to make a first impression and establish a credible position for your deal. The deal is considered shopped when you approach too many investors too quickly with an unbalanced venture package and the street has already negatively positioned the deal in their mind before you knock. Deal shopping is deadly and can extend the time to raise capital by a factor of 10 or more. Rebounding from a shopped deal often requires a costly and time consuming restart.

Art of venture packaging: summary

The key to selling equity to raise venture capital lies in knowing how to skillfully apply the principles of marketing. You must understand the investors' needs in order to present a quality

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venture package that articulates the "wow" and the "how", while executing a word-of-mouth marketing campaign from a credible position. You must also understand how to properly size and segment the investor market and test the waters to work out bugs while building credibility with an advisory board. Realize that pricing is subjective, and after answering hundreds of questions over a period of weeks, the ultimate decision comes down to how well you negotiate a flexible contract that creates value for both parties.

Of course, in order to properly execute a marketing plan and sales campaign, you need a marketing budget. Many companies enter the venture capital process without budgeting for packaging, research, financial modeling, demo units, legal and accounting costs, print needs, travel and so forth, and then find themselves at a severe disadvantage in negotiations. Venture capitalists often budget up to $250,000 for the development of a quality business plan and venture package with entrepreneurs they know and respect. It is not uncommon for startup firms to spend anywhere from $50,000 - $100,000 to raise their first round of $1 million or more. While many consultants and intermediaries work for equity, be sure to check their credentials.

Above all, know what you don't know. Be honest with yourself and know that if you lack the skills to execute the process yourself, use the venture package to attract someone who can.

VenLogic which provides Enterprise Planning and Venture Management educational solutions for entrepreneurs and investors of early stage ventures in Seattle and Silicon Valley.

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Avoiding Two Major Pitfalls of Venture Financing

Every entrepreneur knows the importance of identifying potential road hazards and developing ways to avoid them. Two enormous potholes that cause an unfortunate number of pile-ups and casualties, sometimes before a product even makes it to market, are what venture management consultant Robert Kruse refers to as "the Capital Gap" and the "Chasm." Here is what he means.

The Capital Gap

Ventures seeking between $250,000-$3 million in investments often encounter the entrepreneurial Capital Gap—a lack of working capital between startup and the moment when things take off, the period of rapid growth. Ironically, this gap has widened in recent years because venture funds are doing so well, they have more capital to manage and have increased their minimum investment thresholds.

Low end entrepreneurs generally have a difficult time aggregating more than ten private investors at an average of $25,000 each, to raise $250,000. With venture firms setting first-round minimums between $2 and $3 million, companies that are below this range and seeking capital to launch their product are likely to experience significant challenges in growing their business (see Figure 3).

Tell-tale signs that your company is nearing this dangerous pit include:

- you have less than $100,000 allocated to raise capital to launch your company;
- the only people who will invest in you are friends, family and fools;
- everyone has advice, but no one offers constructive feedback that produces results;
- you find yourself going "hand-to-mouth" raising from $5k to $25k at a shot, never able to attract investors who write checks at $50k and higher;
- you continue to "turn" the business plan every month and you are on "Revision G";
- your “savings” are rapidly being depleted and your spouse is concerned that the money reserved for the family vacation somehow "disappeared";
- your startup team is expanding beyond their homes and communications requires everyone to work in the same facility, but you are not able to afford the rent or moving expenses;
- a few customers show interest in your product but full-scale production is not yet established;
- you think you understand the customer and the distribution channels, but a full sales and marketing strategy is still not developed;
- you are certain the product is finished and will sell, but no customers have purchased any yet;
- stress is increasing both in the office and at home as cash dries up and early investors constantly call for status reports - investor management takes over your life.

Overall, your company requires high-risk capital financing to get past the break-even point, move into full production and roll out sales and marketing strategies.

To avoid falling into this Capital Gap, you must be able to:

objectively and adequately assess whether you can commercialize your technology and move it up, from garage to plant. If the answer is no, it may be time to scrap the idea, or sell it and get out;

- shift your mode of thinking from an entrepreneur to that of an investor - to better understand what investors needs are - strive to know what you don't know;
- understand and articulate the risks (market, capital, etc.) of your venture, along with the technological limits of your product. You must also have well-considered mitigation strategies in place, or be willing to hire expert advice to coach you over the hurdles;
- realize when you are already in it so that you may prepare your partners, investors and employees to batten down the hatches and weather the storm.

