

Raising Venture Capital: How to reduce the risk factor for the Investor

By Reuben Buchanan, Director of Integral Capital Group

Anyone who has raised or tried to raise venture capital for their business will tell you it is no easy road. There are lots of obstacles and reasons why investors won't invest. It's hard to pinpoint just one obstacle but if I had to narrow it down, I'd have to say that risk is the biggest one.

Investors just have a hard time believing that the entrepreneur is going to make anything of their idea. A lot of investors are tending to lean towards established companies or listed companies because the returns are great (at the moment) and risk is much lower.

So the key is to lower the risk for the investor. This will greatly increase the chance of getting funding.

How to lower the risk factor for the Investor...

In a typical situation, the entrepreneur or promoter has had little prior experience building a successful company. If they had, they probably would not need an outside investor. It's sort of a catch 22 situation, therefore the most successful approach for start-ups is to:-

1. Take their idea/concept as far as they can with their own funds (if possible get some sales or at least pre-commitments of sales from worthy buyers)
2. Raise small amounts of money from people who are close to them at a reasonable valuation (most promoters value their idea too high which is a turn off to investors). Say \$10k or \$20k each from a number of friends/family who are close to them and believe in the promoters vision.
3. Use those funds to get the product into the market and get one years trading/sales behind them.

A year's trading gives them a couple of things. Firstly it proves up the business idea and demonstrates that there is a ready market for it. Secondly it proves that the promoter can start/run a business to some degree, and thirdly it gives some figures by which a basic valuation can be done from (for the next capital raising).

All of this lowers the risk for the next investor, who may be asked to put up \$250k or even \$1m if the opportunity/technology is great.

The next round of funding may come from a wealthy individual, professional angel investor, or even an early stage VC fund (the latter is the hardest to get funds from). The next investor may also take out the first couple of investors giving the first group an exit.

There are many other factors which can affect the promoter's ability to raise funds such as:-

- General capital market conditions (at the moment, they are pretty good – most investors have a bit of spare money to play with)
- Appetite for their particular idea (i.e. anything in the green or clean energy sector is pretty hot at the moment).
- The promoters ability to 'sell' their idea or concept
- The promoters track record
- The investors personal situation (they may like the idea but have funds committed elsewhere or may be about to go on holiday)
- Luck (promoter may by chance stumble across right investor at right time)

Typical criticisms of the Investor versus the Promoter/Entrepreneur...

Investor criticisms:-

- Poor investor presentation (sometimes no presentation at all)
- Too early stage – still an idea on a piece of paper
- Poor business planning or lack of
- Business model is wrong
- Promoter does not have the skills required to make it work
- Idea is not scalable – limited market opportunity
- The sector is not favorable
- Idea/technology is easily copied (no trade marks/patents in place)
- Projections are too high
- Value entry point is too high

Entrepreneur criticisms:-

- Investor does not understand their idea
- Investor does not get back to them with an answer
- Investor wants too much of the company for their investment
- Investor wants control of the company (more than 51%)
- Investor terms are too tough (i.e money comes with many stiff terms and conditions)

The best advice is for entrepreneurs to get as much knowledge on raising capital as possible. There are many books including many by Professor Tom McKaskill (www.tommckaskill.com).

Also, get a mentor involved in your business who has a track record of raising capital and building businesses. They may not invest into your business, but knowledge is far better than capital. This is because knowledge will attract capital.

© Reuben Buchanan, Integral Capital Group
www.integralcapital.com.au

About Reuben Buchanan

Reuben Buchanan is a corporate advisor for Sydney based advisory firm, Integral Capital Group. His primarily role involves raising capital for both public and private

companies, of amounts between \$1m and \$10m. These companies use the funds to expand or make acquisitions of other companies. Integral Capital also assist companies with their IPO plans as an advisor, and from time to time do private placements into public companies of around \$1m to \$5m.

Integral Capital Group was founded in 1990 by Len McDowall, who previously was a founding partner of Bird Cameron & Associates, who are now known as RSM Bird Cameron.

Previously Reuben Buchanan started and ran Wealth Creator magazine, launched in 2002. (www.wealthcreator.com.au) He on-sold the business three years later to a private investor group. Wealth Creator is still highly regarded in the business sector in Australia.