Finding Early Stage Funding in 2009?

By
Glenn P. Cato and Wayne Millsap

Most entrepreneurs find raising seed or early stage angel funding a daunting process; particularly post-2000, when the landscape was littered with internet, telecommunications and other high-tech companies unable to raise initial or secondary rounds of financing. The economic meltdown of 2008 and 2009 has only exacerbated an already difficult process. The Angel Capital Association ("ACA") released a report in early 2009 suggesting the level of angel investments declined in 2008 by 10% and expects a similar result in 2009. Survey data from the ACA Angel Group Confidence Report was collected in November 2008. About two-thirds of all members participated in the survey. Based upon their responses, the average size of the group investment per deal in 2008 ($280,936) is about 6% larger than 2007, but the average number of investments per group declined by 16%.

The Center for Venture Research ("CVR") at the University of New Hampshire had been researching the angel investment market since 1980 and reported, "The angel investor market in 2008 had a considerable contraction in investment dollars from 2007, but exhibited little change in the number of investments. Total investments in 2008 were $19.2 billion, a decrease of 26.2% over 2007. However, a total of 55,480 entrepreneurial ventures received angel funding in 2008, a modest 2.9% decrease from 2007." Additionally, the CVR reported the number of angel investors remained flat at 260,500 individuals.

According to the CVR, Healthcare Services/Medical Devices and Equipment accounted for the largest share of investments with 16% followed by Software 13%, Retail 12%, Biotech 11%, Industrial/Energy 8% and Media 7%. Seven out of ten deals relied upon a merger or acquisition as the exit strategy for angels. Initial Public Offerings accounted for only 4% of all exits in 2008.

Angels are still the primary source for seed stage capital, according to CVR, accounting for 45% of all angel investments.

The fund raising process is difficult, complex and time consuming. Entrepreneurs expecting to raise angel funding for their start-up and early stage companies must devote adequate time for preparation and actively network with individuals who can provide introductions to potential angel investors. Here are 10 tips to raise the probability for a successful fundraising effort.

1. ***Chemistry***. The chemistry between an entrepreneur and the angel investor cannot be overstated. It is vital to the success of the start-up to have angel investors who share a similar vision and passion as the entrepreneur. The relationship forged between the entrepreneur and investors will determine the future direction of the company. Entrepreneurs will find post funding much easier if they take the time to perform due diligence on potential investors.

2. ***Expect More than Money***. In cash strapped start-up companies, entrepreneurs are tempted to value angel investors for only the capital they bring to a transaction. Angel investors can bring much more, such as business advice from one who has

been there, industry contacts that are vital for a company trying to raise awareness of their idea or product and initial credibility for the venture.

3. ***Network, Network, Network***. The old real estate adage of "Location, Location, and Location" is also applicable to networking. Most individual angel investors intentionally seek a low profile to avoid a constant flow of presentations that come at unwanted times or do not match their particular interest. The best way to approach an individual angel investor is through an introduction made by a business professional. Based upon the average angel investment in a transaction, an entrepreneur attempting to raise $1million will likely need 10 and 20 individual angel investors and will actually make his/her presentation 5X to 10X the number that actually invest. In this example, a presentation to as many as 200 potential investors may be required in order to find 20 willing investors. Most of these presentations are made to one or two people, which equates to a significant networking effort.

4. ***Corporate Angel Groups***. Organized angel groups, called "Corporate Angels", provide a forum to present to a large audience of investors, often at breakfast or dinner meetings. Although these groups offer an opportunity to reduce the number of overall presentations, some of these meetings are nothing more than social gatherings or networking opportunities for service providers and rarely result in a funding event for the entrepreneur. Entrepreneurs should find out how active the organized group has been by asking questions about the number of deals funded and the total dollar amount invested by the organized group's membership in the last 12 months.

5. ***Compelling Story***. An entrepreneur must be able to make a strong case for why their product or service will gain market or customer acceptance. Investor confidence in the entrepreneur's thorough understanding of the market is very important to the investing decision. The entrepreneur must be able to identify the problem and articulate why their approach is either unique or superior to other solutions. If you are far enough into the development cycle to have a working prototype, your chances of a successful fundraising effort are improved.

