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## **2003 Outlook For Venture Capital Is Brighter**

By Dee Power and Brian Hill

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**Entrepreneurs polish up your PowerPoint presentations and practice your pitches, because the venture capital purse strings may be starting to loosen up.**

The venture capital environment in the United States looks brighter for 2003, according to a survey of 74 venture capital companies located in 23 states. The study was conducted by Dee Power and Brian Hill, authors of *"Inside Secrets To Venture Capital,"* and *"Attracting Capital From Angels."*

### **This report covers:**

#### **Looking Back on 2002**

Do venture capitalists think 2002 a better or worse environment for entrepreneurs looking for early stage capital?

Did activity levels rise or fall?

Did the quality of business plans improve?

**What's On The Horizon for 2003:** Are VCs optimistic about 2003? And why? What do they advise entrepreneurs who don't have a referral?

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Finding Early Stage Capital in a Tough (But Improving) Market  
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**Coming in February:**

The most critical mistakes entrepreneurs make in their business plan page

What is the one characteristic VCs think an entrepreneur must have to be successful?

## Consolidated Results on A National Level

### 2002 About The Same As 2001

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The venture capitalists were asked if the environment for entrepreneurs looking for early stage capital today is better or worse than 12 months ago. The VCs were asked to rate the environment from 1 to 5, 1 -- being much worse, 5 -- being much better.

The average rating was 2.8, about the same.

<u>Rate</u>	<u>Percent VCs responding</u>
1	4%
2	37%
3	32%
4	25%
5	1%

The number of entrepreneurs looking for venture capital has fallen again for the second year. However the quality of the entrepreneurs' business plans the venture capitalists did receive has substantially improved for the second year as well.

### A Brighter Outlook for 2003

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When asked if the next twelve months would be better or worse than the current environment, 60% of the VCs said it would be better. Again the VCs were asked to rate the environment from 1 to 5, 1 -- being much worse, 5 -- being much better. The average rating was 3.6.

<u>Rate</u>	<u>Percent VCs responding</u>
1	0%
2	6%
3	34%
4	54%
5	6%

The three most often given reasons for the optimism were in order:

1. Overwhelmingly in first place -- Improvement in the economy and equity markets
2. There is money available to invest
3. IPO markets and options for potential liquidity are improving.

Followed closely by

4. Valuations are more realistic
4. Portfolio triage is over
4. Capital Spending is up

Other reasons given were:

Can't get any worse

Fly-by-night companies are gone

The negative venture capitalists blamed their pessimism on the economy not improving fast enough and the focus on companies in their portfolios.

There were some geographic variances in the responses. VCs in the Pacific Northwest were the most optimistic with a rating of 4.2, while New York VCs were the least optimistic with a rating of 3.3, but every region believed that the climate for entrepreneurs looking for capital would improve.

Pacific	4.2
Northwest	3.7
Southwest	3.7
Midwest	3.5
California	3.5
South	3.5
East	3.5
New York	3.3

Overall the trend for the last few years has been upward. VCs rated the environment in 2001 as worse than 2000 with an average rating of 1.9. 2002 saw an improvement to 2.8. And the outlook for 2003 is 3.6, a substantial improvement.

Is the current environment better or worse than the previous 12 months.

	<u>2001</u>	<u>2002</u>	<u>2003</u>
1.9		2.8	3.6

## 2003 Venture Capital Survey Results By Region

**A Look Back At 2002:** Do venture capitalists think 2002 a better or worse environment for entrepreneurs looking for early stage capital? Did activity levels rise or fall? Did the quality of business plans improve?

**What's On The Horizon for 2003:** Are VCs optimistic about 2003? And why? What do they advise entrepreneurs who don't have a referral?

**Each Region's Analysis including:** Topics above. And what's the most critical mistake entrepreneurs made in their business plans?

## A Look Back at 2002

The venture capitalists were asked if the environment for entrepreneurs looking for early stage capital today is better or worse than 12 months ago. The VCs were asked to rate the environment from 1 to 5, 1 -- being much worse, 5 -- being much better.

<b>2002 B/W</b>	<b>2001</b>
<b><u>Region</u></b>	<b><u>Rating</u></b>
East	2.4
California	2.7
New York	2.8
South	3.0
Southwest	3.1
Midwest	3.1
Northwest	3.2
Consolidated	2.8

The consolidated average rating was 2.8 indicating little change. However there were some significant variances by region. VCs on both coasts say 2002 was worse than 12 months ago. The remaining regions say it was about the same, or very slightly better. The East was the most pessimistic followed by California.

