
Preparing for the Capital Raising Process

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By Peter T Gow

This article is about the capital raising process and what needs to be done before approaching investors.

Main Points in this article:

- 1 Three decisions need to be addressed prior to raising capital: ownership, control and valuation.**
- 2 Several rounds of capital raising may be required depending on the stages of company development.**
- 3 By introducing external investors, you are implicitly agreeing to step aside if the objectives, funded by the capital raising, are not met.**
- 4 Prepare for the investor meetings with a presentation about the company, not just the technology.**
- 5 Investors don't back businesses they don't understand.**

Capital raising can be a time consuming and costly process.

Before approaching investors, some key decisions need to be made, along with much preparation.

The key decisions relate to issues concerning ownership, control and valuation. Your company's structure, governance and direction will change with input from external professional investors.

Preparation, on the other hand, relates to a number of activities, with the key being the development of a clear and concise business plan. The plan needs to outline the business model, the company's strategic position, and the competitive advantage.

Key Decisions

There are three main decisions to consider prior to raising capital: ownership, control and valuation.

Ownership relates to the sale of shares in your company. Rather than retain full ownership with 100% of the shareholding, shares are issued to raise capital to support the different stages of the company's development.

This implies several rounds of raising capital, rather than the "one off" approach.

The VC managers usually say 10% to 20% of a very successful company is far more valuable than 100% of a company struggling to grow with limited internally generated funds.

Growth opportunities may come and go very quickly, and timing is everything.

How many shares will you need to issue?

The answer to this question is explained in more detail in the [Valuing your Business](#) and the [Valuation assuming Future Dilution](#) articles. Check this Website for further information.

Essentially, the size of the share issue and the amount raised will be dependent on the business opportunity and the company's stage of development.

Control is the next key decision that needs to be addressed. As a company grows from early stage, through the period of rapid growth, and eventually through to slower growth, control of the company starts to change.

Initially, it is the founder/CEO who is the key decision maker determining strategy, culture, governance and levels of performance.

As the company grows, more and more complex decisions need to be made. It is not unusual for the CEO to feel under pressure to make decisions quickly and avoid the bottlenecks.

The CEO's role starts to change from the visionary, operational, "do everything" role to one of direction setting and delegation. He or she needs to become the team builder, coach and chief communicator.

The CEO also needs to be the driver of the organisation's culture, as well as the change catalyst.

It is very rare to find the founding CEO as the same CEO of an established and listed company. There are several key questions that most CEO's need to ask themselves:

- Do I have the ability to change and be part of the company's transition?
- Will I be prepared to step aside and let someone else lead the company as CEO?

Research has shown that the ability to change is a key attribute of successful entrepreneurs. Another critical factor is their willingness to use mentors or coaches to accelerate their learning and development.

This last question, "Will you step aside?" is a crucial one. By introducing external investors, you have implicitly agreed to step aside if the objectives, linked to the capital raising, are not met.

The other issue related to control is the change in the governance structure, with the Board of Directors becoming far more important as the company grows.

The board needs to expand to include non-executive directors with industry and/or marketing experience.

The appointment of non-executive directors brings another dimension to the company with access to independent, informed and experienced individuals. The collective wisdom is generally far greater than that of a small company driven by the founder/CEO.

The expansion of the board also signals the transfer of some key decision making from the CEO to the board.

The expanded board will be focused on strategy, governance, performance, and risk review, with the CEO will be more focused on management, culture and operational effectiveness.

The last key decision for the founder/CEO is valuation. See the [Valuing your Business](#) article at this Website for further information.

Valuation generally arises as the key point of difference between the company's current shareholders and the new external shareholders.

In some cases, the valuation gap will be too broad to achieve any degree of consensus.

The valuation needs to be compared to the valuations of similar companies to arrive at a realistic valuation range.

The key aim for the investors is to see the valuation increase during the investment period. The investors are also seeking increases in the valuation multiples during this period as well.

