

Hitting a Funding Home Run

In the pursuit of funding, entrepreneurs often ask venture capitalists (VC) what they look for in the “perfect deal.” The truth is there is no such thing. Any successful investor will tell you that every deal - even the most successful - is complicated. From an investor perspective, the real issue is assessing and classifying risks: Are the issues controllable or uncontrollable, and can the company succeed in spite of these issues? For entrepreneurs, understanding the lever that pushes a VC to fund involves knowing how an investor thinks.

As the founder of the venture capitalist firm SeaPoint Ventures and an active VC in other ventures Tom Huseby has built a business on learning to distinguish the home runs from the ‘at bats’. At a recent Northwest Entrepreneur breakfast meeting, Huseby detailed five red flags that every entrepreneur should be aware of when pitching potential investors.

According to Huseby, “Hitting a homer is a fallacy because in reality a deal always hurts.” In fact Huseby equates getting a homerun “to pushing a baseball around the bases with your nose 18 times.” Jokes aside, all deals are problem-prone, with some being more difficult. Huseby explains how to avoid the biggest snarls that hamper getting funded. Typically they fall into five areas: Management; Product Offering; Technology; Market; and Previous Investors.

Management

Management problems boil down to two things says Huseby, “Either the management team is weak or worse, the management team is complete and weak.” Many entrepreneurs start out rapidly recruiting a management team.

Wrong move, says Huseby. “The fact is the odds of an early management team being the right team to grow the company is zero.” From a funding perspective having a complete management team that isn’t right only complicates the deal. Instead Huseby advises focusing on the filling the critical jobs that need to be done. The management team can be fleshed out post funding. Even filling the CEO

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role is questionable because not every founder will be a CEO that can take the company through the long haul. However, the one key quality that every CEO should have says Huseby, “is a burning sense of urgency because it shows a determination to do what it takes to get the job done.”

Product Offering

“Problems with a product offering usually boil down to: it’s too complicated; or worse, it’s too limited to ever succeed; or last, it’s trying to solve a nonexistent problem”, says Huseby. The least investment risk is a product that’s too complicated because it’s an easier problem to fix. Huseby explains, “If your product requires 48 clicks it’s obvious no one will do it, but there’s usually a way to engineer a simpler approach compared to trying to engineer more oomph into a product that’s limited.” The higher investment risk comes with betting on a product that solves a problem that doesn’t exist. “With these bets you have to be really, really good at guessing”

which is something that not every investor will want to do according to Huseby.

Technology

Technology issues can also lead an investment into foul territory. According to Huseby there tend to be three problems with technology. “Either an army of geniuses are needed to complete it; or the concept isn’t practical through the general course of science (defies Newton’s laws); or worst of all, it doesn’t require any real talent to create.” Of the three Huseby tends to avoid investing in technology that is impractical or too simple. The reasoning makes sense. “We’re willing to work with a company to see if someone can help solve a problem, but impractical ideas are tough because you can’t timetable an invention and we just don’t believe in investing in simple ideas.”

Market

Market-related issues crop up routinely. When the barriers to entry appear too high, Huseby says there is usually a channel that can be found to open a door. However, the real problem is when there are no doors to entry in a market at all, or worse, when the focus is on using “a lemonade stand” approach to penetrate the market. The doors to market entry usually close when a market is entrenched and saturated by incumbents. These situations require being really clever and finding a way to solve a problem the market doesn’t even know it has. “When you do this, it also creates a great exit strategy because your idea appeals to incumbents,” explains Huseby. As for “lemonade stand” marketing, Huseby equates the approach to putting up a website to enter the market. According to Huseby, “It rarely works because nowadays a single

website can't be the only way to access the market. Distribution channel partners are needed (like eBay and Google) to grow."

Previous Investors

Lining up investors is often viewed as concept validation by entrepreneurs. However Huseby warns, "We steer clear if the cap already looks like the index to a dictionary." Nothing is worse expected when "the list of *owners* looks like a dictionary". This gets chuckles from others in the investment community because people issues, especially owner issues, are the ultimate complication. Huseby's advice, "Be really careful who you bring in and how you do it because it could kill the funding." Naturally deals

require, friends, family and perhaps VCs, but the message is to be very selective. Avoid bringing in people you don't know. Make sure you check them out. Be cautious about how many people you invite and be conservative with pricing. According to Huseby, "Investors will price the company differently than an owner, so make sure that those you bring in have convertible debt that can be easily transferred to the next investor round; give discounts and try to avoid warrants."

With all the issues and risks to consider, how does an entrepreneur prime a company for funding or an investor gear up to take the plunge? Huseby's secret, "You can't win by doing nothing." Deals

are complicated but they don't get any less complicated by overanalyzing and avoidance.

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.