



## Knowing Your Investor Who They are and What They Want to Hear

---



**By Jim Butz**

In 2006, the US Small Business Administration (SBA) estimated about 650,000 new businesses were created. But just a fraction of those were supported by financial backers. Angels invested in 51,000 new businesses while Venture Capitalists made about 1,170 early stage investments. That means only eight percent received Angel or VC funding. While it's safe to assume that not all of the startups looked for funding, it's clear that the competition for backing is significant.

You might have a great idea for a new business, but to really get it off the ground you may decide that you're going to need some financial help. Essentially you now become a salesperson and the potential investor is your customer. And as any successful salesperson will tell you, it's wise to get to know your customers. If you're thinking about seeking investment, find out everything you can about your potential investors and what's important to them.

While there are many investment sources, this article focuses on Angels (usually privately wealthy benefactors, friends or family) and Venture Capitalists (corporations whose business is to identify and invest in startups). If you decide to look at other alternatives beyond friends and family — such as banks, the government or corporate strategic investors, you'll go through the same process.

When talking with investors, keep in mind, that they're always listening for "WIFM" (What's in it For Me). They want to hear facts, figures and strategies from entrepreneurs who signal mega potential — that means deals they believe will produce five to ten times return on their investment in three to five years. Investors hope that, every so often, one deal explodes and returns 30 times return or higher — think the next YouTube. Knowing what money they invest and how they get paid will help you understand some of the questions and processes each use.

### **Angel or VC?**

Depending on how much funding your idea requires will largely determine what type of investor you need. Angels do investments up to about \$1.5 million, while VCs, on the other hand, usually start at about \$5

million. So, if your needs are between \$2 and \$4 million, you are starting out in trouble. You should either think about how to start with less funding or pumping up the opportunity to justify an investment of \$5 million or more.

## **How Investments and Payments Differ**

Generally, Angels are high net worth individuals and successful business people who invest their own money. Most have put aside assets for early stage investments. According to a June 2007 Wall Street Journal article, "How the Rich Invest," people with a net worth of greater than \$20 million, invest about 39 percent of that in startups. So, even though the total amount of funds may seem substantial, they are somewhat fixed and, once funds are placed, have to be returned before new investments can be made. These funds, plus any profits, are available for other investments.

Unlike Angels, Venture Capitalists invest other people's money acquired when they put their fund together. Although they receive a small management fee, they make their real money on so-called Carried Interest.

The best way to describe Carried Interest is by example. Let's say that a VC makes a \$5 million investment in a startup which, at the time of liquidity event, or exit, brings a \$50 million return. The VCs return \$5 million to the fund itself and then split the remaining \$45 million (Carried Interest) between themselves and their Limited Partners based on the terms of the fund. If the terms were 70/30, then the VCs would get 30 percent (or \$13.5 million) and the Limited Partners would get the remaining \$31.5 million. This should give you an idea why VCs are very interested in hearing about Exit Strategies.

The two positive exits are merger/acquisition (M&A) and Initial Public Offering (IPO). VCs used to look for companies that could generate sufficient revenues to justify an IPO. However, restrictions associated with Sarbanes-Oxley have companies rethinking this type of exit. Guy Kawasaki, of Garage Technology Ventures uses the 400-90-10 rule. This states that every year about 400 VC-backed companies have an exit — 90 percent via M&A while 10 percent are through IPO.

For M&A, you should research at what price similar companies in your industry were acquired and the basis for that price. Usually it is some multiple of sales or operating income.

## **A Common Problem Investors Hear**

Many times I listen to presentations (pitches) by entrepreneurs where the financial projections are very low considering the overall opportunity. When I question them, presenters admit that they either decided to use — or were coached to use — conservative numbers. A deathnell to an experienced investor.

Early stage investors know that startups are risky. They know that some number of them will outright fail, others will survive but not produce the desired results, and then there will be the winners who provide the five to ten times or maybe even the grand slam 30 times returns. Does this sound like someone who wants to hear conservative information?

Now, this doesn't mean that you should make ridiculous projections describing numbers and results that

don't make sense based on the realities of your market. You are best off presenting a realistic vision of what you believe you can do if you get the money and any support you are requesting.

I mention support because you should be thinking about raising "smart money." This is when you get coaching, introductions to higher level investors or other help along with the funding. When talking with investors, especially Angels, you should ask about their network.

## Tips to Keep in Mind when Talking to VCs

There are a number of people involved with each fund. You find titles like Managing Partner, Managing Director, Venture Partner and Associate, among others. When talking to someone in a venture firm, it is important to understand the position they hold.

