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OIL PRICE GAINS $1.22 (U.S.) TO $61.10 A BARREL. FULL MARKETS COVERAGE

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REPORT ON BUSINESS

S&P/TSX	DJ Ind.	Nasdaq	Dollar	Gold
11,826.44	11,069.06	2,262.96	87.18c (U.S.)	$556.60 (U.S.)
-39.32	-46.26	-19.40	Unchanged	+2.00
Energy stocks lead first decline in four sessions	Interest rate worries undermine blue chips	Chip stocks drop as Citigroup cuts recommendation	Rate concerns in U.S. and Canada squeeze loonie	Renewed inflation concern underpins bullion gain

VENTURE CAPITAL

Ready for a First Date With Your VC?

SEAN WISE
WISE WORDS

During the last 7 years, I have heard more than 400 pitches annually from entrepreneurs seeking capital from investors. On the set of CBC's new venture capital reality show, the Dragons' Den, I have heard more than 120 pitches in the last eight days alone. What do all of these pitches have in common, whether in reality or on reality TV? The answer is that they all revolve around a number of key questions that most investors wish to cover in the first encounter a.k.a the "First Date."

The bottom line is that all investors want to make money, a return on their investment and in order to do this, it is imperative that they evaluate your potential to facilitate their goals. This assessment includes the evaluation of answers to two main queries:

1. Is this a deal for me (i.e. does it meet my investment criteria)? And;

2. At what price would this be a deal for me (i.e. can I make enough off of this deal)?

In order to evaluate the opportunity using these key criteria, investors strive to obtain answers to a series of questions. As previous articles have alluded to, investing is much like courtship. There is a get to know each other period (i.e. due diligence), before the commitment. Consistent with this metaphor are several key questions, in no particular order that you must be prepared to answer on the first date with your potential investor.

If you are looking for capital from angels, venture capitalists or even on a reality TV series, you must not only anticipate these key queries but you need to formulate your answers in advance, in order to improve your chances for investment.

What is it that you do?

I know this one seems easy, but you would be surprised at how long it takes some entrepreneurs to communicate their elevator pitch. You only have 60 seconds to relay information concerning the business you are in, the capital you are seeking and why investors should be interested.

In previous columns, the importance of the elevator pitch has been stressed and as a recap, it is critical that it satisfy these four criteria:

1. Succinct — under a minute or two;

2. Comprehendible — no technologically specific terminology;

3. Undisputable — makes sense; and

4. Greed inducing — it should be apparent that you can make money.

Therefore, be prepared and remember that you often only get one chance to make a first impression, so practice your elevator pitch with everyone and anyone who will listen. Moreover, ensure your pitch evolves to a universal point where both your toddler nephew and senior great aunt, not only understand what you do, but want to invest.

Why is what you do needed?

This is all about, how you will alleviate the "pain." No matter the product or service, there has to be a need for it. This need is often associated with a source of pain. Take the following examples as illustrations of pain in the market and their corresponding solutions:

1. I have too much junk in my basement, that others might want, but I can not sell it to them myself = eBay

2. Hackers keep trying to infect my computer = Symantec

3. People want accessible e-mail away from their desks = RIM's Blackberry

4. Carrying around a boom box is too cumbersome = Sony's Walkman

Investors want to know that there is a need for what you are building. The greater the need, the quicker the sales uptake and the higher the revenue grows, means less cost in convincing customers to buy your solution. Sunil Selby, Managing Director of Trellis Capital, a Toronto based VC Fund, puts it this way:

"To get interested in a business opportunity, I look for the entrepreneur to clearly, concisely and well articulately communicate if and how the company's product offering meaningfully increases customer revenues or reduces costs."

After all, if there is no pain and hence no need for what you are doing … then why do it?

What traction do you have?

Traction refers to progress or the concrete milestones that you have reached and surpassed. Investors for the most part, seek to evaluate and later mitigate three key types of risk, namely:

1. Management Risk: Can these founders deliver?

2. Magic Risk: Can the product be built? And if so, will it be exponentially better?

3. Market Risk: If the founders deliver and the product works, will anyone buy it?

Traction speaks to these issues. Investing in a company that has significant sales indicates that management to an extent has built a product that the market is interested in. BDC's Steve Abrams, illustrates the importance of the quality of sales and not just its quantity. "Sales are good, but we also look for the 'Marquee Customer.' Early stage companies may have a few local sales, but its ability to attract a major reference account goes a long way."

