

START-UPS & EARLY STAGE COMPANIES Raising Business Capital

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Section 1: An Introduction

FAQ

One of the most frequently asked questions that George James Ltd gets from people we talk to is...‘How do we best set about raising new capital, who do we talk to and can you introduce us to an Angel Investor/Venture Capitalist/P/E Fund Manager or similar?’

Of course, different businesses face this funding challenge at different points, whether an earlier or later stage of their growth curve than others and sometimes, some never need to face it at all! It’s usually intrinsic to their individual business model and product lifecycle(s) and occasionally this need is also largely determined by the industry sector in which you operate.

Our Consulting business deals cross sector, so we appreciate (say) that a software company has a very different set of growth challenges to face as opposed to (say) a small pharma/biotech. Advice is never “a one size fits all”, but there are some parallels. Some businesses are continuously able to grow organically whilst others recognise that adequate and ongoing funding (often with sharply multiplying amounts in the case of pharma/biotech companies) is their only route to survival/ultimate profitability and perhaps a planned exit strategy.

LIFESCIENCE SECTOR

The Life Science sector, has achieved a steady rate of new start-ups, with circa 60 new life science companies being formed annually – a stable rate of evolution that has existed over the last decade. Of these, about 60% today are biotech companies and 40% medtech. (*Source – 2015 UK Life Science Start-up report*).

Many of the businesses we work with are where an academic turns entrepreneur, in effect seeking to convert their considerable scientific expertise into a flourishing business.

Many biotech businesses and small pharma companies find themselves in a different situation than other sector start-ups. Many can be initially supported by their alma maters, with UK University spin-outs accounting for about 1/3rd. These ratios do differ by country, it’s about 60% for Scotland and 20% in Wales. Oxford and Cambridge Universities are noted leaders in this field, with Imperial College and the University of Edinburgh also being major players/supporters of innovation.

Their financial and similar support enable the erstwhile scientist/entrepreneur to focus on managing other challenges re the take-up and development of their promising scientific approach and hopefully its evolution into a viable, commercial offering.

INCUBATORS

Another conclusion, ex *the 2015 UK Life Science Start-up Report*, is that companies based in an incubator do better than those who go it alone. Of the 304 life science start-ups attracting investment between 2010 to 2014, - 173 (57%) were in incubators or life science parks – a considerable advantage.

In terms of monies raised, this trend increases further, a 6: 1 ratio in favour of companies within an incubator/life science park who received £329M in funding, whereas companies elsewhere raised only £51M.

In terms of new Life Science companies wanting to maximise their opportunities of both raising capital and of achieving the maximum amount, the conclusions are obvious, primarily that a close proximity to both professional advice and a potential funding network, a feature of the incubator environment, is an immense asset. Unfortunately, no data is available to present a full picture by clarifying the degree of support provided to/relied upon by those external companies...or if/how any such advice might have been used.

USING THE WEB

Faced with these regular enquiries....and 'yes we know, a brief internet search reveals a mass of sometimes conflicting information, loan suppliers, products, grant agencies, each with a set of procedures and processes etc. etc.', George James Ltd decided to pen its own short range of papers. Our objective being to capture the crucial issues from our perspective, to outline some critical aspects that we've seen and essentially to try to provide some insight(s), based on our practical experiences.

OUR APPROACH – STARTUPS AND EARLY STAGE COMPANIES

How to do this, what assumptions have we made and what compromises? Well, we have decided to approach this from the viewpoint of a new start-up business or an early stage company. So, think a new business, Life Science and/or other sector, focussed initially on survival, then on growth and the recognition that reaching both aims are, or will shortly become, dependent on additional funding, whether from existing or new sources.

OUR APPROACH – MORE ESTABLISHED FIRMS

There is another category of business, those with greater maturity that that gone through the travails of those formative stages and survived. Their owners/shareholders are looking at a parallel objective, how do we best grow the business and how do we finance such growth, whether this be;

- expanding internationally,
- considering a merger or acquisition or perhaps,
- a partnering arrangement or alternative expansion strategy?

