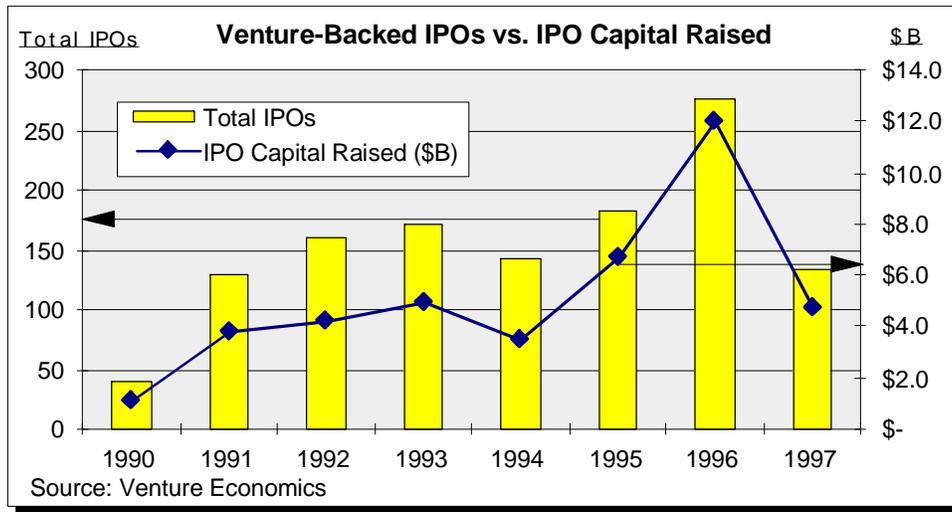


By: Robert J. Kruse  
November 1998

## Raising Venture Capital *The Art of Venture Packaging*

“There has never been more money available than there is today,” says Rolph Selvig, director of business development for San Francisco-based VentureOne, a leading provider of information and analysis for the US venture capital industry. Nationwide, venture capital (VC) firms invested \$3.2 billion in 467 companies during the second quarter of 1998. Overall, VCs are flush with cash from pension funds, other institutional investors, and the recent wave of venture-backed Initial Public Offerings (IPOs) (see Figure 1). In the first half of 1998, venture capital funding totaled \$7 billion, or 34% more than the \$5.2 billion raised in the same period last year, according to Venture Economics Investor Services. Meanwhile, the average venture capital fund size nearly doubled to \$112.2 million from \$65.6 million. Nationwide, deals this year are closing at a rate of \$1 billion a month. The message is: If you have a good management team and a good business plan, you *should* be able to get funding.



**Figure 1: VC Industry Results & IPO Growth**

Or should you? It’s easy to be lulled into a false euphoria by this seeming oversupply of venture dollars. As the Dow Jones industrial average fell this past August (1998), so did the amount of money that could be raised with an IPO—a key exit mechanism for venture funds. Dozens of companies considering an IPO are in holding patterns while the stock market gyrates up and down. “A lot of companies that were set to go public are going to look for private money,” said Arthur Marks, general partner with the venture capital firm, New Enterprise Associates. However the private market may not offer much hope either. Seasoned private investor, Dave Davison, of Knowledge Venture Partners notes, “As the IPO market continues to have difficulties, the IPO market will shift and the Capital Gap will grow.”

Navigating the fluctuations in the public market and its subsequent effects on investors is just another layer of complexity entrepreneurs face when seeking venture capital. With top VCs reviewing 2,000 deals per year but investing in only 10, the competition is tough. Even more challenging is the pressure to beat the odds that VCs place on a given investment: Sixty percent are expected to fail, 30% to go sideways, and only 1 in 10 are expected to score a home run offering extraordinary returns (which make up for the other portfolio losses plus a profit.)

With deal flow at an all-time high, VCs need to screen deals quickly. Deals that consumed hundreds of hours of analysis and development now get little more than a few minutes of investors' precious time to make a meaningful first impression. The entrepreneur's challenge has never been greater, despite the surplus of risk capital. Yet, the outcome of most deals that cross a VC's desk are determined long before they arrive, usually due to a failure on the entrepreneur's part to observe some basic marketing guidelines. As a result, many entrepreneurs needlessly spend tens of thousands of dollars and months seeking capital, when to improve their odds, they should really be investing more time up front thinking harder and smarter.

## **Successful Entrepreneurs Master the Process**

Most entrepreneurs don't realize they usually are in control of their own fate, in a process with odds that otherwise can appear to discriminate against them. Statistically, entrepreneurs who understand how the process works retain more control over their destiny than those who do not.

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 process. While some of the best lessons learned and strategies are already published in books, few entrepreneurs take the time to read them. Make no mistake—mastering this process can save tremendous amounts of time and money and most of all, the opportunity of a lifetime to create tremendous personal wealth while filling important market needs.

Entrepreneurs are not entirely at fault, however. The \$60 billion venture capital industry, unlike other financial and professional service industries, has done little to provide the necessary tools and educational programs to aid those learning the ropes. This article reviews some of the most critical issues entrepreneurs must understand in order to succeed.

## **Equity Marketing 101**

Raising venture capital comes down to understanding the following:

- ⊙ **Exactly what is it you are selling?**
- ⊙ **Who tend to buy the equity you are selling, how do they buy it, and why?**
- ⊙ **How do you sell equity to those who wish to buy it?**

This what, why, who and how analysis—in essence, Marketing 101—is the Achilles heel of many an entrepreneur. What should seem obvious often isn't: the market for buyers of private restricted stock is much more difficult to determine than for most markets of hard goods because it is an insider's game. Yet, the basic tools used by marketers for years can still be applied to selling equity. The secret lies in knowing *what* it is you're selling, when, and why.