### Activity Levels Fall For Second Year in A Row

Nationwide the number of entrepreneurs looking for venture capital has fallen again for the second year. However the quality of the entrepreneurs' business plans the venture capitalists did receive has substantially improved for the second year as well.

Contrary to the national trend, the South and Midwest saw an increase in the number of entrepreneurs looking for venture capital. The Northwest saw the greatest improvement in the quality of business plans and also saw the greatest decrease in the activity level. None of the regions saw a deterioration in the business plans from the previous years, but New York VCs thought the quality had stayed the same.

<b>Region</b>	<b># of Business Plans</b>		<b>Quality of Business Plans</b>	
	1-- increase	5 -- decrease	1 -- worse	5-- improved
Northwest	1.5		4.0	
New York	2.4		3.0	
California	2.5		3.5	
East	2.5		3.5	
Southwest	2.7		3.8	
South	3.3		3.8	
Midwest	3.3		3.6	
Consolidated	2.6		3.6	

## Brighter Outlook for 2003 in Every Region

All the regions are optimistic about 2003. When asked if the next twelve months would be better or worse than the current environment, 60% of the VCs said it would be better. The VCs were asked to predict the environment for 2003 on a scale of 1 to 5, 1 – being much worse, 5 – being much better. The average rating was 3.6.

Region	2003 B/W than 2002	Variance from 2002 rating
Northwest	4.2	1.0
Southwest	3.7	.6
Midwest	3.7	.6
California	3.5	.8
South	3.5	.5
East	3.5	1.1
New York	3.3	.5

The Northwest was the most optimistic followed by the Southwest, Midwest, California, South, and the East. New York was the least optimistic.

The East had the greatest variance from 2002 to 2003, and New York and

the South had the least variance. Another way of looking at these results is to say that the East had the greatest improvement in their outlook for 2003 when compared with their assessment of the environment for 2002, and New York and the South had the least improvement.

### Advice for entrepreneurs who don't have referrals.

A referral by a trusted associate is accepted as the best way for an entrepreneur to be introduced to a venture capital firm. For those entrepreneurs who don't have that precious contact, what do VCs recommend?

Overall the advice most often given was to network, followed by attending events such as venture capital conferences, and in third place direct contact by the entrepreneur.

Not one VC mentioned using an online matching service. Using a searchable venture capital database was seldom recommended and neither was an investment banking network. Introduction through a paid intermediary was not encouraged except in New York where it was highly favored.

VCs in California and the Southwest didn't have a strongly favored recommendation, while the Midwest had the strongest recommendation for networking.

The percentages don't add to 100% because more than one method could be selected.

1. 60% Networking
2. 50% Attendance at events such as venture capital conferences
3. 47% Direct contact by the entrepreneur
4. 25% Introduction by a paid intermediary/finder

5. 18% Through investment banking networks
6. 12% Other
7. 7% Using a searchable database of venture capital firms
8. 0% Use Online matching service

### Regional Variances

Region	#1 recommendation	% of VCs	#2 recommendation	% of VCs
Northwest	Direct Contact	83%	Networking	67%
California	Attend Events	55%	Direct tied Networking	46%
Southwest	Networking	44%	Events tied Direct	33%
Midwest	Networking	91%	Attend Events	64%
South	Attend Events	83%	Direct tied Networking	67%
East	Networking	71%	Attend Events	53%
New York	Paid Intermediary	87%	Direct Contact	38%

### Regional Recount

#### **New York - The Most Pessimistic**

VCs are moody in Manhattan

#### **East Shows The Greatest Improvement In Forecast**

By Groundhog Day, the VCs may come out of their shadow

#### **Northwest Most Optimistic**

Sunny skies in the Northwest, with an increased chance of raising capital

#### **Midwest Is Stable In 2002 And Looking Up For 2003**

The heartland is heartened by 2003

#### **California Recovering**

Coastal fog burning off, venture capital visible again

#### **Southwest Shows Steady Improvement**

Sunbelt attractive to investors as well as tourists.

#### **South Will Rise Again**

Just not quickly

## Summary By Each Region

### New York - The Most Pessimistic

VCs are moody in Manhattan. They thought 2002 was marginally worse than 2001 and looked to 2003 to be a bit improved but not by much. No one reason prevailed for the 2003 outlook. The reasons varied from an improving economy, can't get worse, valuation is better, and capital spending will improve.