Often in these more established businesses, another issue is also emerging....how do the risk-takers, the entrepreneur/ owner and/or the shareholders perhaps, not only protect their lifestyle/family but also secure an exit arrangement to safely extract their capital? These articles are yet to be developed.

OUR ARTICLES AND THEIR INTENDED SCOPE

Startups and Early Stage Businesses – Life science oriented and others

1. Introduction - this paper.
2. Preparing for the Capital Raising process
3. Building and delivering your pitch
4. Where from? – A critical look at some sources of capital funding
5. How much to ask for...and why?
6. Stages of Investment and Funding
7. Term Sheets and Terms
8. Due Diligence
9. Identifying, Understanding, Communicating and Working with your investors.
10. Not working for you? Common reasons for rejections.

Section 2: Preparing to raise capital

INTRODUCTION

Anyone who's ever walked into a bank to ask for a startup loan knows this preparation phase is an essential part of the process. UK banks advise that they reject more than half the financing requests received. This figure increases sharply for businesses operating in more specialist environments like small Pharma and Biotech, where usually only specialists can ever fully understand and evaluate both the science and the business proposition.

'rejection rates for start-ups seeking new loans exceed 50%, in part reflecting lender's difficulty in accurately assessing the viability of businesses with limited track records and in part reflecting the inability of very new business to make regular debt repayments'
British Business Bank Report – Small Business Finance Markets 2015/6

THE BASICS

Give yourself time; gaining agreement to longer term/capital funding is unlikely to be a quick process and it could easily take over 12 months or more!

Short term facilities/overdrafts (covering day to day business activities) are usually quicker to arrange but may have associated short term expiry dates/harsh conditions.

Understand investor perspective and be prepared to mitigate investor risk!

Dreams versus reality. Do not ask a bank...or any other potential investor just to advance monies to make your dream a reality! Banks typically hate being asked to provide funding which means they effectively finance more than 50% of a business building venture! In such cases, who is the owner and who's taking the most risk?

Evidence. Potential investors like to see that an entrepreneur/owner has something tangible to offer. A working prototype, good science/innovative technology (say), with a tested market, evidence of business skills/ability and a rational business model, with a concept they can explain and ideally validate against market need/ any competition etc.

Clarity around the objective. Be prepared to clarify exactly what your venture entails?

What will the money do? (e.g. A plan for where, when and how it will be used), why it will work as specified (e.g. monitoring and controls) and what is the opportunity for external investors?

Business plans et al. Key business milestones/timeframes and associated financial projections/estimates et al are just figures! Caveat - they rarely, if ever, work out in practice so how will the many potential variances be noted, recorded and managed?

ASSESSING THE PROPOSITION

One leading UK Bank uses the following Lending Formula guidelines, to assess loan propositions/requests for capital funding, which all Loans/Advances Managers are obliged to follow. Other lenders use variants of this formula.

Character: – Who is the borrower/entrepreneur/business owner etc and how evidenced? What is the business, what are its aims/objectives etc.

Capability: – Track record with the Bank/Lender or other institution, the business history and integrity, Experience and proven knowledge of business, the science etc.

Capital: - See above, who is really tasking the risk and who is managing/mitigating it?

Purpose: – Implied, see above

Amount – See Section 5

Repayment: Self- evident, but especially as/if set against any business milestone(s).

Terms: - including interest rate(s), fees, any penalty clauses, share capital percentage etc.

Security/Collateral: - what options available to mitigate risk?

It will be apparent that a lender, be it a Bank, Angel investor, VC or whoever, puts as much (or more) weight/value against the person, the owner/entrepreneur as it does against the actual financial proposition.

MEETING INVESTOR EXPECTATIONS

Background: Professional, scientific and technical SME survival rates are in the order of:

- 92% after 1 year,
- 64% after 3 years, but only
- <50% of new business start-ups survive for 5 years.

