

# The Journal

## The Dos and Don'ts of Raising Venture Capital in 2010

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In the past year, getting the attention of venture capitalists has been a challenge for many entrepreneurs. The recent economic downturn has had a two-pronged effect: (i) the demand for capital has increased and (ii) the supply of capital has decreased. These effects have driven pre-money valuations down and shifted negotiating power in favor of the investors.

Many believe this is an ideal time to be a venture capitalist. For entrepreneurs, however, obtaining capital in this market is far from ideal. Even the most promising companies face difficulties. So how can an entrepreneur successfully raise venture capital in 2010? We have spoken with a number of prominent venture capitalists, private equity firms, angel investors, family offices, and entrepreneurs to explore this question.

### The Dos and Don'ts of Raising Venture Capital in 2010:

#### 1. Do "Deal in Facts"

Savvy investors know when entrepreneurs are overselling opportunities or "hockey sticking" projections. According to Patrick Doherty, President of Mariner Private Equity, a private equity and venture capital fund, entrepreneurs that "deal in facts" will have the best chance of raising capital in 2010. In order to gain credibility with prospective future business partners, entrepreneurs need to understand the facts of the marketplace. Unrealistic projections and lack of knowledge of the addressable market demonstrates a lack of an understanding of the facts and may discourage investment. ►

## 2. Don't "Hide Skeletons"

No business plan is perfect. Matthew Prout, Vice President at Culbro, LLC, the private equity investment vehicle of the Cullman Family, says entrepreneurs should develop relationships built on mutual trust early and should not "hide skeletons." Finding a skeleton after weeks or months of discussions may be viewed as a violation of this trust. Even if the skeleton is minor, its presence may lead investors to assume that there are more substantial skeletons in the closet and conclude that the investment is too risky. In 2010, investors will have an abundance of deals to choose from and deals with credible management teams will have a higher probability of getting done.

## 3. Do "Address the Customer Story"

A great idea, great product, or great technology does not always translate into a great company. To have a great company, a product or technology needs to fulfill a demand in the marketplace. Ron Leaf of LFE Capital, an investment fund focused on expansion capital, says entrepreneurs need to "address the customer story" in their business plans. Instead of focusing merely on the unique attributes of their products or technology in their pitch to investors, entrepreneurs need to understand and consider the addressable customer market and be able to demonstrate how they will get the customer to buy.

## 4. Don't "Get Discouraged"

Great companies in growing industries will continue to obtain growth capital in 2010. Darren Guccione, Co-Founder and CEO of Callpod, Inc., a successful consumer mobile technology company, says "despite market conditions, a significant number of start ups and emerging companies have managed to raise capital." Well-positioned companies like Callpod, which will benefit from the projected exponential growth in the Smartphone and mobile application industry, will attract capital in any market.

## 5. Do "a Top Ten List"

In a typical year, leading investment firms see 700 to 1000 opportunities. This number is likely to increase in 2010 given the increased demand for capital. Investors do not have the time to dig deep on every opportunity, and if an investor is not able to quickly grasp the investment considerations of an opportunity, it will likely be ignored. Bill Ashbaugh, Senior Vice President at Capital Southwest, a publicly-traded venture capital and private equity investor, will often ask entrepreneurs for a list of key investment attributes similar to a "Letterman Top Ten List." This allows Capital Southwest to quickly evaluate the merits of the investment. To avoid being passed over in 2010, entrepreneurs should endeavor to create executive summaries that concisely explain why they have a great investment opportunity.

## 6. Don't "Expect 2007 Valuations"

Valuations in 2010 should be meaningfully lower than those seen in 2007 and the first half of 2008 because the demand for early stage capital has significantly increased, while the supply of capital has decreased by a similarly large amount. According to Michael Gruber, Founder of Cornerstone Angels and Co-Founder & Managing Partner at VentureLab, demand for capital has increased because "early stage companies are less able to fund operations through personal savings ►

and friends and family money.” Demand has further increased due to an “increase in the number of new companies being formed by recently unemployed entrepreneurs.” The supply of capital for early stage companies has decreased due to a reduction in the number of venture capital firms, angels, and other investors making new investments. This reduction is the result of a combination of a lower risk appetite, the closure of some firms, and an increased focus on struggling portfolio companies. Entrepreneurs that do not recognize these trends and adjust their valuation expectations accordingly may have a difficult time raising capital in 2010.

#### 7. Do “Be Patient”

Capital raising takes time. A process that might ordinarily take 3 to 6 months may, in 2010, take 6 months to a year because capital is more difficult to find and cautious investors are being much more extensive in their due diligence processes. Even if there is not an immediate need for capital, companies should not wait too long to begin a process. Matthew Pritzker, Founder of Matthew Pritzker Company, has seen a number of entrepreneurs wait until there is a desperate need for capital to begin speaking with investors. According to Mr. Pritzker, sometimes “desperation comes through in entrepreneurs’ presentations, making them appear ill-prepared.” From the perspective of investors, an entrepreneur that does not properly plan for raising capital may signal poor management skills or a lack of foresight, which could cause an investor to pass on an opportunity.

#### 8. Don’t “Try to Do it Alone”

Serial entrepreneurs, by nature, are confident people. Many leave comfortable salaried jobs to pursue their dream of running their own company. Investors love to partner with entrepreneurs with a passion for growing their companies and who are confident in their ability to do so. When seeking growth capital, however, overconfidence or arrogance can work against an entrepreneur if the entrepreneur is not open to the input and ideas of their financial partners. Entrepreneurs cannot do it alone. Those that are successful in raising capital understand that a venture capitalist is more than just a financial partner; he or she is a business partner. Many venture capitalists are current or former entrepreneurs themselves and can add substantial value to the companies they invest in. Michael Persky, Managing Partner at Alerion Partners, a private investment firm where each of its partners has extensive operating experience, says its partners share their own learning experiences with entrepreneurs so “managers of their portfolio companies can avoid making the same mistakes.”

#### Conclusion

2010 stands to be another tough year for obtaining venture capital. A lot of great companies will continue to compete for limited investment dollars. An understanding of some of the Dos and Don’ts of raising capital will be particularly important in 2010, and it should increase an entrepreneur’s chances of success. ■

### About the Author



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