Valuations are based on assumptions and financial projections. If the projections are not achieved, the investor has paid too much for the shares. However, if the projections are exceeded, the investors have picked up the shares at what they would say a "realistic" valuation.

The "buy low, sell high" is their mantra.

Mechanisms can be structured into the terms and conditions to allow the upside, or downside, to be directed back to the party responsible for the variation.

One key point is that, if the valuation goes up during the investment period, all shareholders benefit.

Realistic valuations will also determine whether capital is

available to achieve your strategic objectives.

Preparation for Raising Capital

Having considered the high level decisions related to introducing external investors, it is now important to prepare for the meetings with investors or VC managers.

The key starting point is your business plan.

Your business plan needs to be clear, concise and fully explain both the opportunity and describe the people who will deliver that performance. Understanding execution risk is a key area of focus for investors.

The business plan needs to address nine key questions about the business:

- Who is the Customer?
- What is the Customer's decision making process when buying the product?
- Is this a compelling purchase for the Customer?
- How is your pricing determined?
- How will the customers be reached?
- How much does it cost to acquire a customer?
- How much does it cost to produce and deliver the product?
- How much does it cost to support the Customer?
- How easy is it to retain the Customer?

See "How to Write a Great Business Plan" by William Sahlman, Harvard Business Review, July – August 1997 for more information.

The people providing the skill and experience need to be clearly identified, along with any gaps in the management team. As the future performance and investment returns will be strongly influenced by the

quality of the team, it is critical to show that your company has the requisite skills, or access to them, to execute the business plan.

Preparing yourself for the meetings with the investors or VC managers is essential.

Since VC managers receive hundreds, if not thousands, of plans each year, and listen to numerous presentations, it is important to not only prepare for the process, but to clearly identify who you can work with during the term of the investment.

See the “**How to Select a VC Manager**” article at this Website for further information.

The first meeting with the VC managers or investors needs to arouse strong interest. You need to be fully prepared with a short presentation of around 15 to 20 minutes on the company.

It is not just about selling the technology, or some new revolutionary products, it is all about selling the company.

This means it is necessary to:

- ❑ Establish your people credibility by describing prior successes and execution skills
- ❑ Describe the market opportunity in terms of size and growth of the market
- ❑ Describe your product or technology, especially focusing on its uniqueness and differentiation from other offerings
- ❑ Identify your competitors, both existing and new, as well as likely substitutes
- ❑ Identify your customers, in terms of their needs, potential targets and access
- ❑ Show the opportunity in numbers, with the breakeven point and the cash flow movements

- ❑ Request the capital, and identify the key milestones to be achieved.

The presentation needs to be believable and clearly describe your business model. It is really important to establish this understanding very early on in the presentation.

Investors don't back businesses they don't understand.

If you don't present this type of information in your first meeting, you are unlikely to get a second chance.

Selling the business opportunity is more than selling a product.

There is a definite sales process and cycle you need to go through. If interest is not aroused at the first meeting, you need to have the “Plan B” strategy in place to get back in the door at some later date.

This may involve some regular contact, say every 3 to 6 months to confirm that you are actually making progress and achieving your milestones.

This communication process will also serve to reinforce that you have the team to execute your plan.

Capital raising is a time consuming process that diverts the CEO's attention away from running a business. Companies sometimes flounder and nearly go out of business because too much time is focused on a poorly planned capital raising process. Like all things, a little bit of planning and some discipline goes a long way.

Peter T Gow is the Managing Director of Creative Capital Pty Limited. He founded Creative Capital to accelerate the learning skills of entrepreneurial CEO's and develop their expertise in capital

management, business and strategic planning, cash flow management and market research and analysis. Peter has over 12 years of experience in working with growth companies and has been involved in the completion of over 30 financings in the software, manufacturing and medical areas. His expertise covers company evaluation, strategy and market analysis, capital raising, transaction structuring, documentation and completion. Peter has also set up several venture capital funds for a major financial institution and appraised a range of venture capital managers.

Creative Capital Pty Limited
Peter T Gow
61 412 235 455
petergow@creativecapital.com.au