(Source Credit HQ website - <https://survivalcalculator.biz/>)

Investor's fears and pain points – they don't want;

- 1) To lose money
- 2) To be made to look (or feel) stupid!

They do however, want to feel/believe;

- That the business will meet its stated objectives.
- The business can outperform the competition (now and in the future)
- That there is no discernible 'market disruptor' emerging.
- That your marketing strategy is well thought out, that;
 - There is a good brand (actual/potential), which can be further improved.
 - A strong website with appropriate image/messages
 - Awareness of social media opportunities exists etc.
 - That the business has a good storyline/tale to tell.
- That, where relevant business skills/abilities do not exist, then the business and/or the board is both able and willing to find someone with the appropriate knowledge to assist.
- That the board and/or its leader (CEO?) or entrepreneur/founder/owner, has the tenacity to follow through on a pre-defined course of action. Consider that in terms of raising capital, where rejection of a proposal is almost certain in over 90% of applications/cases submitted.

ARE YOU READY?

Have you got a business plan and associated financial plans, do you have sensible milestones on your path to achievement?

Do you understand this simple reality? Investors do not want to invest with you!....they know that every investment can fail, so this truism needs to be central to everything you do!

You'll have to overcome negativity and do your utmost to explain why the investor cannot afford to turn down your opportunity.

Is the core structure of your business already in place? Can you convincingly show;

- Good management - experienced in the field, enthusiastic and talented, supported by a solid, core team, with relevant skills/experience?
- A skilled, enthusiastic workforce (or plans to develop/train one)
- Defined corporate structure, with access to good legal skills

- Ditto – access to helpful, insightful advisors
- How you're going to market your differentiation, and the competitive advantage it creates?

Do you know (and are you able to substantiate) the value of your business?

Do you know the value of your competitors?

Do you know how much of the business you are prepared to give away in a deal?

VISION

What is your vision? Can you articulate it clearly and concisely?

How has it emerged and what might it say about your business in 1 year, 3 years 5 years and beyond?

Is it realistic, is it achievable? How patient are you...do you know what tenacity means? What is/are your ambition(s)? How will you get there and how will you know when you've got there?

PR AND MARKETING YOUR COMPANY

Marketing and good PR is a fundamental part of business activity today, though it is both an art and a skill that some need to learn...to others it perhaps comes more naturally. It is also fundamental to gaining startup success and thereby leveraging your business profile for fundraising.

How can you utilise the requisite marketing and salesmanship techniques to promote your business and drive your growth plans to the next stage?

Creativity: This is a useful asset. People quickly recognise and respond to a creative PR/marketing initiative. So, think about how best to portray your business but in a way that resonates with the public at large, which also include possible investors, of course. It's not easy, but innovation in conjunction with your knowhow can often yield excellent results.

Integrated: Have you got an integrated growth and financial/fundraising plan? Are all your marketing efforts and the branding messages you're supplying, working in harmony?

Cost effective: Creating business momentum and a strong public profile are critical to your fundraising effort. However, it needs to be cost effective, though a move towards producing an image that looks too cheap or too extravagant, is a constant risk and a balancing act.

OUTREACH

Journalists and local media

Connections/conversations with local journalists is always a good tactic. They like to seek out good news, "local company does good" promotion stories, so try your local newspapers, even perhaps your local newsletter/ radio/television station., who can all become strong allies to your cause. The downside is that this may take time and effort on your part but the payoff can be substantial.

Self-published Press Releases – Web and physical Press.

Anyone can produce their own news today, you just need to use the system.

Is your competitor's new media blitz, causing you concern, are they pulling in key prospects that you were pursuing? Product launches, events can be published and you can pay for stories/releases to be distributed and/or you can use local news agencies – see above. It's also possible to consider producing content/articles/stories etc. for specific sector/industry magazine/publications.

If you adopt a web based approach, ensure that you have the supporting statistical analysis to ensure you are getting value.

Social media and Blogs

If this is not your forte, then is there anyone in your company who is familiar and comfortable enough with this technology, to act on your behalf? Creating an online presence is increasingly important and with it the opportunity to develop an SEO that you own and control.