The New York VCs said:

*"We are starting to be more optimistic regarding the general economy and capital markets environments. Companies appear to be beginning to spend on capital items again, which should encourage innovation and new products."*

*"There will be less capital available and returns will look better than they do now."*

*"I expect a slow economy."*

<b>2002 B/W 2001</b>		<b>2003 B/W 2002</b>		<b>Change in rating 03 - 02</b>	
<u>Rating</u>	<u>Rank by Region</u>	<u>Rating</u>	<u>Rank By Region</u>	<u>Pts Rating</u>	<u>Rank By Region</u>
2.8	5th	3.3	7 <sup>th</sup> – last	+ .5	tied 6 <sup>th</sup> last
	Optimistic to Pessimistic		Optimistic to Pessimistic		Greatest change to least change

The activity levels dropped from 2001 and the quality of business plans the VCs did receive stayed the same.

When asked what is the most critical mistake entrepreneurs make in their business plan, the VCs in New York responded with unrealistic assumptions/projections. In contrast to the other regions, not understanding the market or poor marketing strategies wasn't mentioned at all. Other mistakes included: not concise, lack of clarity – not explaining the opportunity, not focusing on their company. One VC said, *"If initial assumptions are too ridiculous, it will often keep them (the entrepreneurs) from getting a first meeting."*

For the those entrepreneurs who don't have a personal referral to a venture capital firm, 88% of the New York VCs recommended the usage of a paid intermediary followed by direct contact by the entrepreneur (37%), networking (25%), and attending events such as venture capital conferences (25%). Although not many VCs recommended the usage of a searchable database of venture capital firms, a few New York VCs did.

The percentages don't add to 100% because more than one method could be selected.

1. 88% Introduction by a paid intermediary/finder
2. 38% Direct contact by the entrepreneur

- 3. 25% Attendance at events such as venture capital conferences
- 3. 25% Networking
- 6. 13% Through investment banking networks
- 6. 13% Using a searchable database of venture capital firms
- 8. 0% Other
- 8. 0% Use Online matching service

**East Shows The Greatest Improvement In Forecast**

By Groundhog Day, VCs in the East may come out of their shadow. Even though the VCs in the East were the most pessimistic when comparing 2002 to 2001 with a rating of only 2.4, they had the greatest improvement in their outlook for 2003 when compared with 2002. There was a wide range of reasons given for the optimism with the most common being that the capital markets will improve. Other reasons include: money is available, capital spending may improve, and liquidity becoming more normal.

Venture capitalists in the East said:

*“The hope is that the capital markets would improve restoring investor confidence, both in the public as well as private sides.”*

*“We will be closer to a more normal time for liquidity which will encourage funding”.*

*“Funds have money to invest.”*

*“Until later stage investors begin to show an appetite for funding companies emerging from seed stage activity, we seed stage investors won’t commit financial suicide by funding a company to race to the ‘out of cash’ cliff.”*

<u>2002 B/W 2001</u>		<u>2003 B/W 2002</u>		<u>Change in rating 03 - 02</u>	
<u>Rating</u>	<u>Rank by Region</u>	<u>Rating</u>	<u>Rank By Region</u>	<u>Pts Rating</u>	<u>Rank By Region</u>
2.4	7 <sup>th</sup> – last	3.5	6 <sup>th</sup>	+1.1	1st
	Optimistic to Pessimistic		Optimistic to Pessimistic		Greatest change to least change

The East saw a decline in the number of entrepreneurs looking for venture capital and a modest improvement in the quality of those plans. However several VCs thought the quality had deteriorated from the previous year.

The most critical mistake VCs saw in entrepreneurs’ business plans was lack of marketing strategies or not understanding the market, followed closely by unrealistic financial projections/assumptions. In third place was not understanding the competition. One VC said: *“Give the critical points and strong arguments right from the beginning. If you do not generate interest in the initial read, most investors will not read further.”*

For those entrepreneurs who don't have a referral to a venture capital firm the recommendation most often given was networking followed by attendance at events. A few VCs recommended using a searchable VC database.

The percentages don't add to 100% because more than one method could be selected.

