Raising Capital: Practical Tips for Entrepreneurs

Stephen Fleming
Chief Commercialization Officer
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• 10+ years investment experience.
  – General Partner, Alliance Technology Ventures.
  – 18 investments as lead investor, 15 exits to date.
• BS, Physics, Ga. Tech *(Highest Honors).*
• 15 years operational experience at AT&T Bell Labs, Nortel, Lïcom *(venture-backed startup).*
  – Supervised startups developing first ADSL modem and one of the first cablemodems in early 1990s.
• Multiple advisory boards at Georgia Tech; endowed chair in telecomm; occasional instructor in MBA entrepreneurship program.
• Strong regional technology leader.
Financing a Startup

Options:

• The hard way.
• The other hard way.
• The very narrow way.
• The really hard way.
Options:

- The hard way.
- The other hard way.
- The very narrow...
- The really hard way.

Venture capital consists of purchasing equity in startup businesses.
Debt

The Good News
• Other people’s money!
• No loss of ownership.

The Bad News
• Debt service:
  Lenders want a little bit back every month.
  – Often a bad match for startup’s cash flow.
  – Only willing to lend when you don’t need it!
• Lenders care about repayment, not about the success of your business.
The Good News

• No monthly payments.
• Goals of investors are fully aligned with founders:
  – Company success
  – Capital gains
• Large dollar volume available.
• Long time horizon.

The Bad News

• Loss of ownership.
  – Eventual loss of control.
• Founder now reports to Board of Directors.
  – Emotional issue for many founders.
• Focus on exit strategy.
  – Equity investors expect sale, merger, or IPO.
Government Grants

The Good News

- No monthly payments.
- No loss of ownership.
- Variety of sources
  - SBIR
  - STTR
  - ATP
  - others
- Friendly to early-stage businesses.

The Bad News

- Highly competitive.
- Only available for technologies already of interest to certain agencies.
  - Incremental, not revolutionary improvements.
- Limited to amounts typically < $1M.
- Can become a “hamster wheel.”
Bootstrapping

The Good News
• No monthly payments.
• No loss of ownership.
• No covenants.
• “The American Way.”

The Bad News
• Threatens domestic tranquillity.
• Difficult to make large capital commitments.
• Hard to recruit top-notch talent.
• Risk of losing strategic focus by chasing tactical opportunities.
The Venture Equity Cycle

Institutional Investor → Venture Capital Firm → Equity → Entrepreneur → Liquidity Event (Sale or IPO) → Capital Gains → Carried Interest
Pick Investors Carefully!

- Location
- Preferred stage
- Industry target(s)
- Deal size
- Track record
- Potential synergies
- Chemistry

Raising money takes longer than you expect. Don’t waste time chasing the wrong investors.
After the “Bubble”

Venture capital investments in the Southeast

Source: PWC MoneyTree
## Logarithmic Financing

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<th>$1x$</th>
<th>$\text{Amount}$</th>
<th>Mechanism</th>
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<td>10,000</td>
<td>Visa card</td>
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<td>Equity</td>
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<tr>
<td>$10^8$</td>
<td>100,000,000$+</td>
<td>Corporate bonds</td>
<td>Debt</td>
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Back to pre-Bubble positions... but limited availability of funds.
Lessons from Silicon Valley

What are the key value drivers of a successful startup?

• Large, fast-growing market segment
• Unique technology advantage
• Experienced management team
• Reasonable financial terms
• Measurable milestones for success
Key Value Drivers (1)

Large, fast-growing market segment

– If it’s not a large market ($500M/year), you won’t build a large company.
– If it’s not fast-growing (30%/year), you’ll face entrenched competition.
– *Segmentation Errors*: 2% of a billion-dollar market is not a $20M/year company! It’s a failure waiting to happen.
Key Value Drivers (2)

- Large, fast-growing market segment

  Unique technology advantage

  - Create barriers to entry for your competition.
  
  - Startups based on services (consulting, integration, training) don’t clear this hurdle.
  
  - There’s a difference between a profitable business and a venture-fundable business!
Key Value Drivers (3)

• Large, fast-growing market segment
• Unique technology advantage

Experienced management team
– Classic “Catch-22” in the Southeast.
– Highlight your successes & flexibility.
– Be willing to accept “carpetbagger” leadership from outside the region if necessary as the company evolves.
Key Value Drivers (4)

• Large, fast-growing market segment
• Unique technology advantage
• Experienced management team

Reasonable financial terms

– Don’t be shortsighted. The VC wants you to get rich, just as much as you do.
– Think ahead, before you clutter your capital structure with 14 orthodontists!
Key Value Drivers (5)

- Large, fast-growing market segment
- Unique technology advantage
- Experienced management team
- Reasonable financial structure

Measurable milestones for success

- Companies fail for all sorts of reasons. Identify problems early, and have action plans in place ahead of time!
Value Drivers — Summary

- Large, fast-growing market segment
- Unique technology advantage
- Experienced management team
- Reasonable financial terms
- Measurable milestones for success

It’s hard enough to succeed when you have these! Without them, most venture investors won’t play.
Other Attractive Elements

- Multiple potential exit scenarios.
  - Not every company needs an IPO!
- Ability to syndicate with other venture investors.
- Synergy with existing portfolio.
- Ability of General Partner(s) to add substantial value.
  - Industry experience, contacts, etc.
Contacting a VC Investor

- Most venture investors review hundreds of business plans per year.