Section 3: Building and delivering your pitch – verbally and visually!

BUSINESS PLANS – GET REAL!

How perfect is your business plan? Beware. the following Trap!

German military strategist Helmuth von Moltke put it nicely...**“No battleplan,”** he sagely noted, **“survives contact with the enemy”...**

No experienced investor will ever rely totally on your business plan either...they always change!

GETTING YOUR MESSAGE ACROSS

Is it simple?

Is it clear?

Is it consistent?

Can you ...and all your team communicate it? Have you tested/practiced this?

Do you and all your team believe in it? How do you know that all your team supports it? Is it owned by all of the team? CARE This will be tested by any Due Diligence process...

TARGETTING

Do you know, exactly, to whom this message is to be addressed...and have you revised and crafted it accordingly?

Have you researched your target audience, how well do you know them and their expectations/likes/dislikes?

Do you know how to win the opportunity, do you have key ‘buzzwords’ to hold attention and build credibility with the audience?

CRAFTING AND USING AN ELEVATOR PITCH

Do you understand this business term? What is an 'Elevator Pitch' and when/how to use one?

One of the best explanations we've found, is at <https://www.mindtools.com/pages/article/elevator-pitch.htm> and the procedure below follows their methodology, though there are others.

If this one doesn't work for you, we suggest that you try Google!

Introducing your Company Quickly and Compellingly

1. Identify Your Goal
2. Explain What You Do
3. Communicate Your USP
4. Engage with a Question
5. Put It All Together
6. Practice

Some other Tips;

- ❖ Maximum 30 seconds speech, 20 seconds is better...otherwise listener attention will wear out!
- ❖ Ensure it arouses interest and a reply
- ❖ Remember, it's about your Customers, not you
- ❖ It reinforces your unique features
- ❖ It can be told as a story

Ok, so you and your team have cracked the elevator pitch.

It's well-rehearsed and it's second nature in all your conversations...but what else and where might you need to support it, say in a company presentation situation?

SUPPORT: THE ELEVATOR PITCH SLIDE DECK – SIMPLE VERSION

Again, if you know how to do this...great! If not and if perhaps you're new to Powerpoint and the best techniques for using it...again, we suggest try Google, to update and learn the most modern skills and techniques.



When you do, you'll find a common approach! "Less Is More". Typically, the web based advice here ranges from recommending a maximum of 10 to perhaps 15 slides. Remember, make the message clear and easy to understand, ensure it builds a compelling case and that it holds investor interest.

Expanding this theme further, george james ltd endorses Guy Kawasaki's (author of the Art of the Start) approach to Powerpoints - <https://guykawasaki.com/the-only-10-slides-you-need-in-your-pitch/>.

*'I am evangelizing the 10/20/30 Rule of PowerPoint. It's quite simple: a pitch should have **ten slides**, last no more than **twenty minutes**, and contain **no font smaller than thirty points**. This rule is applicable for any presentation to reach agreement: for example, raising capital, making a sale, forming a partnership, etc.'*

Not only does this website espouse this approach, it also provides the slides titles, all you need to do is add the relevant content...what's not to like? Nice!

SUPPORT: THE ELAVATOR PITCH SLIDE DECK – DETAILED VERSION

You might want to reuse/send out the above Slide Deck file, as part of any corporate response to a potential investor or perhaps as a background marketing information to a Customer/contract prospect?

It's necessarily limited though...so consider whether you might need an expanded, detailed version, as well? There are no rights/wrongs here but if you want to amplify some aspects of your message, then this is an option, but again, don't overdo it!

If you don't follow Guy Kawasaki's approach, then you need to consider what such a deck should contain...what extra information do you want to provide, what will a potential investor or new client really want to know about this business?

DESIGN/GRAPHICS?

Using some of the more advanced PPT features is an individual decision, some people like them, other's hate them! In terms of getting the best visuals/animations to represent your business though, we strongly advocate that professional input is usually beneficial. You are representing /portraying your business, so now is not the time to start cutting corners, unless you're confident of your skills.

