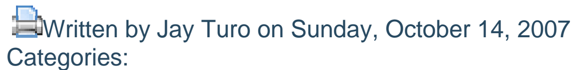
Top Seven Capital-Raising Mistakes

Written by Jay Turo on Sunday, October 14, 2007
Categories:

Financing
Venture Capital

In my experience of working with many managers and entrepreneurs that have had great success in raising capital for their businesses, as well as our experience of working with as many that have struggled, here are some of the key mistakes I see most typically made:

#1. **Vastly underestimate time commitment necessary for fund-raising.** Companies vastly underestimate the time commitment necessary to successfully complete a financing. We recommend that a company seeking financing budget between 500 and 1,000 work-hours to the capital-raising process, spread out over a 6 month time period. The key processes include:

Perfecting the business plan, offering memorandum, and other company due diligence materials;

Developing a comprehensive, targeted prospective investor list;

Contacting this list and responding to investor due diligence requests; and,

Negotiating the transaction.

To see how easily the time adds up, our experience is that only about 25% of prospective investors showing an initial interest in a transaction actually progress to detailed company due diligence. Only about 10% of this 25% actually progress to a bona fide offer of funds, of which only 25% of these actually result in an investment transaction. So completing a financing transaction requires, on average, contacting approximately 160 pre-qualified prospective investors.

#2. **Poor Presentation Skills.** Far too often, investment discussions go astray because of poor oral presentation skills on the part of Company management. Active investors across the risk spectrum (startup equity to secured debt) are literally inundated with investment opportunities. It is not unusual for a principal at a high profile venture capital firm to review dozens of prospective investments every month. As such, it is imperative that your investment presentation be extraordinarily brisk, to the point, and delivered with flair and great enthusiasm. If the key presenters on a management team do not have these skills, then our recommendation is to either invest immediately in professional presentation and public speaking coaching, or to replace company principals with more impressive presenters. It is that important.

#3. **Non-Detailed Use of Funds Statements.** We have spoken with countless companies that get stuck on the simple question, "How much money are you seeking and why?" Our experience is that the most credible and impressive operating executives present sober and credible use of funds forecasts based on multiple funding scenarios. These forecasts are built from "the bottom-up," with specific revenue and costs estimates garnered from the company's historical financials and from forward-looking surveying of vendors, salary bands, property leases, etc.

#4. **Poor Understanding of Cash Flow.** Most operating executives have a relatively strong grasp of the marketing and operational components of their business, but tend to be weak in projecting and communicating the specifics of how they actually make money. And by making money we mean **creating cash.** Before an investor will place cash into a company, they must be convinced that this cash will be transformed into a company infrastructure that will eventually (and sooner rather than later) create much more cash than originally invested. Creating cash requires a rock-solid revenue and cost flow business model. Among others, key variables in the model include customer acquisition costs, pricing and gross margins, accounts receivables aging, realistic administrative costs, and taxation and depreciation. The better that a company understands and communicates these cash flow variables, the stronger and more credible will be the investment offering.

#5. **Targeting the Wrong Investor Audience.** We have seen countless companies waste precious time and money contacting unqualified and inappropriate prospective investors. Before an investment offering is undertaken, a comprehensive prospective investor list must be created, and all of the investors on that must be qualified as to track record of investing in financing stages (private, public, equity, subordinated debt, senior debt, etc.) and market

sectors similar to the company in question. While there are always exceptions, contacting prospective investors that have not recently invested in a company "like yours" is, in our experience, almost invariably a losing proposition.

#6. **Accepting Too Much Feedback.** Capital-raising is a long and arduous process. As discussed in bullet #1, the vast majority of investment presentations made will result in some form of rejection. But in addition to rejection, the company will also receive - either solicited or unsolicited - advice and feedback on the "flaws" of their business. While this feedback is sometimes valuable, it is **critical** to very carefully filter and evaluate this feedback before revising the business plan and presentation. By the time an investment offering is circulated, company management should be extraordinarily convinced and committed as to the validity and solidity of its plan. Be sure to measure all feedback, no matter how well-intentioned, against this conviction and commitment.

#7. **Going It Alone.** Raising money is one of the most, if not the most, challenging undertaking an organization will **ever** make. The pitfalls and hazards are everywhere, and the consequences of failure are devastating. Capital is the fuel that drives business. And without fuel, your venture will sputter along, then stop, and most likely be eventually abandoned. With the consequences of failure so dire and the challenge so great, it only makes sense to seek out the absolute best professional assistance to maximize the probability of financing success. A quality investment banker, ***specifically skilled in equity and debt placements,*** is one of the most important advisory relationships a company can establish. While law and accounting relationships are extraordinarily valuable, they are, in essence, cost centers for a business. A quality investment banking firm, in contrast, is the ultimate revenue center -- vastly increasing the likelihood of financing success and taking the vast majority of its compensation on a contingent basis. The key, of course, is to find an investment banker of true quality. Unfortunately, there are a lot of unscrupulous individuals and firms offering capital-raising advisory assistance. Our recommendation is to always check references and also make sure that the individual or firm is properly licensed with the NASD and the SEC. A transaction participated in by an unlicensed firm can subject all individuals and firms party to the transaction to significant fines and sanctions.