streetwise: HANSON BRIDGETT MARCUS VLAHOS RUDY LLP

Considering Venture Capital For Your Business?

If you are, then there are a number of things you should know and things you will need to do to prepare yourself. The decision to seek out and bring in venture capital is a decision to sell a part of your company. In all likelihood you will find the buyer to be extremely tough, scrutinizing and savvy. Persuading venture capital to invest in your business means opening the hood, answering hard questions and making difficult decisions. Considering the matters discussed below will help you with this process.

Is Venture Capital Right for You?

Venture capital is not the only source of capital, and isn't always the right source of capital. You and your company may not be ready for venture capital, or it may come at too high a price for a business such as yours. If your business is at the conceptual stage, or has yet to work out all the kinks of your product or service, then venture capital is probably unlikely. Alternatives you might consider include self funding, friends and family, strategic partners and debt. You should consider whether "angel" investors are appropriate as well. As venture capital funds grow larger and larger, fewer of them are focusing on early stage companies. Angel investors often fill this gap. Angels range from individuals to sophisticated groups (e.g., Keiretsu Forum), and can often provide valuable resources and expertise in addition to capital. Whether venture capital is right for you will depend on where your company is in its life cycle, and its prospects for extraordinary success in the eyes of others (i.e., venture capitalists). Before deciding one way or the other on any source of capital, you should at least consider the pros and cons of other sources that may be available as well.

Which Venture Capital Firm is the Best One?

Contrary to what you may be thinking, it's probably not just the one that is willing to write you a check. Just as venture capitalists will do a background check on you before making a decision to invest, you should do the same with them to make sure there is a fit. Consider where they are based and what they have previously invested in. Your industry? Your competitors? Consider what they know and their area of expertise. You might consider contacting individuals working for their portfolio companies to find out how helpful they have been. Have they introduced such portfolio companies to customers, suppliers and/or other venture capitalists? Have they participated in follow-on investments in their portfolio companies, and if the answer is yes, do they have available capital to do so with you? Finally, look at their track record to decide whether this is the firm you want to do business with. If the answer to any of these questions gives you pause, you should probably keep looking.

Get Your Pitch Ready

By this I mean your elevator pitch, your executive summary and your business plan. Your elevator pitch is the thirty-second description of your business. It should describe the pain you address and the relief you provide. It should pique the listener's interest and leave them wanting more. Your executive summary should be seven to ten pages long. Often it is in the form of a PowerPoint, and should describe:

- your company
- your product or service
- what is unique or different about you compared to your competition
- your marketing plan
- your current financial position and prospects
- your management team
- obstacles to your success
- the investment opportunity
- valuation
- exit strategy

Your business plan is the flesh to the bones of your executive summary, and should answer most if not all of the questions from investors who see your executive summary. All of these should be perfect. Typos and errors will indicate carelessness or a lack of attention to detail, and make your audience wonder what else you have been careless about, or what other details you may have missed.

Become Your Greatest Critic

Before going to market, you should explore your weaknesses and try to examine your company from the eyes of an outsider. Ask friends and colleagues to do the same. Be realistic in your review. To say you have no competition means you probably haven't done your homework. Venture capitalists know and accept the fact that revenues for younger companies will not always resemble a hockey stick, even though this is how most entrepreneurs show them on graphs charting their financial projections. Finally, a $10 million pre-money valuation in a Series A round based primarily on sweat equity is a sure way to stifle interest. After completing this review and analysis, you should revise your pitch as necessary.

Get an Introduction

While the website for almost every venture capital firm in existence will tell you how to submit a business plan for review, you will be better served if your business plan reaches someone's desk via an introduction. Ask your contacts, accountants you know, lawyers, bankers and other service providers for an introduction. Ask who they know in the venture capital world and whether they might introduce you. If a venture capitalist you have been introduced to is not interested, ask them to introduce you to one or two others who they think might be interested.

Make Your Pitch

First, review and revise your pitch, again. Your pitch should be perfect. Make sure to practice as much as possible before the

Continued on page five

Continued from page four

real thing so your delivery is smooth and effortless. When giving your pitch, remember less is more and not to get bogged down in the details. There will be opportunities for questions later. Your goal should be to create an interest. Knowing your stuff and showing a passion for your business is the best way to do it.

Get Your House in Order

Venture capitalists invest in entities, not sole proprietorships. Therefore, your business should be a corporate entity that has been properly formed such that investors will be afforded basic yet fundamental protection against liabilities in connection with your business. Your capital structure should be clear cut and properly documented. Your intellectual property rights should be secure, your intellectual property strategy should be clear, and all necessary steps should be taken to protect the information and rights that are critical to the success of your business. Contracts with your customers and suppliers should be in writing, signed, and clearly articulate your rights and obligations. If your business has issues in these or other areas, disclose them fully and as early as possible. Surprises are the quickest way for a deal to sour. While it may be possible to do some of these things on your own to save money, it is not recommended. There are structures and documents that are customary, so to speak, which investors will look for when considering your company. It will not sit well if in one respect or another you vary from what investors are used to seeing, and you may spend more time and money fixing problems than if you had engaged an expert to begin with. Its recommended that you engage a lawyer that works with early stage businesses to handle all of these things for you. Make sure your lawyer knows what investors look for, how to get your deal done and can advise you as far as what to expect throughout this process.

Be Prepared to Pay a Price

As indicated in the first paragraph above, taking on venture capital means selling a piece of your business. With this comes a loss of some control and having to account to others. For instance, venture capital investors will almost always insist on various voting rights and protective provisions that will prevent you from taking certain actions without their pre-approval. Venture capital investors may request or require seats on your board of directors and information rights that will enable them to closely monitor their investment and your progress. Finally, with venture capital funds may also come strong advice as far as how you should run your business. This advice may include suggestions regarding the right persons to fill management positions, and questions as to whether you are the right person for the job.

Conclusion

If venture capital is an option and something you are considering, you should be aware that venture capital comes at a price. How high this price is will depend on how well you prepare yourself and your company, and how much homework you do in advance to know what your options are. The steps and suggestions outlined above are just some of the things you might consider to better your bargaining position and help you with the process.

Scott Smith is a partner with Hanson Bridgett Marcus Vlahos Rudy LLP.
For more information contact Scott Smith at SSmith@hansonbridgett.com or visit www.hansonbridgett.com.