CAPITAL RAISING - SHOULD WE SPECIFY AMOUNTS?

A common question...“ if we’re seeking funding...should we include the precise amount of capital sought?

Suggested solution...we advocate using a range. Don’t be too precise! Some funders have cut off points, and/or bands whilst others apply different (more strenuous) criteria for higher sums. Give yourself the best chance by not boxing yourselves into a corner. Be aware of the potential professional and other costs associated with Due Diligence...see **Section 4**, it’s not cheap!

THE ONE PAGE PROPOSAL

Another optional, though frequently used marketing tool is the one-page proposal.

It combines, collates and brings all the various business parts together in a single, easily digestible format. So, think about creating this to unify;

- ❖ The Business Plan
- ❖ The Pitch Deck
- ❖ Your Mission Statement

Section 4: Funding: From Where and Why? A Brief Critique of Capital Sources.

INTRODUCTION

What are the fundraising options for today's Startup business and what are the pros/cons associated with them?

This is not a simple topic to analyse, but we will attempt to draw out some interesting/useful threads and conclusions. Nor is the capital provision market static, so what is covered herein (at the date of writing – June 2017) might well either become irrelevant, at worst, or subsequently amended by government regulations/ finance market changes at best.

POTENTIAL UK TAX RELIEFS – SEIS AND EIS, MITIGATING YOUR RISK

Before examining potential sources of funding, we should capture the main tax reliefs currently available to investors, although we refer you to HMRC website for up to date information and perhaps the financial press re any planned changes.

Two schemes seem particularly relevant;

- The Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS), were introduced by the UK Government to help early-stage companies raise equity finance.
- The schemes assist these early-stage businesses by offering a range of tax reliefs and incentives to investors who purchase shares in those companies.
- And these benefits really are outstanding.

SEIS

- SEIS encourages investment in qualifying companies by providing investors with 50% of their investment back in income tax relief.
- On top of this, investors can also benefit as the sale of their shares may be exempt from capital gains tax.
- On the flip side, loss relief is available if the company goes bust.

EIS

- EIS meanwhile, provides investors with up to 30% of their investment back in income tax relief.

- It also allows investors to defer CGT on gains which are reinvested in EIS eligible shares.
- Like SEIS, gains from the sale of your shares may also be exempt from CGT and again... loss relief is available if the company fails.

The availability of these benefits differs from person to person, depending on individual circumstances, please see:

<https://www.gov.uk/seed-enterprise-investment-scheme-background>

<https://www.gov.uk/government/publications/the-enterprise-investment-scheme-introduction>

If you are considering investing into a start-up, look out for those that qualify for either scheme...and ask to see the company's Advanced Assurance, being HMRC's confirmation that a business is in fact, using an eligible scheme.

1. BANK FACILITIES: LOANS AND OVERDRAFTS

Typically, the first option a new, would be entrepreneur thinks off... this is also usually the most disappointing for a business seeking to generate longer term capital funding. Banks offer overdrafts to cover 'working capital needs, read this as supporting the day to day operational aspects of the business financial cycle. This is usually for 6-12 months only, typically reviewed against updated business results/accounts etc.

Similarly, although Business Loans are available, these are usually intended to cover the purchase/acquisition of business assets, like machinery, property etc. A Loan, by definition, is expected to be repaid over an agreed term, the expectation being that the asset acquired will generate additional revenues to assist in paying back the borrowing. A Bank Business Loan is NOT intended as a source of long-term capital, repayable against some far-off sale/business exit/liquidation event.

Another frequent problem, is that Banks will only consider loans etc to companies with a good track record, so startups fail this dual longevity/profitability test and often their owners have little in the way of available collateral either, another condition often applied.

2. BUSINESS INCUBATORS

Business incubators are organisations, set up to support fledgling companies. Typically, they will provide startups/early stage businesses with office space and equipment, some seed finance and business mentoring. They operate in a variety of

forms, many nowadays are funded by Universities, perhaps also managing/ allocating Grant monies from Government or Regional sources. Typically, such seed funding is provided against a small shareholding – 10-15% in the startup business.

