

The Search For Investors

Back in the old West, it was common for a prospector to seek out investors to provide him with the working capital to search for gold. This was the earliest form of venture capital, and was referred to as a "grub stake."

This very fitting term defined the use of the funds to provide the miner with food, or grub, until he could strike it rich to repay his investors.

Every day, modern-day prospectors search for investors to make their dreams come true. The modern entrepreneur, fashioned after rags-to-riches success stories, is not only growing in popularity but also in his sophisticated techniques to attract potential investors.

VENTURE CAPITAL. Most venture capital is raised to finance the start-up of a business. Another popular use is to finance acquisitions, particularly leveraged buyouts.

Before approaching the market, one must decide the best way to take the new venture from the idea stage to a proven, successful company. In many circumstances the alternatives are to start your own company or purchase an existing business and integrate the new ideas or products into an established company.

The advantages to starting your own business include:

- Not inheriting others' problems, stereotypes, and inefficiencies.
- Having the opportunity to form and develop your own team.
- Being able to flex your entrepreneurial muscle and talent.
- Having maximum flexibility.

The advantages to purchasing an existing operation in order to integrate new ideas include:

- An established company has as sets upon which to grow.
- The stream of income can offset research and development costs, thereby reducing the amount of speculative investment.
- Acquisitions are typically easier to finance than start-ups.
- Acquisitions are often financed through debt, which customarily does not include the requirement for equity participation.
- The existing organization affords the new owner the ability to fix problems rather than reinvent the wheel (e.g., hiring management, leasing space, and getting trade credit

established).

- Start-ups tend to be more time consuming than acquisitions.
- Good acquisitions are easier to find, and have a lower failure rate, than start-ups.

Start-ups go through various stages in their life cycles. For each stage there is a different capital requirement and risk level. It is extremely important to understand where the venture fits in this continuum as different levels of funding are required for each stage.

For example, the first stage of a start-up might be likened to an aspiring restaurant entrepreneur testing various recipes in his home kitchen. The cost of the ingredients, the time away from his regular job, and the research required to develop the ideas are examples of the expenditures that are required at this early stage.

The second stage of a start-up would include menu development, conception of a prototype store, and the accompanying business plan.

A company enters the third stage when it has proven its concept in a limited market area. The third stage may continue for some time, until the company has proven its ability to be successful. It then moves away from the start-up stages and should have the ability to generate more permanent non-equity types of funding sources.

WHAT THEY EXPECT. By its very definition, venture capital is a risky business. Professional venture capitalists impose a number of requirements on companies they finance, including:

- **Size.** Can the operation expect to grow to \$15 million or more in annual revenues? Do the projections show a realistic net profit of \$1 million or more within the first five years?
- **Product.** Is the industry segment expanding quickly? Is there a proprietary market for the product or service with minimal competition?
- **Management.** Do you have a real management team in place or available? Is the team strong in marketing, finance, administration, and all the other critical areas involved in delivering the product to market?
- **Planning.** Do you have a current five-year plan, including projections of cash flow and net income with clear assumptions based on reality rather than wishful thinking?
- **Goals.** Do you want to manage a publicly owned company? Are you willing to merge or sell out to a bigger company if you succeed? Are your goals centered on what is good for the company, or are they driven by ego and a false understanding of your own abilities?

Venture capitalists tend to stick to industries they are familiar with from past experience. They do not like lone wolves, no matter how brilliant they are, and they want an organization that is built upon a sound financial plan.

CORRALLING A CAPITALIST. For the would-be entrepreneur seeking to hook a venture capitalist, the dilemma may not lie in finding a good idea but rather in the way the venture capitalist is approached. Some time ago a group of venture capitalists was asked to develop

a list of "rules" for those seeking venture capital. These should prove to be helpful in both developing the business plan and defining the most logical capital source.

- When you play several venture capitalists against one another you create mistrust, show a lack of business sophistication, and turn the venture capitalist off to you and your ideas.
- Don't try to be omnipotent. Most chefs are terrible business managers. Venture capitalists understand this and prefer to see the recognition of the need for a balanced team.
- Show that you will be frugal, and mean it. Venture capitalists want to know that you will be treating their money with the utmost respect. The allocation of funds to the proper resources is an essential ingredient that the venture capitalist will take time to evaluate.
- Keep your ego under control. Venture capitalists want an entrepreneur with the drive to succeed. Your ego must be channeled so that you become an effective leader, not an autocrat.
- Show sincerity and a willingness to invest a significant amount of your worth in the project. One sure way to discourage a venture capitalist from investing is to give him signs of your unwillingness to give the project all your talent, energy, and financial resources.

BUT WHERE TO FIND THEM! Where is the best source for start-up financing? It may lie in several different types of institutional and private investors. It may also be a combination of equity and debt financing. It might include friends, relatives, or strangers. You may have to give up a significant share of the equity of your venture. The following sources should be included on your list when the search begins:

- Privately owned venture capital firms. There are well over 300 venture capital firms specializing in providing venture funding to entrepreneurs. Most have industry focuses and startup level bias. There are several lists of venture capital firms available through public and private sources that outline their investment criteria.
- Investment bankers. Many investment banking firms have established venture capital arms in hopes of grooming promising start-up companies to become larger public operations.
- Government sponsored. Some funding or guarantee programs may allow qualified financial institutions, usually banks, to invest in young companies.
- Insurance companies. Basically, most insurance firms operate very similarly to private venture capital groups; however, they tend to invest in later-stage start-ups or mature organizations.
- Parallel manufacturers. This is a tricky avenue, but if the circumstances are right it can be extremely profitable. By investing in your company and adding your products to their line, a parallel firm gains innovative products and you gain the sales and support necessary for a start-up operation.

- Vendors. This frequent investment avenue has been used in the restaurant industry for years. Vendor-lease programs for equipment are a valuable means of financing both start-up and ongoing operations.
- Investment groups. Doctors, lawyers, executives, cash-rich individuals, and companies often band together to form investment groups. But many participants have a desire to take an active interest in the market, which can often be disruptive to the operation.

Like the grub stake in earlier times, the need for venture capital continues. Today, however, the sources available to the entrepreneur are vast and readily available if the criteria are met.

The bottom line, for both our prospector of old and today's entrepreneur, remains this: A good idea, at the right time, is always financeable.

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