Entrepreneurs that successfully make it through the Capital Gap do so under Darwinian rules—only the strong survive.

The Chasm

The second pitfall entrepreneurs strive to avoid is the Chasm, “the gap between early adopters of technology and the rest of the marketplace” (Geoffrey Moore). It occurs because the product

has not yet met the needs of the mainstream market, who often hold back until a product does. Products that have fallen into the chasm include: video telephones (introduced in 1964), pen computing (introduced in 1991), and Internet telephony (introduced in 1996).

Here are some of the signs that you are approaching the chasm, or haven fallen in:

- You are experiencing a surge of early success and rapid recognition, but there are indications that future demand may decline sharply —sales people are not getting as many bites, and obvious potential customers have a “wait and see" attitude.
- Full production capacity is in place, employee payroll needs to met, "overhead" is now a reality, and a tremendous amount of venture dollars and entrepreneur equity is being consumed as market adoption lags.
- When engineers continue to add features from "market feedback", but sales into the mainstream buyers lags.
- When management does not have a clear answer as to who the customer is and blames engineering, product management, or channel partners for lack of performance.
- Stress appears as frustration rooted in uncertainty results in workplace venting, and arguments over simple decisions can develop and escalate, exacerbating unsolved problems.
- Among investors, your deal becomes "shopped" as you continue to contact the informal network searching in vain for capital to meet the monthly burn rate and revenues can not accurately be projected.

Examples of strategies to avoid the Chasm include:

- Prepare a detailed marketing plan, business plan, and financing strategy with management who have experience in creating a business in your field;
- Create a step-wise approach to launching your product, interpreting feedback, and ramping up production based on demand - not hunches;
- Involve marquis customers in the development, refinement, and promotion of your product that speak to features, bottom-line benefits, and sustainable demand.

To avoid the Capital Gap and Chasm act to position your deal while applying proper market segmentation (reference other article) – a success crossing of these canyons will likely put you in the mainstream market, where you’re well on your way to sustained growth and success.

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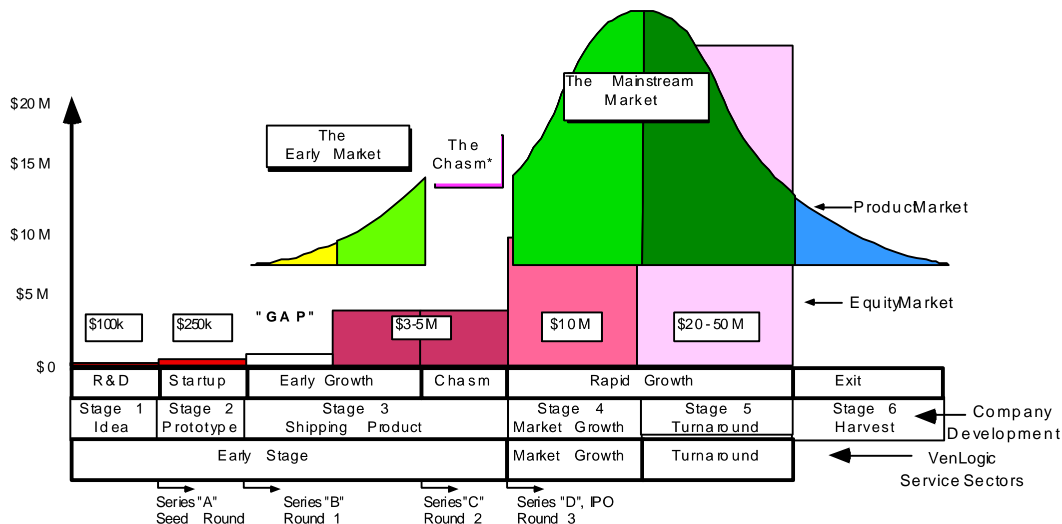
For additional information, Rob can be contacted at: Email: info@venlogic.com or www.venlogic.com. For more information refer also to: www.chasmgroup.com, and "Crossing the Chasm" by Geoffrey Moore (San Mateo, California).



* G. Moore, “Crossing the Chasm”