1. 71% Networking
2. 53% Attendance at events such as venture capital conferences
3. 47% Direct contact by the entrepreneur
4. 29% Introduction by a paid intermediary/finder
5. 24% Through investment banking networks
6. 18% Using a searchable database of venture capital firms
7. 0% Other
8. 0% Use Online matching service

### Northwest Most Optimistic

Sunny skies in the Northwest, with an increased chance of raising capital. The Northwest was the only region where every venture capitalist said the next 12 months would be substantially better in 2003. They also had the most positive outlook for 2003 of all the regions. The reasons most commonly given were a three way tie among: triage for existing portfolio companies is over, capital is available and economy has improved. Northwest VCs considered 2002 about the same as 2001.

Venture Capitalists in the Northwest said:

*“There is plenty of capital available and VCs will have more of their problem companies resolved.”*

*“The environment is dramatically improved.”*

*“Need for more early-stage investing is necessary for venture funds to have attractive new deals to invest in. Many venture firms have noticed the lack of seed/angel investing and are funding/incubating select opportunities.”*

<b>2002 B/W 2001</b>		<b>2003 B/W 2002</b>		<b>Change in rating 03 - 02</b>	
<u>Rating</u>	<u>Rank by Region</u>	<u>Rating</u>	<u>Rank By Region</u>	<u>Pts Rating</u>	<u>Rank By Region</u>
3.2	1 <sup>st</sup>	4.2	1 <sup>st</sup>	+ 1.0	2 <sup>nd</sup>
	Optimistic to Pessimistic		Optimistic to Pessimistic		Greatest change to least change

The Northwest saw the greatest decrease in the number of entrepreneurs looking for venture capital and the greatest improvement in those business plans.

The most critical mistake seen in business plans, overwhelmingly was a lack of understanding the market or how to reach the market. Unrealistic projections/assumptions were in second place. Lack of clarity and overly optimistic were also mentioned. One VC commented, *“Listing the key players by name and function only – without background detail as to why these folks are THE folks to make this particular business succeed.”*

Direct contact by the entrepreneur was the most often given advice for those entrepreneurs who don't have a referral followed by networking. A few VCs recommend attending events.

1. 83% Direct contact by the entrepreneur
2. 66% Networking
3. 33% Attendance at events such as venture capital conferences
4. 17% Through investment banking networks
5. 0% Introduction by a paid intermediary/finder
6. 0% Using a searchable database of venture capital firms
7. 0% Other
8. 0% Use Online matching service

### **Midwest Is Stable In 2002 And Looking Up For 2003**

The heartland is heartened by 2003. The majority of Midwest VCs thought 2002 was about the same as 2001. Not one VC thought that 2003 would be worse than 2002. About 80% thought it would improve. The economy improving was the most common reason followed by there is money available. Other reasons mentioned were state and local entities getting into the arena, IPO activity will improve and that valuations will improve.

The Midwest VCs said:

*“There seems to be a lot more activity and entrepreneurs are doing a better job of looking at the economics of getting to profitability.”*

*“NASDAQ will improve.”*

*“The venture capital industry will complete the sorting out of its dead portfolio companies during the next twelve months and finally be able to deploy money that has been sitting on the sidelines.”*

<u>2002 B/W 2001</u>		<u>2003 B/W 2002</u>		<u>Change in rating 03 - 02</u>	
<u>Rating</u>	<u>Rank by Region</u>	<u>Rating</u>	<u>Rank By Region</u>	<u>Pts Rating</u>	<u>Rank By Region</u>
3.1	Tied for 2 <sup>nd</sup>	3.7	Tied for 2 <sup>nd</sup>	+ .6	Tied for 4 <sup>th</sup>
	Optimistic to Pessimistic		Optimistic to Pessimistic		Greatest change to least change

Interestingly the Midwest is tied with the Southwest in the ratings.

Midwest VCs thought the number of entrepreneurs looking for venture capital was slightly greater in 2002 than 2001, and that the quality of business plans improved somewhat.

The most critical mistakes entrepreneurs make in their business plans were unclear marketing strategies -- lack of understanding the market tied, with unrealistic financial projections/assumptions. Also mentioned were: too optimistic, not understanding the basic economic model, not clear on amount of capital required or the uses of capital. One VC said concerning critical mistakes that entrepreneurs make in their plan: *“Assuming the sales will come easier than they actually do. Selling is difficult, especially for a new company and an unproven offering. Overcoming these challenges is very difficult and requires a lot of work, resources, (\$\$ and talent) and luck.”*

91% of the VCs recommend networking as a way for entrepreneurs who don't have a personal referral to find venture capital followed by attendance at events.