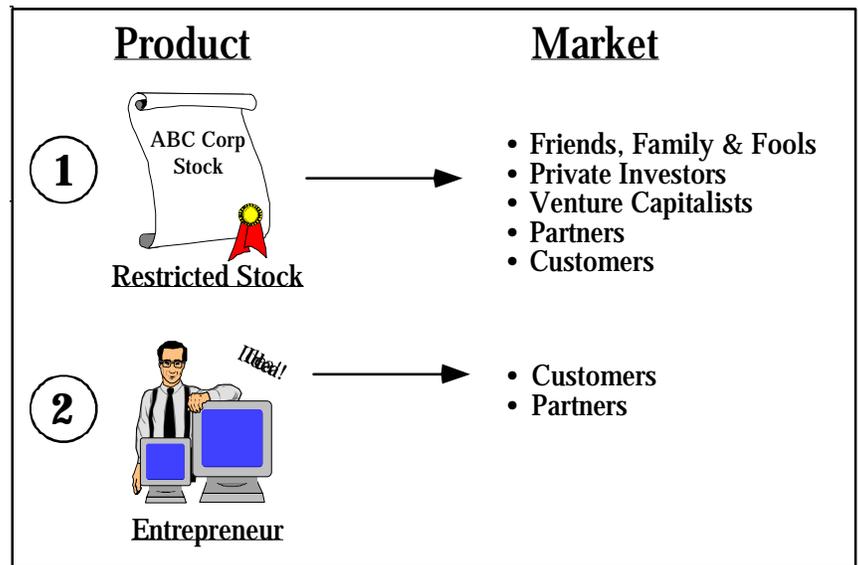


Figure 2: Stock is the First Product a Startup will Sell

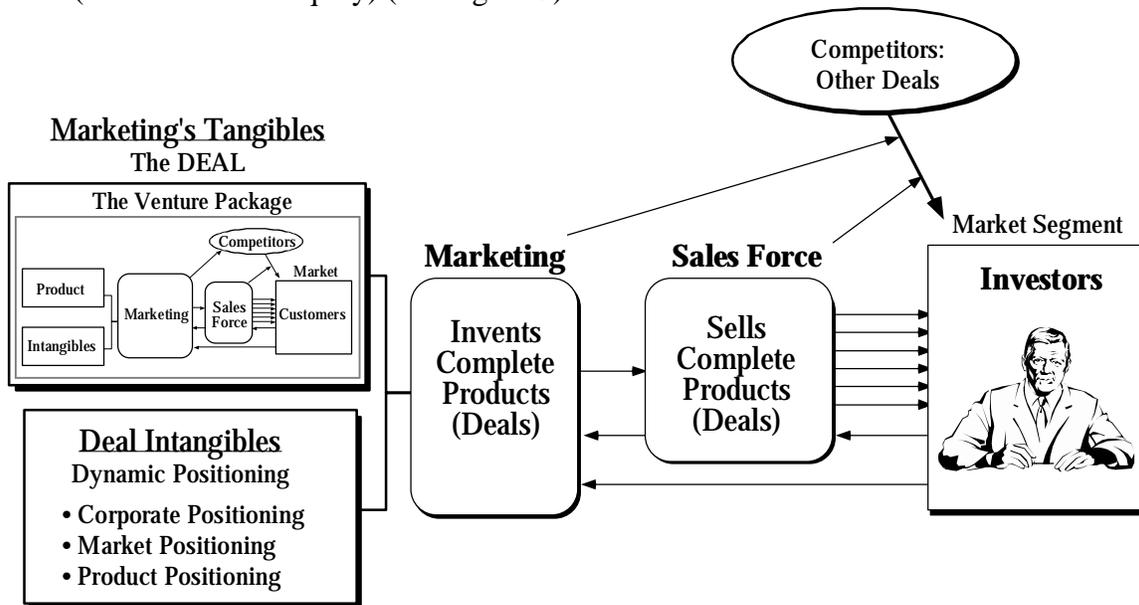
To succeed, you must know the first sale a startup company makes is **restricted** stock. Unfortunately, unless you understand the market, your first sales approach can also be your last. As any experienced salesmen will attest, using the wrong sales strategy and tactics to the right customer can be a fatal mistake. Most entrepreneurs show up on an investor's doorstep with their widget and start selling to the investor as a potential buyer of *widgets*. What should be abundantly clear is that investors buy *stock*, not widgets.

One myth among entrepreneurs is that due to the power of numbers, investor databases provide an advantage in raising capital that will enable them to get through the process faster. After all, in ordinary markets, a customer list can be surveyed to tell you statistically what the customer generally wants and how much they are willing to pay for it.

Unfortunately, databases may not provide any advantage in raising venture capital. Investor databases can accelerate the shopping effects when a deal is spammed, instead of targeted directly. Still, informal surveys reveal that most investors know what they "don't like." They *don't* necessarily know what they "do like." Therefore, a qualified investor database can be useless for surveying to uncover specific needs and buying habits. Most VCs and seasoned private investors tend to snicker at the stereotypical "glossy-eyed" technologist/entrepreneur who doesn't "get it" and proceeds to drown them with excessive details about their product when they really have other questions on their mind. Unless the database has a rich member profile that is managed by experienced professionals and is actively kept up-to-date, investor databases are best used as a last resort.

Understanding the venture process starts with rethinking what it means to market and sell equity. Logic dictates that if widgets are sold with marketing plans, selling equity should be no different. And indeed, entrepreneurs who apply the 4 Ps of marketing (Product, Promotion, Place, and Price) to their product line of restricted stock (in the same way as they do for their widget) can

raise capital in record time. However, the double challenge entrepreneurs face is that selling equity requires the marketing of **two** nested products: The Widget (to customers of widgets) and the Deal (to customers of equity) (see Figure 3).



**Figure 3: The Double Challenge of Selling Equity**

It's no wonder then that so many entrepreneurs have difficulty raising capital. Unless the CEO (*the sales force of equity*) possess a strong understanding of marketing, and how to apply it to selling equity *and* widgets, the company will be at a severe disadvantage with professional investors, regardless of the quality of the widget or how much venture capital is "available" locally.

### ***The First Product: Equity***

Much like hard goods, equity is a fundamental product that has tangible and intangible features, advantages and benefits that appeal to different types of venture investors.

#### Tangible features include:

- ⊙ Deal terms (preferred vs. common)
- ⊙ Deal type (increasing returns business model, etc.)
- ⊙ Capital requirements
- ⊙ Widget marketing plan
- ⊙ Management
- ⊙ Geography or proximity to the investment

#### Intangible features include:

- ⊙ The flexibility of the offering (ability to lead or syndicate)
- ⊙ Credibility of the referral

- ⊙ Communication mechanisms
- ⊙ Learning curves
- ⊙ Know how
- ⊙ Security & comfort

Just like a computer is incomplete without intangibles such as software, cables, and 1-800 customer support, the equity product is incomplete without intangibles expected by the target investor group. Therefore, it is your job to ensure that the equity has been properly productized or packaged by including the intangibles before approaching investors. After all, you are the only one who investors are backing, not brokers or anyone else! Besides, investors tend to give entrepreneurs only one shot at presenting their deal.