Although both Oxford, Cambridge and other Universities operate in this way, supporting the most promising company innovators/technologies. this support may only extend until the business proves its viability (and perhaps the underlying science/technology etc.?)

Angel investors and other funders, VC/PE and Other Fund Managers do work closely with Business Incubators though, so the very best prospects can and do sometimes find resources introduced/becoming available to enable them to grow to the next stage of development, without necessitating a market search for external finance.

3. BUSINESS ANGELS/SUPER ANGELS

These are private individuals, typically seeking to invest amounts, typically of around £25,000 but with no fixed limit, into businesses, where they see opportunity for growth. Because they're individuals, they may be agreeable to accepting greater risks than VC or PE companies, so are currently the largest investors in early stage and seed startups.

Usually, such investments are made against a share stake, the other advantage to a startup company is that the Angel typically also brings experience of a successful business career with them and often wish, to become involved in some 'hands on way'.

There are a variety of Angel Investor Associations and networks, possibly the main one being the UK Business Angels Association, (UKBAA) which claims a membership of over 160 organisations and 18000 investors.

See <https://www.ukbaa.org.uk/>

There is also a new trend, the emergence of 'super angels' who are prepared to invest larger sums and offer extensive business support

4. GRANTS

This is a complex topic, which is constantly evolving. Grants in the UK are provided by central and local/regional government bodies and by the European Union, as well as other organisations.

Grants usually do not have to be repaid and do not have associated interest payments. Grants are used in conjunction with other forms of financing, normally only covering up to half (or less) of the finance costs. They are also limited to new ventures, so not for existing corporate development. They are though bureaucratic and often subject to rigorous scrutiny /oversight of the associated business and proposal plans.

5. VENTURE CAPITAL

This complex topic is the proposed subject of a future george james ltd project, being a more detailed, separate paper. Not usually available to startups or very early stage businesses, unless involving a Micro Seed capital specialist, this style of financing is more relevant to larger, established businesses.

If this topic is of interest, please contact george james ltd consulting to arrange a conversation around your situation/obtaining of further advice. For reference, usually this request is best managed either on a workshop basis or via a consulting engagement.

6. CORPORATE VENTURING/ALLIANCES/PARTNERING

Corporate Venturing is the term used when one company, usually a larger business, makes an investment in another, smaller company. Such arrangements come in many forms, so it is difficult to discuss generalities. Tax allowances are available for business making such investments – see HMRC Corporation Tax: Corporate Venturing Scheme (CT600G (2006) Version 2) –

<https://www.gov.uk/government/publications/corporation-tax-corporate-venturing-scheme-ct600g-2006-version-2>

7. BOOTSTRAPPING

Really talks about a business startup, commencing operations and growing under its own resources and ploughing back all/any additional resources generated. This often entails the entrepreneur living very frugally at the outset until the business reaches a respectable size, although that could be years! Can be linked with FAMILY AND FRIENDS – see following, the advantage is that the entrepreneur retains control of the business, with minimal investor pressures and continues to own all the equity.

8. FAMILY AND FRIENDS

Can be very straight-forward, family and friends typically lend to the individual, only rarely do they support the underlying proposition. That in time can create major stresses on the personal relationships, for many reasons.

No entrepreneur starts a business believing it will fail.... but many do, statistically only about 50% will still be trading in 4 years.

Against these downsides, are the benefits. Flexibility, minimal costs, possibly attractive terms and potentially speed of decision/ready access to monies.

9. CREDIT CARDS

Sometimes the only available option! A 'Last Chance Saloon' manoeuvre for many entrepreneurs. Probably never a sensible approach, it's not cheap but it is an option and many entrepreneurs/risk takers have been forced to take that decision.