1. 91% Networking
2. 64% Attendance at events such as venture capital conferences
3. 37% Direct contact by the entrepreneur
3. 37% Through investment banking networks
3. 37% Introduction by a paid intermediary/finder
6. 27% Other
7. 0% Using a searchable database of venture capital firms
8. 0% Use Online matching service

### **California Recovering**

Coastal fog is burning off, venture capital is visible again. Venture capitalists located in California thought 2002 was a worse environment for entrepreneurs looking for early stage capital when compared to 2001. But they did forecast improvement for 2003 at a modest level. The positive forecast was based upon the economy improving followed by the portfolio triage is over. There were only two VCs that mentioned terrorism as a reason for a lack of improvement for 2003 and they were both located in California.

Venture capitalists said:

*“Business recovery will proceed and trigger stronger economic growth, which in turn will fuel some recovery in the stock market. All this will improve the general environment for entrepreneurs seeking early stage funding.”*

*“I believe that over the next 12 months the VC nuclear winter will begin to thaw. The elements of warmth producing the thaw will include: improving economic conditions, a crack in the IPO window, higher M&A valuations, an increase in corporate IT budgets and pressure felt to put the overhang of capital committed to VC funds to work.”*

*“Tourists and losers are gone.”*

<b>2002 B/W 2001</b>		<b>2003 B/W 2002</b>		<b>Change in rating 03 - 02</b>	
<u>Rating</u>	<u>Rank by Region</u>	<u>Rating</u>	<u>Rank By Region</u>	<u>Pts Rating</u>	<u>Rank By Region</u>
2.7	6 <sup>th</sup>	3.5	4 <sup>th</sup>	+ .8	4 <sup>th</sup>
	Optimistic to Pessimistic		Optimistic to Pessimistic		Greatest change to least change

Activity levels were down for 2002 when compared to the number of entrepreneurs contacting their firms but the quality of the business plans improved.

The most critical mistakes entrepreneurs make in their business plans were lack of competitive overview tied with lack of marketing or weak marketing strategies, followed by unrealistic financial projections/assumptions. Other mistakes mentioned included; undercapitalization, lack of clarity, undefined use of proceeds. As one venture capitalist summed it up *“Hyperbole.”*

For those entrepreneurs who find themselves without a referral to a venture capital firm, the VCs are split pretty evenly between attending events, direct contact by the entrepreneur and networking.

1. 55% Attendance at events such as venture capital conferences
2. 46% Networking
2. 46% Direct contact by the entrepreneur
4. 9% Through investment banking networks
4. 9% Other
6. 0% Introduction by a paid intermediary/finder
7. 0% Using a searchable database of venture capital firms
8. 0% Use Online matching service

One California VC was kind enough to comment on the alternatives. His/her comments are in italics.

Use on-line matching service – *“No filter”*

Introduction by a paid intermediary/finder – *“Dislike Finders Fees”*

Attendance at events such as venture capital conferences – *“Meat market, dogs with fleas”*  
 Direct Contact by the entrepreneur – *“Still one of the best methods”*  
 Through investment banking network - *“No filter, ulterior motive”*  
 Networking – *“Same as contact by entrepreneur”*  
 Using a searchable database of venture capital firms – *“Form letters tend to get little attention”*

**Southwest Shows Steady Improvement**

Sunbelt attractive to investors as well as tourists. Venture capitalists thought the environment for early stage entrepreneurs was marginally improved in 2002 when compared to 2001. And they see further improvement for 2003. The two most common reasons given for the optimism was the improvement in the economy and equity markets and that there is money available to invest.

VCs in the Southwest said:

*“Entrepreneurs are pricing their companies more rationally and investors are paying attention. In addition the shakeout of the fly by nights is almost over.”*

*“It appears that the venture economics of early-stage deals are becoming more reasonable and that the overall end user market for early-stage products is beginning to reopen.”*

*“I believe we will see some improvements in the overall equity markets, as well as the economy, thus easing the private equity investment constraints.”*

<b><u>2002 B/W 2001</u></b>		<b><u>2003 B/W 2002</u></b>		<b><u>Change in rating 03 - 02</u></b>	
<u>Rating</u>	<u>Rank by Region</u>	<u>Rating</u>	<u>Rank By Region</u>	<u>Pts Rating</u>	<u>Rank By Region</u>
3.1	Tied for 2 <sup>nd</sup>	3.7	Tied for 2 <sup>nd</sup>	+ .6	Tied for 4 <sup>th</sup>
	Optimistic to Pessimistic		Optimistic to Pessimistic		Greatest change to least change

Oddly the Southwest is tied with the Midwest in all of the rankings.