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Ironically, *finding* investors is often  
the least difficult part of the process!

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While an entire industry of investment bankers exist to provide packaging services to companies going public, few consulting firms or brokers provide this critical service to entrepreneurs “going private.” Which explains why entrepreneurs often receive dubious advice when approaching the usual intermediaries (lawyers, bankers, accountants, etc.) Most approach these professionals not for their services, but for their access to their wealthy clients. This is not always the best approach.

The most difficult step in raising capital is knowing how to productize or package the deal, and then market it so that it appeals to a specific class of investor (i.e., venture capitalist vs. private investor). Ironically, *finding* investors is often the least difficult part of the process! Word of a good deal travels quickly among the private, international network of professional and nascent investors.

If stock is the product, then the *product line* is the capital structure. To succeed, you must know how to create a capital structure with equity products (e.g., convertible debt, preferred stock, warrants, etc.) that appeal to different investors. This requires the foresight to determine any future potential products a company may offer, how the overall equity dilutes, and what the potential Internal Rate of Return (IRR) is 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.

Next, you must arrive prepared to persuade. Metaphorically, if the business plan is the sales brochure to get the customer interested in buying, then a thoroughly prepared corporate folder is the Users Guide. Successful entrepreneurs know the importance of developing a balanced venture package, which includes a business plan, presentation, brochures, and corporate folder, including articles of incorporation, bylaws, minute books, contracts, financial statements, tax returns, and testimonials. Though this may take a few days more of time and organization, presenting a complete venture package can shave *weeks* off the due diligence process for a venture investor.

**The Second Product: Widgets**

So, you have the equity plan, now what about the widgets? To sell equity, the widget’s marketing and sales plan must be adequately thought out. Technology entrepreneurs need to thoroughly apply the 4 Ps of marketing to their widgets as well, because most venture investors prefer to fund the development of products that fill a critical need. In other words, investors prefer “painkillers” not “vitamins” (see Figure 4). If this critical need has not been clearly stated, VCs are known to cut to the point by asking, “Who cares?” before the presentation ever begins.

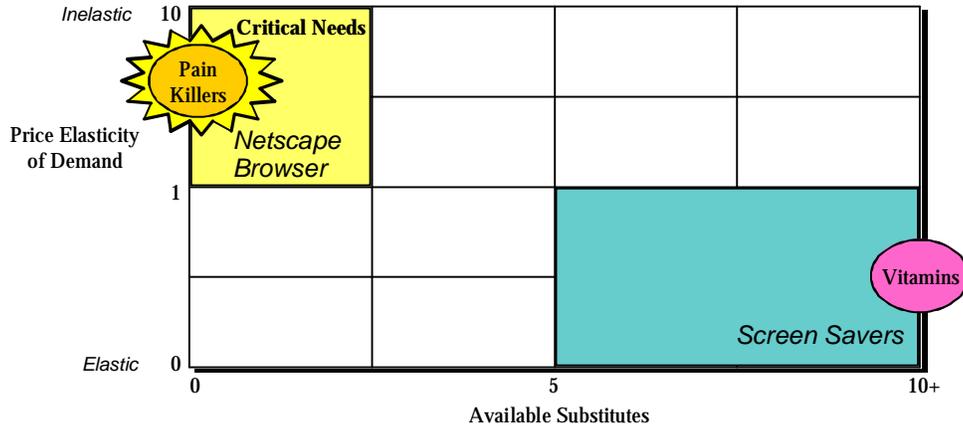


Figure 4: Investors Prefer to invest in Painkillers not Vitamins

Your challenge is to clearly articulate the *critical need* your product meets by driving home its bottom-line measurable benefits, for example, savings of time, money, productivity, market share, safety, environmental impact, sustainability, etc. And you must tell this story with a carefully threaded story of linkages—needs, features, benefits, competitors, market sizing and growth—at the end of which an investor’s only thought should be “Wow!” Like every good salesman, your salability must be sizzling within the first few minutes. So start cooking!

A company must achieve a commanding position in the marketplace or die. The number of companies that can survive profitably in any marketplace is limited. Certainly, no more than six companies can have more than a 15% market share.

A company only has to be as large as its own protected market segment to be successful. The key is proper market segmentation.

-- William Davidow, *Venture Capitalist & Author*  
 “Marketing High Technology, an Insider’s View.”

The Free Press Division of Simon & Schuster, New York, NY, 1986.

A marketing plan is certainly not complete without a thoughtful discussion of the “How.” This includes describing the channel strategy, sales methods, core competencies, sustainable competitive advantages, and partnering opportunities that lands your widgets into the hands of those “who care.” The key lies in convincing the investor that you not only have the “Wow,” you also have a team (on-board or within reach) capable of executing it. The business model

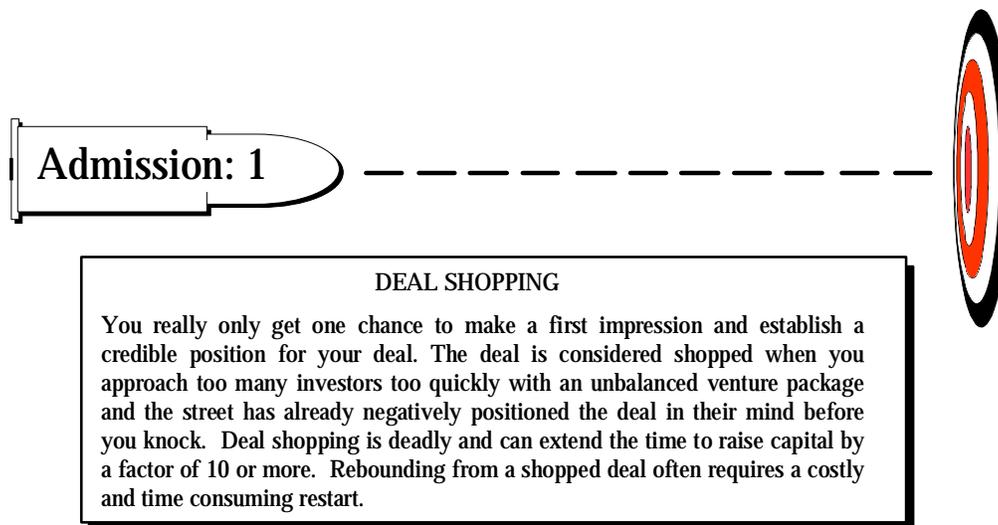
must make sense and be ready for action. The entrepreneur that tends to be successful in raising capital is able to gracefully tell a story of sizzle and execution within a concise, 10- to 20-minute presentation.

