



Is Your Company a Good Fit for Venture Capital?

A brief overview of what makes a company attractive to venture capital...and what to expect

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The Thunderwood-B Investment Fund is set aside specifically for products and services in the FileMaker industry. There are a lot of companies in this space that don't have much experience with venture capital, so this document is intended to give a reasonable overview of what this is and how this works, to help you better gauge whether you should invest the time and effort into putting together an executive summary and a business plan.

Venture capitalists are in business to make high-risk, high-return investments. Only very particular companies fit this model. There are many high quality products and services, with exceptional managers and great people behind them, with good profits and great futures, that are simply not good candidates for the fast turn that venture capitalists are looking for. The vast majority of business plans are declined, but don't take it personally. By no means is it a negative comment on your business or your product.

Type of Corporate Entity

Your company will need to be a C Corporation before an investment can be made. Following a venture investment, there will need to be at least two classes of stock: preferred and common. The investor(s) will be purchasing preferred stock, and the original owners will have common stock.

Losing ownership of a significant percentage of your company is a necessary component of accepting venture capital. The investor will also require representation on your Board of Directors.

If you are interested in investment only in a certain product and not in your entire company, that's no problem. The product will simply need to be spun off into a separate entity. If this is the case, be aware that the key personnel will be expected to be dedicated to the new company, and not splitting their time and resources with the previous company.

Exit Strategy

Investors are interested in a large return on their money. Obviously, this means that there must be an opportunity for a liquidity event: basically a merger or acquisition of your company by a larger entity, that creates liquidity and returns cash or valuable equity to the stockholders.

In most cases, this is not the original owner's plan or desire. They are looking for a cash investment to help them grow their product, and hope that the promise of a percentage of future sales will satisfy the investor. This is not what venture capital is looking for. If you plan to continue operating

your company for the foreseeable future, you are not a candidate for investment. There is no upside for an investor in owning a portion of a company that's going to remain privately held.

Not all types of products and services are good candidates to even have an exit strategy. A conventional FileMaker Pro solution is unlikely to be considered an unassailable product that can withstand competition. Similarly, a consulting service would have a hard time proving that their model is differentiated and has a truly sustainable competitive advantage. Simply being profitable or having great customers doesn't mean that a potential acquirer has no course other than to buy your company.

You really need to be a product or service that has a ravenous buyer ready to take over, but are missing that one little piece that venture investment can bring. Such opportunities are truly rare.

Operations

The most important part of your company that attracts investment is your management team. Your management team will remain in charge of the company, subject to the Board of Directors. The Board may require that a CEO be hired.

The investor may offer some assistance with certain matters, but you should not expect the investor to solve all your problems. The investment is in your management team, and your management team is expected to use the funds wisely to achieve the investor's desired end.

Early Stage vs. Late Stage

Whether your company is early stage or late stage doesn't necessarily matter. Often, the challenge for an early stage company is proving that their product is truly a target for potential acquisition, even though they don't yet have a track record, or even a finished product. Conversely, late stage companies need to show a good reason that if they're such a great target, why has nobody already acquired them?

One type of attractive investment in late stage companies is what's called a "mezzanine round". This is essentially a token investment, the purpose of which is to establish a valuation, shortly before an IPO or an acquisition. Anyone presently considering an offer of acquisition would be well advised to consider mezzanine financing, as it gives you all the bargaining power in negotiating the valuation.

Lead Investor

Many venture investments involve more than one investor. Often the original owners add some cash of their own in order to secure preferred stock. If you are seeking venture capital, chances are that you're making pitches to multiple investors. You might even be so lucky as to get multiple bites.

In such cases, there is always one lead investor. This is the investor that establishes the valuation and the terms. Other follow-on investors generally invest at these same terms. Thunderwood-B is happy to participate either as a lead investor or as a follow-on investor.

If Thunderwood-B decides to invest, you'll receive a term sheet outlining the terms of the deal, which you can accept or reject. Term sheets are rarely negotiable.

Conclusion

Chances are that this document has "scared you away". If so, it probably means that you're a businessperson with a responsible view of how best to run your company. If you are still seeking capital but venture investment doesn't sound like it's for you, then you may want to look into other forms of financing such as debt financing, or clever schemes involving your customers.

If not, then we look forward to seeing an executive summary, and let's hope that we have a match.

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