Activity levels have fallen in the last twelve months, the number of business plans received by the venture capitalists is down. However the quality of the business plans they are receiving has improved.

The most critical mistakes entrepreneurs make in their business plans are weak marketing strategies followed by unclear competition. Also mentioned were unrealistic financial projections/assumptions, lack of detail on usage of funds and rather disturbingly, lack of honesty. As one VC commented on entrepreneurs *“They show that they don’t fully understand the market’s pain points and therefore are unable to articulate their company’s go-to-market strategy.”*

Venture capitalists in the Southwest are split like their California neighboring VCs and don't have a strongly preferred recommendation for entrepreneurs who don't have a referral.

1. 55% Networking
2. 46% Attendance at events such as venture capital conferences
2. 46% Direct contact by the entrepreneur
4. 33% Other
5. 11% Introduction by a paid intermediary/finder
6. 0% Through investment banking networks
7. 0% On-line matching service
8. 0% Using a searchable database of venture capital firms

### South Will Rise Again

The South will rise again, just not quickly. The South is looking up, but just a bit. VCs thought that 2002 was the same as 2001 and see a marginal increase for 2003. The reasons for the forecast are varied and at times conflicting including: economy is improving, money is available, portfolio triage is over, VC activity is picking up counteracted by VC activity is slowing down.

Venture Capitalists in the South said:

*“Conditions are gradually improving. I believe we hit bottom in the late spring/early summer of this year (2002). After trying to raise capital for 18 months, several of our companies have just closed rounds with new investors. It seems VCs are beginning to stick their feet in the water again”*

*“Economy should loosen up a bit, current surviving portfolio companies will be stronger, and VCs will need to deploy capital beyond follow-on funding to current portfolio companies.”*

<u>2002 B/W 2001</u>		<u>2003 B/W 2002</u>		<u>Change in rating 03 - 02</u>	
<u>Rating</u>	<u>Rank by Region</u>	<u>Rating</u>	<u>Rank By Region</u>	<u>Pts Rating</u>	<u>Rank By Region</u>
3.0	4 <sup>th</sup>	3.5	5 <sup>th</sup>	+ .5	Tied for last
	Optimistic to Pessimistic		Optimistic to Pessimistic		Greatest change to least change

Contrary to the national trend, VCs in the South saw an increase in the number of business plans they received and improvement in those plans as well. The critical mistakes most often cited by VCs were lack of marketing strategies and overly optimistic. Lack of clarity and lack of detail were mentioned as well. As one VC said: *“Entrepreneurs don't use the document to show that they have thought through the business and where they are going.”*

Venture capitalists in the South most strongly recommend attending events such as venture capital conferences to those entrepreneurs who don't have a referral.

1. 83% Attendance at events such as venture capital conferences
2. 67% Networking
2. 67% Direct contact by the entrepreneur
4. 17% Other
4. 17% Using a searchable database of venture capital firms
4. 17% Through investment banking networks
- 7 0% Introduction by a paid intermediary/finder
8. 0% On-line matching service

## Finding Early Stage Capital in a Tough (But Improving) Market How the Venture Capitalists Nationwide Say to Do It

### What advice would you give to entrepreneurs looking for early stage capital?

The venture capitalists' responses are in italics and quotes.

1. In both good times and bad, this is good advice: **Be thoroughly prepared for the presentation to VCs and focus on why your business will make money for investors.**

*“Have a true and deep understanding of your market. Have a detailed and realistic operational plan for building and growing your company---don't rely on sparsely detailed pro forma financial statements.”*

*“Prove that you're solving a clearly identifiable problem for your target customer, and that your solution is proprietary and not easily replicated.”*

*“Articulate the value proposition well and get references from customers (or beta customers) as quickly as possible to demonstrate the commercial value of the proposed product or service.”*

