How to Get Venture Capital for Your Technology Investments

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May 2002

INTRODUCTION. The purpose of this article is to provide practical guidance to minority- and women-owned businesses (M/WBEs) seeking venture capital funding for technology and/or e-commerce investments.

A venture capitalist (VC) is an investor looking for opportunities that will return above market returns and who is open to taking the right risks in order to achieve those returns. This is commonly done by exchanging funding for equity. There are two types of VCs – active and passive. Passive VCs invest with other lead investors, but do not involve themselves with operations and strategy of company. Active VCs take a voting seat or operational position with the company, to help the company grow and hit the right milestones.

VCs expect a return within 3 to 5 years, typically by the sale of the company to another, going public, or sustained growth and profitability. VCs get money from others such as banks, funds, and other financial institutions that are willing to accept the trade off between making an investment of higher risk for potentially higher-returns.

M/WBE CONSIDERATIONS. There are several challenges facing M/WBEs as they seek VC funding for their businesses. Some of the most important ones are:

- Difficulty with Getting Access to VC Networks.
- Stereotypes and Misconceptions.
- No Mentors or Champions.
- Limited Access to Higher Level Jobs that Provide Experience.

The Internet is making it easier for M/WBEs to find venture capital since they can use search engines to find VCs in their area and also use e-mail to contact them. As a practical matter, VCs need to find deals that make their investors money. So the source of the idea is not as important as the idea itself. It's also important to note that not all deals are candidates for VC funding.

BUSINESS PLAN ELEMENTS. Having a good business plan is the critical to getting venture capital funding. Mr. Niño and Mr. Cifre noted a business plan should always contain at least the following key elements:

- Executive Summary.
- Management Team.
- In-Depth Business Description.
- Marketing Plan.
- Financials.

The business plan needs to reflect the company's business knowledge, so it is always better to have more information than less. A VC would rather skip sections than ask for them. It is also important to include supporting research and documentation of assumptions, especially for general VCs who may not know your area or if the idea is new.

PREPARATION CHECKLIST. Most VCs see hundreds of business plans a month. M/WBEs need to carefully prepare for their meeting with VCs. The section below discusses what a VC wants to see from you.

- Executive Summary. Most go right to the executive summary, which provides an entrepreneur with their "two minutes of fame" with a VC. The summary should excite and motivate a VC to read on. Do's are: discusses your niche, justify why the niche exists, and discuss revenue potential. Don'ts are: lack of clarity, lack of directness, and too much talk (not getting to the point). The executive summary should not exceed 2 pages. The most popular VCs get the most plans, which is why the summary must be compelling to stand out from the crowd. When first looking at a deal a VC will rarely have time to read the entire business plan cover-to-cover, which is why an executive summary is so important. If he is interested significantly more time will be spent on reading your documents, and be sure it will be read cover to cover more than once.

- Business Plan. This is one of the most important parts in the VC process. The business plan must be a strategic outreach of your business. It must avoid becoming a long, boring essay. A business plan must communicate a purpose, concept, vision, and a positioning of your business.

- Revenue and Expense Projections. VCs evaluate these forecasts based on the level of expertise and knowledge of the management team. Some VCs look for "scalable" investments such as software where there are high development costs but low incremental costs as volume increases.

- Management Team. VCs look for experience and accomplishments. They want to see people that have successfully run businesses once or twice before. Non-experienced management teams add more risk.

- Identify and Quantify Risks. Most businesses feel it's a negative to talk about a possible downside or competitors. However, most VCs like to see management teams who are aware of the risks in their businesses since it shows a degree of maturity and their ability to deal with adversity. There are positive ways to talk about risks. VCs appreciates acknowledge of competitors but also wants solutions about how the company will be more competitive. Addressing risk helps develops a sense of trust. Part of this discussion should be an acknowledgement of how many companies the market will support.

- Alliance Partners. Alliances give VCs more of a degree of comfort. They provide a vote of confidence in your business which enhances your appeal.

TIPS FOR WORKING WITH A VENTURE CAPITALIST. The section below provides a list of the more common do's and don't when it comes to meeting with a venture capitalist. This section provides practical, real-world advice from 2iCapital and Cypress Asset Management. The do's are:

- Executive Summary. A concise, well-written summary will make your two minutes of fame count.

- Business Plan. The plan needs to deliver on the executive summary.

- Networking Forums. M/WBEs should try and participate in local VC networks. For example, The Indus Entrepreneurs (TIE), which as 30 chapters around the world and 6,000 members. TIE focuses on nurturing entrepreneurs. One of their successes was Hotmail.

- Competition Among VCs. This only works only if a VC likes your business plan. M/WBEs should shop around with different VCs to see what types of deals they are offering. Besides your plan, a VC also evaluates how well you carry yourself, to see if the relationship will last.

- Research Your VC. Sometimes it's a good idea to approach a VC that specializes in your industry. This may help you better communicate with the VC. You want the VC ideally to understand the subject matter as much as possible. Some VC specialty areas are leveraged buyouts, manufacturing, and start-ups. It's also good to check out the minimum investment levels. You need to research the information about VCs to see if you fit in their area. Some VCs won't look at certain industry groups regardless how good your business model may be.

- Funding Rounds. VCs differ in their funding styles. Some prefer to give you a lump sum, while others prefer incremental funding or disbursements based on periodic consumption of cash. Typically a VC who buys into your deal understands your cash needs on a long-term basis, so they will provide you with contractual access to funds. It has become more widely used now where VCs want to be able to cut their losses early if you don't hit your business plan milestones. Usually the larger the funding amount, the more active the VC becomes.

- Value-Added Services. It's a good idea to find out what other services the VC offers. Some VCs want companies that can fend for themselves. Others provide services such as: advice, referrals, and management consulting.

- Protecting Your Idea. This is an important area and practices vary. Mr. Cifre noted there is legal and "natural" protection. A non-disclosure agreement (NDA) may not be as important if you simply send a VC your executive summary, since it doesn't say how you are going to implement your plan. However, a VC should sign a NDA, as well as a non-circumvent, before they see the business plan. Natural protections are patents and alliances. VCs don't want to be involved in litigation or get a bad image so there aren't many problems in this area. Mr. Govil offered another perspective. He said it was hard for VCs to keep track of NDAs. There is a low probability a VC will steal your idea since there are many other things to consider such as expertise and team that VC doesn't have. Having a technology or process patent also provides protection. VCs and angel investors do not typically sign NDAs.

- Finders Fees. You need to ask if the company is a "broker" or real VC with discretion on the funds they manage. Intermediaries or funding brokers shop for deals with VCs. Be sure not to confuse brokers with actual VCs. Consulting fees range from $100 to $300/hr plus expenses. Fees range from 3% to 10%. Fees go down as size and quality of deal go up. Most intermediaries only take a commission, not a retainer. Some VCs typically like to specialize in a geographic region.

WAIT TIMES. Approval times vary. For VCs with discretionary authority over their funds, approval time is limited by due diligence. VCs generally want to get a deal as soon as possible so you should expect a letter of intent almost immediately after they read their executive summary. Due diligence can typically take between 30 to 90 days on the VC side after your business plan has been read, depending on the complexity and scope of your business plan.

SUMMARY. Finding funding is one of the most challenges aspects of being in business. The above tips are provided to help M/WBEs improve their chance of success when they get their opportunity to work with a venture capitalist. Buena suerte (good luck)!

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