### **Product Summary**

The essence of the presentation comes down to describing a logical business model that generates returns that meet the needs of the prospective investor audience. Ask yourself:

- ⊙ **Does your company have market-ready technology that meets a critical need and produces outrageous margins? (The Wow)**
- ⊙ **Can your team execute the plan and navigate uncharted waters quickly by leveraging its unfair sustainable competitive advantages to achieve an exit in less than five years?**
- ⊙ **Is your team complete and credible? (The How)**

These are just some of the key “product features” that attract and retain venture investors. Unless the deal (i.e., business plan or equity product) meets an investor’s fundamental needs of *Wow and How*, your equity product is not ready to be promoted, placed, or priced.



**Figure 5: The Most Important Lesson Learned**

While broker-dealers are available to assist in the latter three steps, few take the time (or are qualified) to test the completeness of the deal as a product while also offering quality feedback *before* it’s shopped. Why is this important? Because, without this “pre-testing,” you could find yourself paying substantial fees to intermediaries to raise capital on your behalf only to find that the deal has been over-shopped among a market of investors who prefer to buy direct. Meanwhile, entrepreneurs rarely receive feedback on why their deal did not meet investors’ needs, resulting in needless second-guessing. Since investors only give you one chance to make a first impression, lack of a thoroughly planned and confidentially executed test-the-waters program can be damaging in many ways (see Figure 5).

Instead of potentially wasting time and resources, a successful tactic is to use a Red Herring to “tests the waters” on the quality and completeness of your deal before formally offering it for sale. If the deal product is not complete, your company is far better off spending its time and money finishing it—no matter how urgent your cash needs are.

Rarely will an unfinished venture package receive financing from professional investors. Unless the CEO can professionally demonstrate your company’s execution plan and back it up with a successful, credible track record (i.e., return generated for venture investors in a previous deal), unfinished deals are like trying to sell laptops without screens. It’s far better to stay home and preserve your one admission ticket to the game than to severely damage your credibility, while at the same time extending a fundraising process that may never succeed.

## **Equity Promotion & Dynamic Positioning**

OK, you’ve properly tested the waters and determined that your deal is complete and of sufficient quality. Now it’s time to apply the next steps of the equity marketing process: Promotion, placing, and pricing the deal.

As with ordinary products, if your deal is not properly positioned in the customer’s mind, the customer will do it for you. Therefore, it’s essential you take the proper steps to position the deal in the mind’s eye of the investor. Of course, there are ample books available on the subject of positioning that can be applied to this situation. As marketing expert, Jack Trout, notes, “Minds can’t cope, minds are limited, minds hate confusion, minds are insecure, minds don’t change, and minds can lose focus” (The New Positioning, Jack Trout and Steve Rivkin. McGraw Hill, 1996.) Your job is to keep the story simple and establish a credible position in the investor’s mind from the first moment of contact.

Since unlike most markets, the investor marketplace is dynamic, companies must establish strategies that can survive the turbulent changes in a real-world environment. In his book Relationship Marketing, seasoned venture capitalist and Silicon Valley marketing guru, Regis McKenna, stresses the following three important steps to dynamic positioning (Relationship Marketing, Regis McKenna, Addison Wesley Publishing Co., 1991.)

### **Step 1) Product Positioning**

As with any new product, almost all new deals are experiments. 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. With ground-breaking deals, investors can’t know what they want until they’ve seen the product. But after hearing the story, an interested investor may suggest modifications so the deal fits their needs. Obviously, your ability to rapidly adapt to early investor needs is critical for success.

### **Step 2) Market Positioning**

In market positioning, the marketplace responds to the new product. The company must use the leverage of the investor market to create the company’s deal position. Working with the selected investors, advisory groups, beta customers, and third parties before the deal is formally introduced establishes advocates early (tests the waters). The company finds out during this

early phase whether its widget and equity products are positioned well. *Winning a quick endorsement from the market is absolutely critical for success.*

Just as with widgets, you can't wait until the product is "in production and shipping" to find out if you have infrastructure support for it. Once a deal wins over the infrastructure, it picks up momentum in the broader marketplace. Success builds on itself. On the other hand, once the market sticks a "loser" label on a product (the deal has been over-shopped), the company has a tough time overcoming its unfavorable reputation and may have to undergo a total restart. Clearly, companies have little direct control over this stage of the positioning process.

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Once the market sticks a "loser" label on a deal that has been over-shopped, the company has a tough time overcoming its unfavorable reputation and may have to undergo a total restart.

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Market positioning is determined largely by the perceptions of those in the infrastructure marketplace. It is possible, however, to influence the market-positioning process. By understanding the workings of the market, you can influence the market's perception of your deal. You can create a stronger image for your deal by taking steps to make both yourself and your product more credible.

### *Building Credibility*

Credibility is the key to the whole market-positioning process. With so much deal flow, investors have become quite adept at rapidly sorting through the claims and counterclaims made by various companies seeking capital. Successful entrepreneurs tend to use the following three-step process in positioning their deals:

1. Start with a strong product (deal) position
2. Build credibility, and
3. Build market positioning

Building credibility is the key to successful market positioning when raising capital. It is a slow and difficult process, but it is absolutely critical to success. Some of the steps used to establish credibility include:

1. Use word of mouth
2. Develop the infrastructure
3. Form strategic relationships
4. Sell to the right customers (investors)

Word-of-mouth is probably the most powerful form of communication in the business world and VCs rely on it. Word-of-mouth messages stand out in a person's mind. Face-to-face communication is much more likely to gain commitment, support, and understanding—it is more likely to be believed and remembered. Studies indicate VCs prefer to deal direct with entrepreneurs and rarely fund deals referred by broker-dealers. Therefore, a wise strategy is to carefully organize a strategic "word-of-mouth" campaign. This campaign, however, must avoid shopping the deal, but instead create momentum and demand.

When in the due diligence phase, professional investors are more likely to make decisions based on what they hear directly from other VCs, seasoned executives, and customers. You need to beware of intermediaries who fail to add meaningful value to a venture package, which can negatively affect the offering if not carefully selected for the campaign. You should only consider working with intermediaries (e.g., law firms, accountants, broker/dealers, consultants, and other investors) who have successfully navigated the process *and* carry strong credibility with investors.

