US venture capital

How to hit a homer with a VC

In boom times or recession some principles are always the same when seeking funds, write Laurence Naughton and Rees Hawkins.

All said and done, 2009 is a year most companies and venture capitalists would like to forget. There are, however, signs for cautious optimism in the 2010 venture financing landscape. For instance, statistics have shown that quarterly investment activity increased 17% in terms of dollars from 2Q09 to 3Q09.

Furthermore, Nasdaq (an indicator of venture capital confidence) is improving and anecdotal evidence indicates a similar pick-up in the acquisition and IPO markets. Moreover, even in one of the worst years on record, 2009 venture investments in the US may well exceed $15bn. Many expect that increased levels of venture capital in the US will be available in 2010, but that the markets will still be relatively tight so that a company seeking funding needs to lay the groundwork now and pursue funding in an effective fashion.

If your Irish- or European-based company is seeking to tap into the U.S. venture capital market in 2010, here are practical tips and advice for getting the deal done. Whether there's a boom or a recession, these principles will almost always apply to obtaining equity funding from U.S. venture firms.

Home run potential in every bat

Many venture capital funds in the US (US VCs) are larger than their European counterparts. Thus, in order to provide an adequate return to their own investors, US VCs seek companies that have potential to be game-changers, even if there is meaningful risk associated with the opportunity.

US VCs are less interested in gaining a 10% market share of a sizable market and much more interested in a company that changes the way business is done in a market, or that even creates a new market. Even with larger funds, one significant exit can provide for the repayment of the entire fund – it is often said that 80% of US VCs' returns come from just 20% of their deals. Therefore, rather than playing it safe, convince the US VC that you have the potential to hit the long ball.

Treat your executive summary like a first date and beware of gossip

The adage that "you never get a second chance to make a first impression" rings as true with obtaining VC funding in the U.S. as it does with a job interview or a first date. One bad (initial) impression can easily be the end of your relationship.

Many venture firms receive hundreds, if not thousands, of executive summaries and business plans each year and need to aggressively narrow the field of candidates. Prepare a one-page executive summary that quickly captures their attention. Focus on the first paragraph and present the opportunity with alacrity and authority.

If you make it past the first step, don't let your guard down – the process has only begun. Perform at the top of your game for every interaction with a prospective investor, even if a meeting purportedly is informal. What's more, always remember that VC's frequently talk to one-another, and if one has a concern about the quality of a company, it is quite possible that others will soon hear about it.

Go with what they know; know how they go

US VCs have an affinity for brand names when it comes to matters such as deal terms, intellectual property strategy and composition of advisory boards. This is in part because experience breeds efficiency, and in part because US VCs trust that experienced consultants, attorneys and advisors weed out some of the less-qualified opportunities. The bottom line: US VCs value information and analysis that comes from a familiar source when evaluating or negotiating a potential investment.

In order to go with what they know, however, a company seeking financing from US VCs must also know how they go. Take extra time to learn about both the types of VC firms you are pitching and the practices and tendencies of each individual firm. What stage of company do they prefer? What is their industry focus? How much do they typically invest? How much capital do they have available for investment? Do they already have a competitive company in their portfolio? Target the right firms and tailor your pitch to best convince the VC that you're the right match.

Avoid cold calls

Avoid contacting a US VC, whether by phone, e-mail, or submission via webpage, on a "cold" basis. As noted above, US VCs are inundated with executive summaries and business plans, and also spend time tending to their existing portfolio companies. Accordingly, they primarily

rely on referrals through trusted sources, including accountants, investment bankers, attorneys, industry contacts, and executives in current or former portfolio companies. US VCs generally assume that if an entrepreneur doesn't have the contacts and skill set to coordinate a proper introduction, then that individual likely will have a challenging time building a successful business.

Never ask a US VC to sign an NDA…but make sure you protect your special sauce

Asking a US VC to sign a non-disclosure agreement (NDA) is one way to be left out in the cold. US VCs strongly resist signing NDAs, especially during the early stages of the process (and may even get insulted if you ask).