2. In the late 1990's, capital was much more plentiful and in some cases, management teams looked at the term “burn rate” to literally mean they had investors' money to burn, and when one round of financing ran out, they could easily go out and get more. From 2000 and up to today, a massive reality check occurred in the market for early stage capital. **The emphasis now is on conserving capital and reaching as many milestones as you can on your own without investors' money.**

*“Scale back short term aspirations and cash needs. Construct a plan for cash neutral operations within the constraints of the money to be raised. Be positioned to be still standing when markets (financial & commercial) recover.”*

*“Bootstrap - search for ways to do without capital.”*

*“Develop the product as far as possible before seeking venture funding. Build a plan which requires modest capital to reach break even.”*

*“Raise a \$250-500K friends and family round first on a convertible note basis. Start talking to next round sources in order to determine key milestones. Achieve those milestones. Explore creative alternatives to raising investment capital in order to finance the business.”*

*“Show demonstrated progress towards the end goal before approaching any investor, and tell a focused, compelling story.”*

3. **In the due diligence process, investors try to determine the level of commitment the management team has to the business.** Will the team exhaust themselves trying to make this business succeed? Part of that commitment can be financial, both in terms of willingness to

commit personal resources to the venture, and the willingness to forego compensation until the cash flow of the venture becomes positive.

*“Be prepared to put every dime you have in your own venture, along with outside investors.”*

*“If you are a believer in the value of equity, don’t pull out large salaries from the business at its initial stages. This may help gain investor confidence by showing that you’ve got “skin in the game” and that you understand the criticalness and scarcity of capital during the early stages of a company. Especially with the current market conditions where the greatest risk may be future financing risk.”*

This last sentence is important. The harsh reality now is that a company may not be able to secure that follow-on round of capital, so the seed or first round of financing is even more precious and must be conserved.

**4. One way investors mitigate risk is to only put money behind the very finest management teams.** An ever-viable maxim applies (and you imagine VCs carry this around in their wallets): a great team with a mediocre idea succeeds more often than a great idea with a mediocre team. The strength of the management team is even more critical to them when the new venture will be trying to gain a foothold in tough economic times.

*“If you assemble a “dream team” from your domain, and you identify a very large opportunity undergoing fundamental technological change - the rest of the business plan is largely filler.”*

*“Be very organized behind a great team.”*

*“Be very precise be sure of quality of management team, be able to support what you present.”*

5. Even in the exhilarating days of the Internet boom, entrepreneurs were sometimes shocked by how long it took them to obtain seed stage or first round capital. For one thing, they did not take into account the incredible number of ventures that were begun in a short period of time, all pounding on investors’ doors at once. Today, the number of entrepreneurs looking for capital has declined, but at the same time, investors have become much more cautious. **The bottom line: nothing succeeds like perseverance.**

*“Be prepared for an exhausting experience and don’t take rejection personally. Every time you have an opportunity to present to an investor must be as fresh and enthusiastic as the first.”*

*“Perseverance. Keep your burn rate low because it will take much longer than you ever envisioned.”*

*“Plan on needing 9-12 months to raise the round. Build a great team and utilize conservative (honestly) projections.”*

*“Network like crazy, don’t give up.”*

\* \* \*

Our survey pointed out a definite lifting of the gloom that has hung over the early stage capital market for more than two years, but not all VCs were in agreement, as quotes from these two VC’s show:

*“Good entrepreneurs will get funding! Great companies are often started in a recessionary environment.”*

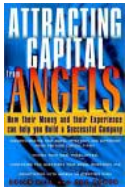
*“Keep your day job.”*

Perhaps this venture capitalist most clearly stated what entrepreneurs looking for early stage capital in 2003 should keep in mind:

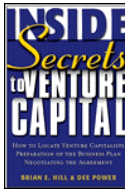
*“Conserve capital, get customers, be patient, be persistent.”*

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Dee Power and Brian Hill are the authors of



***“Attracting Capital From Angels: How Their Money and Their Experience Can Help You Build a Successful Company,”*** 2002, John Wiley & Sons available in bookstores nationwide, online booksellers such as amazon.com and <http://www.AttractingCapitalFromAngels.com>



***“Inside Secrets To Venture Capital,”*** 2001, John Wiley & Sons, available in bookstores nationwide and online booksellers such as amazon.com and <http://www.InsideSecretsToVentureCapital.com>.

They are also the founders of Profit Dynamics Inc. located in Fountain Hills Arizona and of <http://www.capital-connection.com>