- Make yours stand out:
  - Clearly explain unique technology, target market, and planned management team.
  - If you haven’t done your homework, the VC will not do it for you!
  - Ruthlessly cut excessive details (or put them in an appendix). Time enough for those later.
  - Spelling counts!
The goal of a written submission is to set up a face-to-face meeting.

- 1 out of 10 plans get to a meeting.
- 1 out of 10 meetings results in an investment.

Use any available intermediary (banker, lawyer, accountant...) to give your plan added credibility.
The Seven Deadly Sins of Business Plans

- Insist on a nondisclosure agreement up front.
- Focus on the technology—not the market, the competition, and the customers.
- Practice top-down sales forecasting.
  - “2% of a billion-dollar market...”
- Use four significant digits everywhere.
Seven Deadly Sins (cont.)

- Position investors as necessary-but-unpleasant “mushrooms.”
- Fill your plan with typos, errors, chartjunk, and repetition.
- Expect to be acquired by Cisco.

The basics aren’t difficult. Get them right, and you’re already miles ahead.
You Got a Meeting!

- Congratulations!
- Do more homework on the person.
- Understand how you fit his or her:
  - Existing portfolio
  - Stage of fund
  - Internal industry model
- An investor pitch is not the same as a customer sales pitch!
  - Sell your company—not your product!
Getting the Term Sheet

• Again, congratulations!
• Full disclosure on both sides.
• Don’t expect to negotiate every item... pick your battles.
• Make sure you understand everything in the term sheet!
  – Term sheets exist for a reason
  – Negotiating after document prep gets very expensive!
Falling into Valuation Gap

- Don’t value yourself compared to Amazon.com, or Ciena, or Yahoo!
- Remember that lots of good startups fail—your valuation reflects that.
- Be creative with terms for upside.
  - Performance hurdles, redemption, buyback, etc.

Take the money.
After the Deal

• Now for the fun part!
• You have new bosses (the board).
• They want to turn equity into cash someday.
• They will forgive almost anything...  
  – Except being lied to!

**Over-communicate, under-promise, and over-deliver.**
Maalox Systems, Inc.

- Raised multiple rounds of professional venture capital (over $20M invested).
- Ran into a market buzzsaw.
  - Staffed up to meet customer demand.
  - Customer turmoil meant zero sales.
  - Burn rate killed them.
- Sold to a competitor for pennies on the dollar.
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TulipsOnline.com

- Initial business model based on Internet subscription revenue.
- Switched to advertising-based model, brought in new management.
- Went public at height of Internet hysteria.
  - Sustained a market cap in excess of $1 billion for several months.
  - Now trading 90% off its high.
  - Layoffs, underwater options, etc., etc.
Timing is everything!
Whistling Dixie Corp.

• Concentrated on proprietary technology.
• Got an initial customer commitment.
  – Demonstration led to field trial.
• Management realistically assessed capital requirements to take product through development.
  – When an acquiror called, they listened.
• Sold for 30x return on investment.
  – Founder is now living on a sailboat in the British Virgin Islands!
Tortoise Technologies, Inc.

- Technology transfer from university.
- Very tight focus on one particular piece of intellectual property.
  - Almost all employees were Masters/PhD level with industry experience.
  - Relied on corporate partnerships to handle manufacturing, sales, and marketing.
- Went public with top-notch bankers based on expected royalty streams.
- “Slow and steady wins the race.”
IPO market is (cautiously) back.
- 2002 was the bottom of the trough.
- Google helped.

Return to traditional metrics for IPO: consistent profitability and growth.
- Deals no longer turning in 18 months!

**Structural problem**: Sarbanes-Oxley is powerful disincentive.

We won’t see 1997–2000 again.
Technology in Southeast

Multiple technology centers.

Anchored by:
- Atlanta,
- Research Triangle,
- Florida.

Pockets of innovation:
- Universities,
- Federal R&D centers.

Biggest challenge: Lack of local venture capital.
Attractive Targets in SE

- Local startups have demonstrated consistent potential to attract investment dollars.

Source: MoneyTree Survey, 1998-2003
Regional Capitalization

- Local venture firms do not offer adequate leverage for local R&D.

Substantial room for improvement!

