CHAPTER ONE

Introduction

The greatest challenge for entrepreneurs in starting and growing a company remains simply *money.* Though easy to state, financing your venture is a time-consuming, complicated, inefficient, and frustrating process. Entrepreneurs have often compared it to Winston Churchill's line, "A riddle inside a mystery wrapped in an enigma." This book attempts to provide you with information, guidelines, and resources to take the mystery out of the process. Don't be fooled, however. Raising capital is hard work and you must be well-prepared for every opportunity to pitch your company, either planned or unplanned. Remember the age-old adage: You can only make a good first impression once. It is infinitely true in raising capital.

Traditional funding sources—angels, venture capitalists, commercial banks—have a plethora of investment and funding opportunities. Your ability or inability to clearly and succinctly communicate your market focus and financial projections can make the difference between bringing your dream to life and shelving your brilliant idea. Therefore, preparation is key. This book will help you understand how angel investors think, how to identify their expectations, understand their investment analysis process, and prepare for post-investment requirements.

Just as no two people are alike, no two angels or angel groups will have the same hot buttons or demands. Through this book, you will gain a broad understanding of angels and angel investing. Be mindful that angel investors have varying degrees of sophistication and experience. The book will prepare you to deal with the most knowledgeable angels. Even with experienced angels, preferences on investment terms, depth of due diligence, and post-investment involvement will vary. Therefore, you will learn about multiple scenarios to minimize surprises you may encounter in your dealings with angel investors.

You can use this book as a reference guide for understanding and preparing yourself and your company for the mysteries of angel fundraising. If there is only one message you take away, it must be this: *passion*—every successful entrepreneur has passion. Investors look for passion in entrepreneurs; the willingness to take risks with life savings, to work nights and weekends, to see their idea become reality. It has to be more than excitement. So never lose the passion for your company, and show it each time you speak about your dream.

You also need to understand that professional angel investors are interested in companies with great growth potential; companies with a large market potential and a strong path to profitability. They do not invest in lifestyle companies, small retail operations, or other companies that, while profitable, lack room to expand. In addition, angel investors are interested in companies where the founder has a desire to grow the company. For example, if the entrepreneur only wanted funding for a chain of three boutiques, angel investors would probably yawn and look elsewhere. However, if the entrepreneur wanted funding for a chain that would start with three boutiques and then expand nationally over ten years, angel investors would be likely to take a real interest. Professional angel investors look for entrepreneurs with the drive and capability to build a great company. Angels are looking for strong exit opportunities to realize significant gains on their investment. These are important factors to keep in mind when you think about the possibility of pursuing angel financing for your company.

Over the last several years, private equity financing has created a lot of misunderstandings. During the dot-com bubble (from 1997 through 2000), many companies received massive amounts of financing on little more than an idea (see Figure 1.1).

Webvan.com (1999–2001)
Online grocery store that undersold its products in an effort to gain market share. It expanded too quickly and had no way to get to profitability.

Amount Lost: $1.2 billion

Pets.com (2000)
Quirky commercials could not help the online pet supply business figure out that you cannot make a profit subsidizing the shipping charges on fifty pounds of dog food.

Amount Lost: $282.5 million

Kozmo.com (1998–2001)
An online convenience store that made deliveries to your home, but never figured how to make the costs of the infrastructure work.

Amount Lost: $280 million

Boo.com (1998–2000)
A fashion Web site that attempted to start a global brand in several countries at once, and got hung up on a poor business plan and the technical limitations of the time.

Amount Lost: $160 million

Freeinternet.com (1998–2000)
A combination of excessive spending, poor management, costly lawsuits, and a business model that just didn't make any sense sank this Internet service provider right after its IPO.

Amount Lost: $86 million

Figure 1.1 Examples of Failed Dot-Com Companies

We still have many young entrepreneurs who think venture capitalists are the primary source of financing, even at the very early stages of a business. They also naively believe they need merely slap an executive summary together and the money will beat a path to their door. Well, here's a dose of reality:

- The vast majority of venture capitalists do not invest in seed or start-up financing rounds.
- Most investors require seasoned management, with successful start-up experience, before they will sit down and talk about providing capital.
- To arouse any interest in your proposal, you must have skin in the game; in other words, you have invested your own money.
- Your business plan must be well-written, with detailed financial projections that extend three to five years.

- You are prepared for due diligence and are able to answer any question posed.
- Your corporate structure is clean and uncomplicated, without multiple layers of ownership.
- You own all necessary intellectual property, which has been properly protected.
- Many investors prefer to see completed prototypes, which are already being test marketed or sold.
- Many angels require a board of advisers along with a board of directors.

These are just highlights of what you may encounter as you step into the financing arena. As stated before, angel investors display an almost infinite variety of needs and approaches, so few absolute rules exist. But there's one absolute fact: you can never be too prepared.