- [Managing Partners or Directors usually are the ones who decide which deals actually get funded.](#)
- [Venture Partners find and "mind" deals, provide coaching and direction to the startup.](#)
- [Entry-level Associates do the leg work. They research to determine how target market sizing and competition estimates stack up.](#)

Often, I hear entrepreneurs thinking that VCs are arrogant or lack focus because they stop paying attention to them when trying to explain their opportunity. Well, if that's happened to you, it might be because in your presentation you said something that got the VC to mentally come to a "no."

Here's the problem from the VCs perspective; an active VC firm gets several thousand opportunities (business plans, phone calls, and referrals) thrown at them each year. They deem around 100 worthy of taking a closer look and then do due diligence on about 10 and maybe invest in one.

Because of the large volume of deals, each VC has their own process for paring down to the precious few. It focuses on getting to "no" as quickly as possible.

## Potential Restriction within a Firm

Most firms have restrictions on the number of companies each partner can manage in their portfolio at one time. Partners are continuously involved with portfolio companies and they need to ensure that they have adequate time to allocate to them. It is usually somewhere between five and eight companies. So, if you run into a firm that has six partners, you can expect that they can manage relationships with approximately 30 to 48 portfolio companies — although the math is never that clean since partners also specialize in various areas like life sciences, Internet companies, wireless or enterprise software. So, if your business is enterprise software and the partner you are talking to already has a full plate, he or she might not be able to take on another investment until one of the portfolio companies has an exit.

## Remember WIFM when Talking with VCs

When you finally get a chance to talk (pitch) to a VC, remember they are listening for the WIFM — they want to hear a crisp description of six key points:

1. What is the business opportunity you're offering?
2. How big is the market?
3. What pain are you solving?
4. How much money do you need and how will you spend it?
5. How long you need the investment?
6. What is the projected payout to the VC on your exit?

If you start the conversation talking about why you created the product or too much about the technology before you get to your business model, the VC's filtering process kicks in. They get to "no" and stop listening.

## Finding Investors

Here are some ways you can learn about Investors and do a better job of preparing for conversations with them:

- Find out about Angel Groups by visiting the Angel Capital Association site at <http://www.angelcapitalassociation.org>. The directory provides a list by region.
- Look for Angel Groups in your area and contact them to find out about the organization's process and if guests are invited to entrepreneur presentations.
- Try to talk to some investor members and find out about the types of investments they make, the average investment size and other members. Ask them about the last few investments they made.
- Find out about investment timing — not just the average time but the longest time.
- Check out their website. Most firms' websites describe their philosophy, specializations, partner bios, and even list portfolio companies. Looking at their portfolio companies, try to have coffee with one of the CEOs to get his or her perspective on the VC firm.
- Manage your expectations. Entrepreneurs are more optimistic about the funding than is the Investor.
- Most VCs admit that the best way to get their attention is to be introduced by someone they know and trust.

## VC Bloggers (IMAGE)

Another shortcut to learn about the venture community and some specific VCs is to begin following VC blogs. You may be surprised to learn that there are a number of VCs who actively blog and write about their funds and strategies on a regular basis. Most are Managing Directors or other senior level members of their firms. If you know about blogs, then you know that most bloggers provide a list of who they follow and read on a regular basis. It makes sense that VCs follow other VCs and it's a great way to learn about their networks. See the table below for a few to get you started.

<b>Weblog</b>	<b>Author</b>	<b>Company</b>
<a href="#">A VC</a>	Fred Wilson	Union Square Ventures
<a href="#">Beyond VC</a>	Ed Sim	Dawntreader Ventures
<a href="#">Colorado Startups</a>	David Cohen	Colorado Startups
<a href="#">Deep Green Crystals</a>	Martin Tobias	Ignition Partners
<a href="#">Feld Thoughts</a>	Brad Feld	The Foundery
<a href="#">How To Change the World</a>	Guy Kawasaki	Garage Technology Ventures
<a href="#">Software Only</a>	Jeff Clavier	Softech VC
<a href="#">Will Price</a>	Will Price	Hummer Winblad

One last place with information on mainly VCs but include some Angel groups is at [www.thefunded.com](http://www.thefunded.com), a Web community of entrepreneurs who rant about their VC experiences. You can only join if you are an entrepreneur and investors are not accepted. Since it is a rant and rave site, you have to factor this into your own thoughts, but it might raise a flag in your due diligence.

Get to know your investors, and they might just want to get to know you and learn about your ideas.



**About the Author:** After a Fortune 50 Telecom/High Tech career, Jim Butz founded Resonnect where he has provided “Gray Hair” perspectives to numerous startup companies. He is also a member of the Southern California Chapter of Keiretsu Forum Angel group and a Venture Partner with California Capital Partners, a venture debt fund. Jim also has a blog on Southern California business issues at <http://socialbuzz.wordpress.com>.