### **Step 3) Corporate Positioning**

Corporate positioning supersedes, and can validate, a company's market positioning and its product positioning. A strong reputation and corporate position can sometimes be established by one or two key products. But beware: A corporate position is hard to achieve and even harder to regain. Just as product positioning gives individual products a unique presence in the market, corporate positioning provides a unique presence for an entire company. The most important factor in corporate positioning is financial success. Without financial success, everything else is meaningless.

Corporate positioning is based on many factors, including management strengths, corporate history, and personalities of the top executives. For example, a seasoned CEO such as Jim Clark carried substantial corporate positioning of his new fledgling startup, Netscape, in 1994, and raised \$5 million in first-round financing. After being rejected by two venture funds, he sold 13.3% of the company to Silicon Valley's preeminent venture firm, Kleiner Perkins, at an extraordinarily high pre-money valuation (\$32.6 million). This was at a time when most startups were receiving valuations for their first-round capital of between \$2 to \$8 million. Results of proper positioning speak for themselves. At IPO, Clark's 24% of Netscape was a staggering \$565 million, whereas the average venture-backed CEO owns only 5% of the company worth an average of \$6.5 million (High Tech Startup. John L. Nesheim, Electronic Trend Publications, San Jose, CA. 1992.)

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Investors probably face the greatest risk when funding entrepreneurs who "don't know what they don't know"...

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**Successful entrepreneurs realize their own strengths and weaknesses.** They are able to look in the mirror and be truthful about their own ability to meet investors needs. Professional investors respect entrepreneurs who admit their weaknesses and provide plans for mitigating risk, especially when it comes to finding the right CEO to lead the fundraising process and establish a strong corporate position. After all, for many companies the CEO's number one job is fundraising through multiple financing rounds.

Investors probably face the greatest risk when funding entrepreneurs who "don't know what they don't know" about how to intelligently raise capital and build a successful company. This often results in unexpected repercussions, as the risk shifts back to the entrepreneur who has raised capital from investors who "don't know what they don't know" either. Ultimately, the results can be devastating when cash runs out (which it almost always does). Disputes often arise

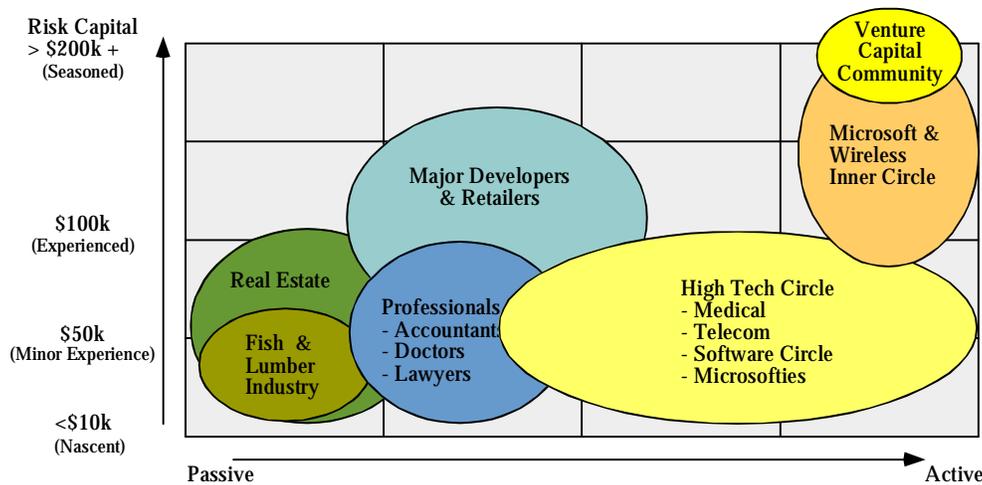
between investors and nascent entrepreneurs on issues such as bridge financing, interim valuations, and further dilution when anti-dilution clauses kick in.

To rise above these potential problems, you must know how to target the smart money by having experienced executive talent apply dynamic positioning of the deal to the investor marketplace for maximum results. The significance of experiential marketing cannot be overstated. Remember: *References and reputations sell products!*

## Equity Placement & Investor Channels

Now armed with a confidentially tested deal of merit, and a carefully orchestrated word-of-mouth campaign directed by an experienced credible executive, the next step is to determine the best “channel” for direct marketing to the appropriate investor segment.

One way to view the investor market is to classify venture investors in terms of three primary factors: active vs. passive, seasoned vs. nascent, and the amount they tend to invest per deal. This process is represented in Figure 6. In the diagram, investment experience and the capital invested is combined into the Y-axis, with the X-axis ranging from passive to active. Known investor groups are then placed on the grid to form a landscape that helps to identify specific groups of investors for a high-tech deal. Note that this orientation would be different for environmental deals, where investors who come from the “Fish & Lumber” industries may be more active in this case than in high-tech projects.



**Figure 6: Seattle Investor Market Segments for High-Tech Deals**

While the investor landscape provides a map with which to navigate, every good marketer knows the importance of identifying potential road hazards. Two major potholes that consume many ventures include the Capital Gap and the Chasm.

### **The Capital Gap**

Ventures seeking between \$250 thousand and \$3 million often encounter the entrepreneurial Capital Gap, or a lack of financing sources. Ironically, this gap has widened in recent years due

to the success of venture funds, which requires them to manage more capital. Average fund sizes have doubled in the past year, to more than \$112 million, thus increasing the minimum capital investment thresholds (Venture Economics, August 1998).

On the low end, entrepreneurs have a difficult time aggregating more than 10 private investors at an average of \$25 thousand apiece, or \$250 thousand total. With venture firms setting first-round minimums between \$2 and \$3 million, companies that are in-between this range and seeking capital to launch their product may experience significant challenges in growing their business (see Figure 7). Entrepreneurs that successfully make it through the capital gap do so under Darwinian rules—only the strong survive.