Source: Venture Economics and the Center for R&D
VC in Southeast: Funds

- Most early-stage funds are dormant or dead.
  - Many firms have shut down entirely.
  - Former early-stage leaders have shifted focus to later-stage deals.
  - Remaining early-stage players are spending disproportionate time on existing portfolio, not new deals.

The worst is behind us... but the worst was pretty darn bad.
Stages of VC Investment

- Early-stage investors are the last to recover from the Bubble... later-stages predominate

Source: MoneyTree Survey
VC in Southeast: Angels

• Angel investors have headed for the hills.
  – As individuals, they simply lost too much money in the Bubble.
  – Shifting resources to other classes of investment (real estate, etc.).

• Remaining angel groups/clubs are protecting previous investments.

NASDAQ 2003-05 helped... but still “once bitten, twice shy.”
The Carpetbagger Problem

• Less than 10% of the money invested in Georgia is managed in Georgia

• *Item 1:* Out-of-town investors have a natural tendency to want companies located closer to home

• *Item 2:* It’s easy to move a startup

*Result:* Top-quality Georgia startups can attract out-of-town venture capital, but the companies get relocated out of state!

  – *Recent examples:* Texas, California, New Jersey...
What To Do Now?

• Is the glass half-full or half-empty?
• The Southeast remains an economic powerhouse.
  – Universities.
  – Government institutions.
  – Fortune 500 HQs and operations.
  – Entrepreneurial startups.

Still an attractive region — *but* lacking local risk capital.
Earliest Money Is Hardest

• Venture investors damaged by Bubble are putting more money into “proven” ventures
  – Series B or later equity rounds
• Nationwide shortage of seed-stage investors
  – Even more acute in Georgia
  – No thriving ecosystem (yet) of investors and entrepreneurs...

Impact on Georgia Tech:
  – Some ventures start, but go broke fast
  – Other never get started at all
Innovation at Georgia Tech

- Taking the Institute’s knowledge and invention, and...
- ...transferring the technology...
- ...to support enterprise partners.
VentureLab

• Founded Sept 2001 — a model for other universities
  – Faculty-focused process
  – Risk identification and mitigation for venture-backable innovations

• Money
  – Pre-seed funding available through the Georgia Research Alliance
  – Access to wide network of professional venture firms

• Management
  – Matching opportunities with skilled and experienced managers

Goal: Successful startup companies based on Georgia Tech research
VentureLab Results (12/31/2005)

  - Over 300 technologies examined since inception.
  - Over 60 patents issued or pending.

- Ten companies have completed program and have raised $42M to date.
  - 4 GRA Eminent Scholars, 40+ faculty involved.

- 9 products being marketed today.
  - Multiple customer relationships/alliances
  - Intel, Dell, Agilent, DOD, Boeing, Merck, etc.

- 39 projects/business opportunities currently under evaluation.
VentureLab Projects  (12/31/2005)

Active Optical Interconnects
Ajeetco
Auraryd
Avian Flu Sensor
Aware Home
AXONA Peripheral Neuropathy
BionTTech
C2 Biofuels
Carbon Nanotubes PV Cell
Cognitive Radio
Crossing Point Technologies
Damballa
DETECT / ImmersiTech
Digital Camera Disabling Technology
Eagle Eye Networks
Energy Watch
FPMicro
Gold Nanoparticles
Guided Systems Technologies
Innovolt
Lumoflex
Magellus
MedShape
MEMS High Frequency Oscillators
MEMS Inertial Sensors
Miniature Optical Interferometer
Minimally Invasive Aortic Valve Treatment
Molecular Imaging
Nano Contrast Agent
Plasma Torch
Plum Combustion
PSiSense
SIPWorx
Synedria Meeting Capture System
Urban Transportation Network
Verco
Virtual Aerosurface Technologies
Weather Futures
Georgia Research Alliance

- Recruiting Eminent Scholars from all over the world to Georgia
  - 50 teams so far...

- Investing in university capital equipment
  - Over $600 million in last 15 years

- Innovation grant program
  - Phase 1: up to $50K to university R&D
  - Phase 2: up to $100K (must be matched)
  - Phase 3: up to $250K loan (must be repaid)
Advanced Technology Development Center

- Consulting
- Connections
- Community
- Credibility
- Centre

GTRC

Commercialization Services

- Start-up
- Licensing
- Consulting

Faculty
Research Staff
Graduate Students

ATDC (optional)

Sustainable VC-backed Venture

Emtech Bio (optional)

Value-added Licensable Technology

Corporate Partners

Office of Technology Licensing

Evaluation

Terms
Ga. SBIR Assistance

- Small business R&D funding available from eleven Federal agencies
  - NASA, DOD, DOE, NIH, EPA, etc.
- Grants, not loans or equity!
- For help with SBIR and STTR process, visit <http://www.sbir-georgia.org>.
- Up to $850K available across two phases of development
For Further Information

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