Since there is a direct correlation between the risk that investors take and the reward that they seek in return (i.e. the Risk: Return ratio), a company that has traction will not need to offer as much of a return, when compared with a company that does not. To that end, traction not only affects valuation, but also the type of investors you will want to attract. For instance, it would be in the interest of companies without traction to focus on family and friends. While a company with sufficient traction and aspirations to expand, falls more appropriately into the venture capital arena.

Who else believes?

An old adage in investment circles expresses, that "you can't be the only one drinking the kool-aid." This comment deals with both third party validation and traction. The former asks, "who else believes that what you are doing is needed and a good idea?" Third party validation is critical; without it, all the investor has is the word and enthusiasm of the entrepreneur, who is trying to sell the idea and by definition is in conflict, since they are the one's pitching the cash.

So what is the best form of third party validation? Simply stated, it is sales. Nothing says that your product will sell massive quantities better than the commendable sales to date. If you can show that customers are begging to buy your prototype, demanding to join your beta test (i.e. trials) or lined up to license it, then you have not only secured third party validation, but you have also achieved traction.

As discussed above, nothing impresses a potential investor more than traction. Trellis Capital's Selby agrees, reminding us that not all "sales traction" is pure revenue:" While the best proof of traction is the amount of revenue a company has generated from the sale of its product, the quality of the sales funnel and pipeline, and the entrepreneur's understanding of the customer's purchasing priorities, process and timeline also provide increased comfort that the company's commercialization is moving in the right direction."

However, if you are too early in the entrepreneurial process to have sales, not all hope is lost. There are other forms of third party validation. The list is as follows, in descending order of impact:

- Sales
- Large leading Corporate entities in your field have partnered with you
- Joint Ventures with other small players
- White Papers from future customers
- Industry reports from large investment banks and research companies

Yes, I know, Forrester and Garner are often wrong, but they are more reliable than entrepreneurs seeking cash from investors, at least from an investment perspective. After all, an analyst that is constantly wrong will not be an analyst for very long. Similarly and more to the point, every entrepreneur pitching for cash, claims that they have the best product, the best team and the best opportunity and investors have no choice but to disregard these claims due to the internal conflict of the entrepreneur.

How much do you need?

"How much capital should I ask investors for?" is a question that is often posed to Dan Mothersill and I, following our Bootcamps on raising capital. The answer of course is different for every company, but in general the benchmark I give is defined in this way:

"Get enough money to make sure you can make it past the next critical milestone, whatever that may be."

It is necessary to deploy enough capital, so that when you go to the market looking for more, you have successfully moved the company forward to its next critical point. This point is directly linked with the company's key milestones, including but not limited to: finishing a product, filing patents, launching a beta, completing a beta, selling the first product, scaling up sales, reaching the break even point and the list continues.

You have to ensure that by the time the money depletes, you have successfully moved the company forward, exponentially added value, mitigated one of the three risk criteria (management, market, magic), so that you can now raise new funds to meet future goals. Investors have little appetite for a company that fails to hit its growth milestones and is now in search of additional funds. Instead, investors often punish the founders in these situations, by providing very punitive valuations.

Consequently, investors not only want to know how much you need, but what the goal of such an investment will be and what goals you have already met.

(Next month we'll continue to explore the questions that investors ask on the "First date" with those entrepreneurs seeking capital)

Sean Wise, BA, LLB, MBA is the Managing Director of Wise Mentor Capital, a national venture capital consultancy focusing on bridging the gap between entrepreneurs and capital. He is the on-line host of the CBC's new venture capital reality show **Dragons' Den**.

Sean is a former Director with Ernst & Young's Venture Capital Advisory Group for Canada, and currently sits on the Boards of the Canadian Venture Forum, the Banff Venture Forum, the Toronto Venture Group and Silicon Valley's IBD*Network* as well as a number of high growth companies in the public and private sectors.

You can read his blog and listen to his podcasts at www.SeanWise.com.