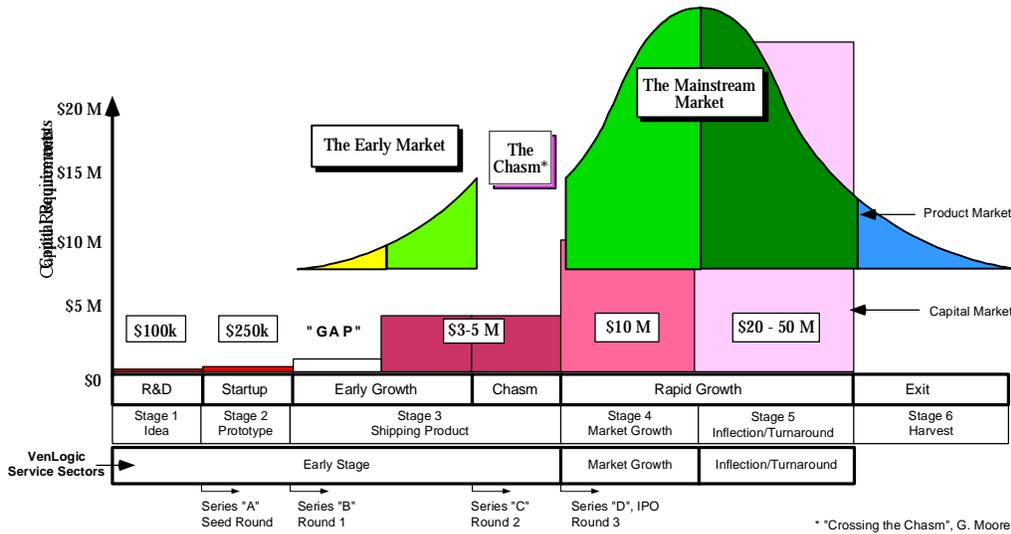


Figure 7: Entrepreneurial Capital Gap

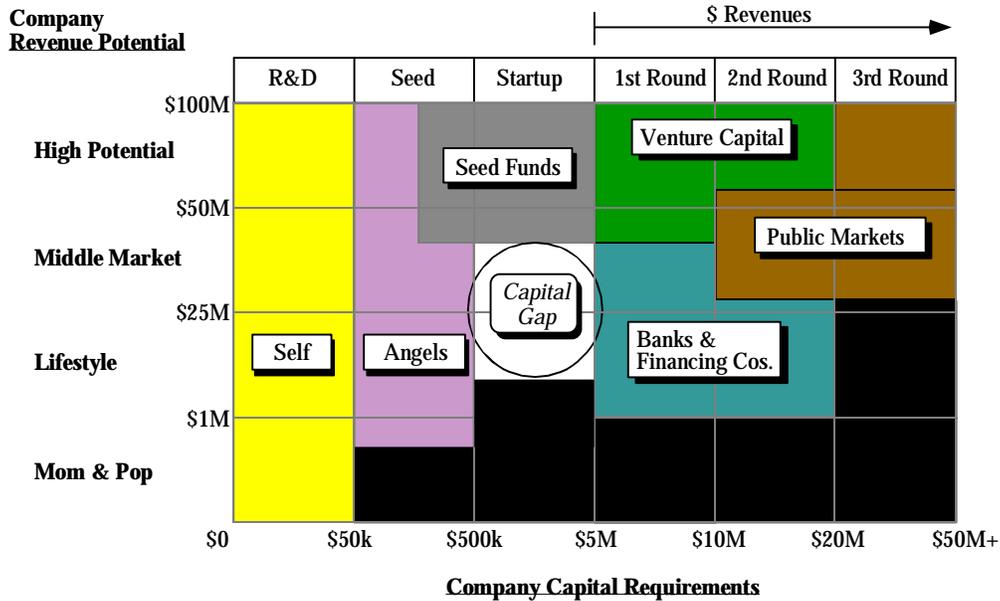
**The Chasm**

The second pitfall entrepreneurs strive to avoid is “the chasm.” In the product marketplace, the chasm model, as developed by Geoffrey Moore, author of *Crossing the Chasm* (Crossing the Chasm, HarperBusiness a division of HarperCollins Publishers, 1991) is defined as the gap between the early adopters of technology and the rest of the marketplace. The Mainstream market is reluctant to adopt because they don’t want to make mistakes; thus they tend to hang back. The chasm is the period in the development of a marketplace where a product gets a surge of success with rapid recognition by the early market, and then the demand sharply falls off. For companies that successfully cross the chasm, there is the mainstream market on the other side, which is often accompanied with a burst of hypergrowth.

The chasm is a tremendous consumer of venture dollars and entrepreneur equity, as market adoption lags. Companies that have suffered in the chasm include 3DO (multimedia game system), Momenta (pen computing), AT&T (videophones, Internet telephony), Virtual I/O (3D video headset), and General Magic (palmtop operating system). Clearly, entrepreneurs and investors need to avoid the chasm at all costs.

**The “Grand Canyon” of Seed Financing**

Another view of the capital gap occurs when investors “devalue” the future revenue potential by applying a hurdle rate (typically 50%), which immediately positions a \$100 million company as a \$50 million company. This is done as a form of sensitivity analysis, in order to test the IRR potential of the company’s business model. As a hurdle rate is applied, it pushes the company closer into the capital gap, where traditional venture funds give way to seed funds that lack the syndication power to provide bridge financing in tough times (see Figure 8).



**Figure 8: The “Grand Canyon” of Seed Capital Financing**

As a result, the cash-starved company caught in the gap, or chasm, experiences severe hardships. Founders find that they have to go back to investors, family, and friends, thus further stressing personal relationships. Many go as far as mortgaging their homes, selling assets, and accruing severe credit card debt. Key employees drawing a salary may leave, taking valuable intellectual property with them. Married employees that stay can begin to experience family problems. Frustration rooted in uncertainty results in workplace venting, and arguments over simple decisions can develop and escalate, exacerbating unsolved problems.

Among investors, the deal becomes “shopped” as the entrepreneur continues to contact the informal network searching in vain for capital. Since decisions are made primarily on personal references, instinct, and “following the herd,” entrepreneurs find doors start closing before they even arrive. In the company, the stress continues as the project limps along, snuffing out employee motivation that is so critical to success and that is often a key reason why investors got involved in the first place. The downward spiral continues, making it increasingly difficult for the entrepreneurs to raise venture capital, until the company eventually folds.

**The Power of Positioning and Proper Placement**

Professional investors tend to be aware of both the capital gap and the chasm, and will lag behind until either a real business has developed for the product or the management team is sophisticated enough to attract their investment. Successful entrepreneurs understand that the capital gap and the chasm are deadly pitfalls that surround the investor landscape, and therefore act to position their deal while applying proper market segmentation to achieve success.

