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Raising Money Now: When, Where, Who & How

The hardest part of being an entrepreneur usually centers on one thing: money. How to get it, make it, keep it, and grow it. Geoff Entress, a prominent Seattle venture capitalist and angel investor, has a few thoughts about money. Geoff has played a key role in many successful start ups. His experience includes practice as an attorney, founding a company and personally investing in dozens of local start-ups; he is a board member for the Alliance of Angels, and serves on decision-making teams as a venture partner at Madrona Venture Group, one of Seattle's premier venture funds.

At a recent Northwest Entrepreneur Network breakfast meeting Entress shared his thoughts about raising money, including some insider tips.

Where to find the money

When it comes to raising money Entress is clear, "Only raise it if you need it." However, he cautions, "Make sure you raise it well before you need it, or you could find yourself in a bad negotiating position." Sound advice. Relative to geographic and market considerations Entress says there is plenty of money available locally even in the current economy and you won't have to travel as much.

Entress is also pointed about whom to raise money from. His hierarchy starts with: Yourself first, then friends and family. Both critical first steps to enticing broader investments. With friends and family he warns, "It will be some of the hardest money you'll ever take." Understandably, with grandma's retirement at risk. As the money stakes increase, angels or Venture Capitalists (VC's) will be key sources. Entress also reminds us not to forget Strategic Partners who may want to invest in your technology vs. build it on their own.

Who's money to take: Angels vs. VC'S?

In general:

- Angel money is easier to raise, comes in smaller amounts, and takes longer to find.
- VC money can be raised faster and in larger amounts, is expensive and may cause a loss of company control. However, it often provides market validation.

When it comes to investments, understanding why angels and VC's invest is critical to determining which is best for your business.

Executive Insights

Cheryl Isen

Angels invest because they want to make money, but they get involved for broader reasons too. Oftentimes they're looking to engage and share their business ideas. They may want to have fun and leverage their experience into their investments. They may be seeking out opportunities to advance fields that they care about. Participating early is key and provides these opportunities.

You'll know you're a good match with angels if you're looking to assemble a group of strategic advisor/investors and want a better chance of maintaining managerial control. Because angels usually invest less than VC's they offer a relatively easy and quick way to raise money. You might also find better terms. Angels are sometimes easier to work with than VC's, especially if they are engaged and understand the nuisances of your business. However, these relationships require time and energy to build and manage.

If you're looking for a larger investment VC's are a good choice. VC money comes from institutional investors who invest small portions of their assets in high-risk alternative asset classes, such as start-ups. They take on the risk to increase overall return. This defines VC money—VC's invest because they need to make money.

A VC will be a good fit for your business if you have a large opportunity. They're not interested in turning \$2 million into \$5 or \$10 million. They seek a competitive advantage and compelling business model or value proposition. You need to clearly demonstrate how your business will make money and grow large. VC's also look at market timing. Is your idea hot now? Assuming yes to all, they will want reasonable terms and a great team in place, with management that has been down the road before.

A word about terms

Investors will value your business in one of three ways: Convertible Bridge Debt, Preferred Stock and Common Stock. Most often family and friends receive common stock and VC's and angels will insist on preferred stock.

Early stage investors also use convertible debt as a funding bridge until a larger round of investment is closed, usually by VC's. Convertible debentures are debt instruments that convert into equity at triggering events. This bridge loan is converted to an equity investment under the same terms and conditions as the subsequent VC investment and at the same valuation, less a discount to compensate investors for added risk. Discounts vary from 5% to 30%, depending on the length of time between the closing of the bridge round and the closing of the subsequent VC round. The trick is to understand warrant coverage and discounts, which are not the same. Discounts are much better for investors whereas warrants benefit the entrepreneur.

Tips to bank on

Wherever you find the money, Entress provides these cautionary tips:

- Watch the option pool and long term financing strategy—these will change as valuation rises.
- Don't give away your company—monitor the control provisions in your documents.
- Be nice to your lawyers and use them—you often don't know what you don't know.
- Time kills all deals—money may not be there if you wait and secure a staged investment if you can.
- Know your investors—frequent communication is necessary with all three kinds of investors, the active, who add value; passive, who need money; and the active trouble makers.

If something seems wacky run away—these are long term relationships.

These "Executive Insights" are based on monthly presentations provided by leading entrepreneurs at the Northwest Entrepreneur Network (NWEN.org), a non-profit organization dedicated to helping entrepreneurs succeed. The column is written by Cheryl Isen, founder of Isen & Company, a strategic marketing and public relations firm that helps emerging companies increase corporate visibility and brand awareness Contact Cheryl at (425) 222-0779, Cheryl@IsenandCo.com or on the web at www.IsenandCo.com.