US VCs often evaluate opportunities that are in similar, if not overlapping, industries and cannot risk having to turn down a strong investment opportunity because they fear a lawsuit from a company in which they previously declined to invest. Therefore, it is important to research the reputation of your targeted VCs in advance. Furthermore, stagger the delivery of sensitive information to coincide with the progress of the negotiations and the likelihood of obtaining funding.

Address the Atlantic Ocean

Being based 3,000 miles away from prospective investors doesn't improve the chances of obtaining financing. Many US VCs are prohibited by their charter documents from investing outside of North America. Of the remainder, a significant percentage has little experience investing outside the US.

Consequently, when approaching a US VC, it is vital for an Irish based company to address this challenge proactively, even if the prospective investor doesn't specifically broach the topic. There are a wide range of options for addressing this challenge, such as including an Irish-based VC firm in the syndicate, locating your sales-and-marketing team in the US, establishing a co-headquarters in the US, and relocating. There is no one right solution – the proper approach needs to fit the plans and goals of the company as well as alleviate the concerns of the prospective investor – but the issue should be addressed.

In addition to the above bedrock principles, it is important that a company's strategy and outreach reflect the prevailing economic environment and current preferences of prospective investors.

The following are principles that a company seeking US venture financing in 2010 should consider.

Think "must have" and not "me too"

As mentioned above, most US VCs seek out companies that have home-run potential. The current environment, where successful exits are more difficult to achieve and companies face challenges on the macro-level, heightens this instinct.

As a result, US VCs desire to invest in companies who offer products and services that are "must haves" and that are disruptive, revolutionary and indispensable. In prior periods, companies that were characterized as "me too" or that made modest improvements to existing technologies might have been able to secure funding. Going forward, however, a company that offers a product or service that screams "You need me!" might get funded; while a candidate that mutters "Mine's like his, but a bit better" likely will be passed over.

"If it works in europe, it will work in the US" is not a business plan

In the past, companies had some degree of success in securing financing from US sources based on rosters of strong European-based customers. Although having credible customers in European markets was no guarantee of success in the US, some investors were willing to take the risk that a company that achieved a foothold in Europe would also be well-received in US markets.

However, in the current climate, most US VCs are not willing to invest without a more substantial basis for believing that the offering will be accepted by the US market. Accordingly, it is important to have a customer, partner or investor that the prospective US VC knows and respects – to have established commercial acceptance in the US and to be seeking funds solely to scale the effort.

Follow the Yellow Brick Road…and Make Sure it is Short and Capital Efficient

Now more than ever, US VCs want to see a well-developed, clear path to profitability, and the shorter that path is, the better. "Capital efficiency" is in vogue as VCs are concerned about having to sink endless sums of money into companies as the amount of capital they themselves can deploy has decreased. As a practical matter, this means that companies in capital intensive industries have a challenging path, and companies that obtain financing will be asked to do more with less.

Consequently, companies would be well-advised to build and present a business model that propels the company to a self-sustaining stage much earlier in its lifecycle. In addition, when preparing to meet with US VCs, take extra time to prepare and focus the presentation of your strategic plan on the path to profitability and the total capital required to reach that milestone.

Remember, a good commercialisation strategy is more important than the world's best widget – show when and how the company and, in turn, the VCs will make money.

You Won't Get Far on Half a Tank of Gas

You wouldn't pull up to a filling station on a long trip and only ask for a half a tank of gas. Similarly, you don't want to approach a US VC and ask for less than what you need to achieve milestones that drive valuation in a meaningful fashion.

As noted above, many US VCs have more capital to deploy than their European counterparts, so if you ask for too little you might not get any funding at all. In addition, in determining the proper amount to seek, carefully identify the next major milestones that will significantly increase your company's valuation and how much capital will be required to achieve those milestones. If you run out of funds before increasing value, the next round of financing will be highly dilutive…if one occurs at all.

In short, 2010 will almost certainly be a better year to raise U.S. venture capital than 2009, but challenges still remain. Irish companies wanting to maximize their chances to receive these funds need to pursue the process effectively.

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