## **The Road Show & Equity Pricing**

While fine-tuning the venture package, entrepreneurs should spend time preparing and rehearsing private “test the waters” presentations, using feedback to stop and regroup whenever a major hole is revealed. For example, many companies lack the experienced management necessary to grow a company to the next level, thus attracting venture capital. To improve the odds of securing venture funding, entrepreneurs can use the venture package to recruit a management team into advisory board positions. This powerful coalition can then rewrite sections of the venture package together, with the understanding that each member will be assuming full-time jobs once the deal is financed. This tactic has real advantages; in general, venture investors love add-cash-and-stir “instant deals,” where a solid management team has been recruited to the sidelines.

Once the venture package has been refined, tested, and positioned; the word of mouth campaign developed; and the investor market segmented; only then is it time to begin the formal road show. Armed with the valuable knowledge that investors only give you one shot, you should skillfully craft a strategic direct marketing plan to minimize unwanted deal-shopping effects.

### ***The Direct Marketing Plan***

The strategic direct marketing plan for equity is difficult to build, especially for someone without the proper tools. However, if a fundraising budget has been developed, then a wise choice is to invest in powerful database tools (e.g., VentureOne, Lexis-Nexis, and CD-ROM directories like Galante’s). These competitive intelligence tools greatly accelerate the research process while providing unbiased information and keeping your strategy quiet.

In addition, these information power tools can help you quickly sort through the myriad of options for financing your company, ranging from venture capital, marquis customers, strategic partnerships, and joint ventures. Datamining can also uncover invaluable hidden networks. For example, by reverse engineering a venture capital firm’s portfolio of companies, you may find a top executive who wants to take on an advisor position with a promising startup. The first task of that advisor, of course, is to sit in a confidential test-the-waters presentation and *advise* (investing comes later...).

### ***The Investor Presentation***

Ideally, you should gain introductions and qualify investors before starting the word-of-mouth campaign. Since private investing is obviously a *private* affair, group presentations are to be avoided if possible since there is no way to, a) be direct and private, and b) qualify everyone in

the room. After all, there is no faster way to stop a word-of-mouth fundraising campaign dead in its tracks than with a deal that has been power-shopped in one sitting.

Figure 9: Typical Investor Questions

- What do you do better than any other company?
- What else do you have besides technology?
- Who is your real customer? How will they buy it?
- So what, who cares?
- Why can't they live without it?
- What do you have that will enable you to shift gears if the market is a lot different than you plan on?
- Is this a product or a business?
- Can the market support a company that will grow to more than \$100 million in five years?
- What are your unfair sustainable advantages?
- What is your organization's uniqueness? Core competency?
- What do you consider to be your greatest weakness?
- I only have five minutes. Can you please explain your business model in one diagram?

At the presentation, you must arrive well prepared to give the 5-, 15-, or 30-minute versions of your presentation, and have available complete sets of handouts and evidence that the venture package is complete (i.e., the corporate binder). After all, negotiation and due diligence really begin on Day one, and you need to send a strong message that this deal is going to be easier to invest in than the other deals the venture capital firm is preoccupied with.

### ***Negotiations & Due Diligence***

The due diligence phase can last from two weeks to six months or more, depending on many unpredictable factors including, a) how well you and your deal are prepared, b) how motivated the investor is to write checks, c) the nature of the market for the company's product, and d) how many other investors are interested in your deal (e.g., competitors vs. syndicates and partners). You can expect to answer hundreds of questions, ranging from a thorough examination of your character, personal issues, and work history to your financial needs, expectations, and ability to execute the vision (see Figure 9).

### ***Equity Pricing, Valuation & Closing***

As a term sheet is developed, the investor will have been testing you for their "pre-money valuation" figure, or your company's estimated value before investors count the addition of their capital. Entrepreneurs often stumble over this question because, a) they may not have a clue how to respond, b) valuation is highly subjective, and c) their response may have a lasting impact on their ownership and net worth. Nevertheless, you must articulate your perceived market value of the company or suffer the consequences. Again, the successful entrepreneur will leverage ideas from the public markets by using multiple approaches to arrive at a range of figures. What is key here is that you are confident, flexible, and firm where necessary. The goal is to *price* on value but *charge* what the market will bear.

Veteran venture capitalist and author, Bill Davidow, reminds us that prices and market positions are intimately related (Marketing High Technology, *ibid*). Companies should avoid participating

in businesses where corporate positions inhibit them from pricing competitively. A company should have only one goal in setting prices—achieving a commanding position in the market segments it serves. This process is subjective and tricky. A low price (or valuation) may make your company easier to sell initially, but impossible to support or develop future products (or rounds of capital as previous investors experience dilution). A low price may also contradict your company's positioning statement (as a quality deal), creating the wrong impression.

Good pricing sets prices at the highest possible level where the product still represents the best value for the market segments being served, yet enables the company to achieve its market goals. With widgets, the pricing must be high enough to cover the cost of the product, distributor margins, services the customer will demand, and still provide a fair profit. With equity, the pricing must be high enough to motivate management and provide room for selling equity in the future, while maintaining the interest of the investor. Financings are often tiered with scheduled buy-back provisions to provide a means of reconciling valuations when substantial growth is anticipated.

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The key to selling equity to raise venture capital lies in knowing how to skillfully apply the principles of marketing.

Understand that in order to properly execute a marketing plan and sales campaign, you *need a marketing budget*.

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Your job is to not only have a sense of fair pricing of equity, but also know how to negotiate flexible terms that allow both parties to win. After all, professional investors realize they are entering into a long-term relationship and prefer to negotiate directly with the entrepreneur, not their lawyers. Besides, part of the test is knowing whether you are qualified to negotiate solid contracts on behalf of your company and its shareholders.

## 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 venture package that articulates the Wow and the How, while executing a word-of-mouth-relationship 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.

Finally, understand that 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. VCs often budget a seed round up to \$250k for the development of a quality business plan and venture package. Its not uncommon for startups to spend anywhere from \$50k - \$100k to raise their first round of \$1 million or more. While many consultants and intermediaries work for equity, be

sure to check their credentials and that they observe the critical issues revealed herein. You may be getting what you pay for.