6. ***Elevator Pitch***. Active angel investors may see 50 to 100 business plans annually. An entrepreneur must be concise, yet build a convincing case. Thoughtful entrepreneurs will identify key areas of interest to an investor on a single sheet of paper. Interested investors will seek more information from the entrepreneur, resulting in a more effective and efficient process for both. CFO Advisory Services developed a one-page Executive Summary template for its clients, which has proven successful in motivating interest among angel investors and venture capitalists.

7. ***Effective and Thorough Business Plan***. Business Plans are typically 20 to 40 pages in length and cover the topics of interest to investors. The avalanche of Plans an angel may review over the course of a year makes it imperative that you "hook them immediately." The first few sentences should captivate the reader and motivate him/her to spend their time reading more of the Plan. A good business plan will expand on the topics contained in the elevator pitch and add topics that show the depth and breadth of an entrepreneur's understanding of the problem and their unique solution. Other important topics include:

    - market size
    - product roadmap
    - competitive landscape
    - management team

- reasonable and believable financial projections, including the potential for a solid return on invested capital
- key performance metrics, such as milestones and the timing to reach market
- exit strategy

8. ***Investor Presentation**.* Entrepreneurs will usually have between 30 and 45 minutes to make the presentation, which includes time at the end for questions and answers, ("Q & A"). A good presentation is brief, no longer than 12 to 15 slides with prepared comments ranging 15 to 20 minutes. The balance of the time should be set aside for Q & A. Our firm typically advises clients to use the elevator pitch as a guide to developing their presentation. The elevator pitch helps in the organization of the presentation and covers the main topics that will motivate a potential investor to make further inquires.

9. ***Management Team**.* Angels typically take a minority position and are completely dependent upon the management team to execute the business strategy in order to achieve a return on invested capital. Angels are investing in management and need assurance the team is comprised of experienced leaders who are competent and trustworthy. A successful record of accomplishment within the industry gives credibility to a start-up company and improves chances for attracting capital.

10. ***Exit Strategy**.* It is difficult for an entrepreneur to think about exit strategies when he/she is living day to day in need of cash to move from an idea stage to a tangible product. In addition, an entrepreneur's passion and intent to solve a problem further complicates the thought of an exit strategy. While investors may share your passion for solving a problem, they also want to know how and when they can expect a liquidity event. Serial angels will take investment returns from your opportunity and eventually find a new deal. Thus, an entrepreneur needs to be prepared to discuss the potential exit strategies that exist for the venture.

For a seed round of capital, most entrepreneurs will find their own savings and/or investments from friends and family as the most likely source. As the start-up develops a working prototype and gains initial customer validation, more angels will be attracted to the investment opportunity. Once you begin seeking angel capital, entrepreneurs should expect a minimum of six months.

These are just a few tips that entrepreneurs need to consider as they embark on a fundraising effort. If we can be of service, please contact us at gcato@cfo-advisory.com or wmillsap@cfo-advisory.com.

* * * * * * * * * *

***CFO Advisory Services** provides strategic financial guidance by serving as a fractional CFO for early stage and middle market companies. CFO Advisory works as part of the management team, without the full-time overhead of a CFO. This frees a CEO from tending to non-core tasks and encourages focus on core objectives. The Firm's experience and knowledge creates a "Just in Time" approach that builds an appropriate infrastructure in support of the business plan, maximizes cash flow and maintains the integrity of meeting milestones. CFO Advisory also provides business valuation services that assist its clients in executing growth or exit strategies.*

Glenn and Wayne have worked with numerous early-stage/start-up company CEO's to development business plans and operational strategies; implement capital formation plans with equity and debt financing; establish and manage the accounting finance and reporting functions; assist in building the team and develop the HR functions; and working with entrepreneurs to manage the growth of their company through monitoring the plan and managing cash flow.