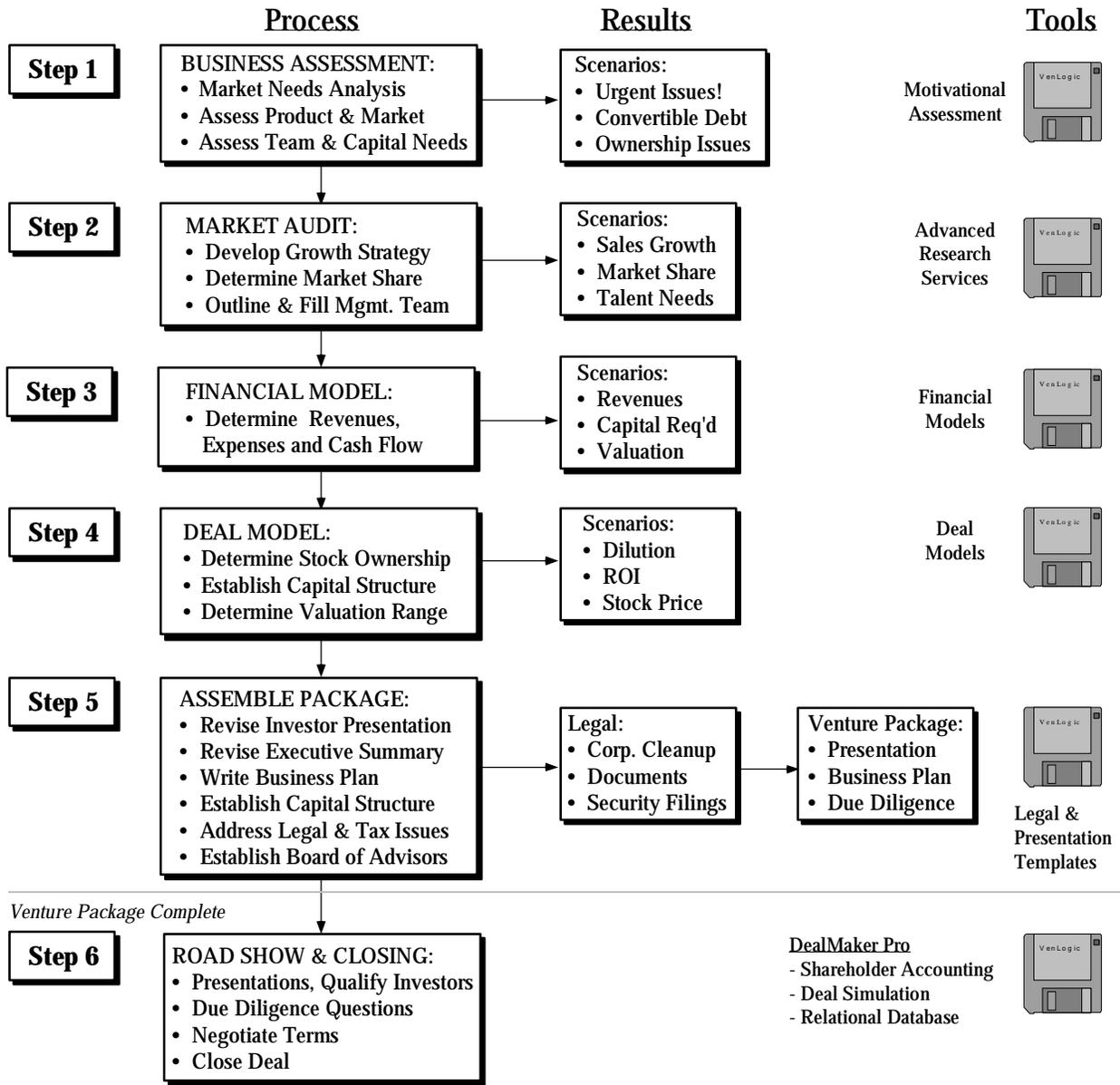
Above all, know what you don't know. Be honest with yourself and know that if you lack the skills to execute the process yourself, use the venture package to attract someone who can. Ultimately, your goal is to sell the venture package. Your *success* is directly proportional to the quality of the venture package and *how* it is sold.

## **VenLogic Venture Packaging Program**

To raise capital quickly and with the greatest valuations, deal marketing to venture capital investors requires specific knowledge tools and resources that must be applied in the proper order. The investor market is unforgiving; failure to observe these unwritten rules can potentially erase the opportunity of a lifetime, while creating significant financial setbacks for your early investors.

Using a proven process, VenLogic guides its clients through a thorough packaging program that exceeds the due diligence guidelines of most professional venture investors (see Figure 10). Even experienced entrepreneurs can expect to develop new skills and learn fundamental strategies from real-world experiences that have cost thousands of dollars and hours to learn and perfect. Best yet, VenLogic can help you learn how to make raising capital more fun and rewarding for everyone involved.

VenLogic's clients are also exposed to advanced software tools that help accelerate the process at every step. Leveraging powerful resources such as IDC Research, DIALOG, and Lexis-Nexis, clients quickly learn how to improve their marketing plans. VenLogic's team of experts describe in detail how comprehensive financial modeling can simulate business models and generate valuation scenarios used to project equity dilution among multiple rounds of investment. Similarly, shareholder accounting tools greatly simplify the critical, mathematically challenging task of projecting investor IRRs and dilution among different classes of stock.



**Figure 10: VenLogic Venture Packaging Program**

Among the most valuable steps of the VenLogic program is a custom-designed test-the-waters program that preserves confidentiality while fine-tuning the package. Here clients practice in front of seasoned executives who have successfully raised venture capital and learn the secrets of how private equity is *really* sold. Clients learn the tips that establish credibility through negotiations and the closing techniques that enable them to draft lasting shareholder agreements with investors to create a win-win for both parties.

For long-term assistance, VenLogic remains available as a company advisor to assist in growing and raising future rounds of financing. Through a relationship of trust, integrity, and expertise, our goal is to add value to companies throughout their lifecycles.

### **About VenLogic**

VenLogic provides Enterprise Planning and Venture Management services for entrepreneurs and investors of early-stage ventures. Venture packaging services focus on opportunity and team building, investment strategy, business model, and road show development. Just as investment bankers help prepare companies to raise public financing, VenLogic prepares companies to raise *private* financing. VenLogic's proprietary venture packaging software focuses on financial modeling, deal simulation, relationship management, fund modeling, and valuation. In this capacity, VenLogic acts as a strategic marketing and sales advisor of private equities.

VenLogic has established strategic partnerships with venture investment organizations and consultants in Seattle, San Francisco, Silicon Valley, Vancouver BC, and Melbourne, Australia to help it fulfill its mission.

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