Obviously, it needs to be tightly controlled! Any monies borrowed must be repaid on time, to minimise the potentially heavy charges/penal interest rates. A failure to manage it properly also risks damage to the borrower's credit score, which of itself will restrict the ability, if ever needed, to repeat the same exercise.

10. START UP LAUNCH AND CROWDFUNDING

Once separate websites, now combining. Crowdfunding is an old concept, rebranded in the last 10 years, to reflect the technological age and the capabilities of the internet. Now enables startup and early stage entrepreneurs to reach out online and make their business pitch to people, for funding support. A different form, donation crowdfunding is effectively more like charitable giving.

Today, startup capital and equity crowdfunding is managed via a platform with a web portal! There are many of these, each with different specialities. Some sites of interest might be;

<https://www.startups.co/>

<https://www.crowdcube.com/>

<https://www.entrepreneur.com/article/228534>

<https://gust.com/>

Broadly all enable promotion of a business idea – the 'pitch' and the registration of investor interest. If/when a threshold limit of investor commitment is attained, the collection of investor capital is completed. This is then either invested for them as shareholders or possibly via a nominee identity, dependent on the proposal terms. Repayment of capital comes around when the entrepreneur exits, usually ex a sale or similar arrangement.

Today, this online option represents only a small portion of the total funds raised (Shadow Foundr says only average 12.4% equity needs are raised this way) but it seems possible that this percentage will increase as the market and its operation becomes ever more sophisticated.

11. FLASH FUNDING

Flash Funding is a new, popular concept started by www.flashfunders.com. This is where start-ups who have a lead investor (typically 20% of the raise) can use the domino effect by posting their pitch deck online with their capital raised, and other investors can jump in for a fixed equity rate. It is an excellent way to get extra attention if you already have that initial kicker - 10- 20% from a lead investor.

12. PROFESSIONAL SOCIAL NETWORKING SITES

Linked In is obviously the prime name here, to source potential investors. Beyond that however, other professional social networking sites can connect you with investors from other countries who want to participate in the global business environment and often bring your product or service to their part of the world. Some professional social networking sites to consider for investor connections include EFactor, Xing, Plaxo, Startup Nation, Cofoundr, and Meetup.

13. FAMILY OFFICES

Although investors are experiencing a fall in the levels of investment by VC firms, this has been offset in part by the emergence of single family/multi-family offices, who are responsible for management of family wealth/capital to ensure that the wealth they are responsible for can both be grown and efficiently passed down across generations. Single family offices (SFO's) manage funds for just one family, while other firms are responsible for managing multiple family fund/investment arrangements.

They have been around for many years – Family Offices for J P Morgan and the Rockefellers are both long established, having been in existence for many decades or even longer, some are over 100 years old! Emergence of “new monies” in the last 15-20 years has created many more of these SFO's, Ernst & Young currently estimate that there are now over 3000 SFO's globally, with a high rate of growth.

Ironically many of these families originate from the investment banking, hedge fund, private equity and fund management sectors, which have been extremely profitable for some individuals. They wish to stay in these sectors but wish to avoid the very penal VC charges, “the 2 and 20”, being the typically, a minimum 2% annual charge

(or even higher annual charge) plus 20% ROI. So, they also seek out suitable direct investment opportunities, aimed at the longer-term horizon, which match their investment aims.

WHO ARE THEY? WHERE ARE THEY? HOW TO MAKE CONTACT?

The downside, many of these offices are “off radar”, many do not exist on the www although for those familiar with the financial world, it is possible to assess likely names/prospects. However, as they usually lack a website, then email marketing etc is impossible.

The only route-in is actually, similar to accessing VC companies! An introduction is essential, so you need to network and find out if anyone you know, knows someone, directly or otherwise, who can vouch for you and effect an introduction.

Otherwise, we suggest talking, reviewing if and how other, similar sector entrepreneurs to yourself have found such family office based funding, which might open the door to a conversation.

Section 5: How Much To Ask For ...and Why?

A CAVEAT:

The working assumption for this section is that the Reader has read and considered the impact of Section 9, Understanding and working with Investors.

HOW MUCH TO ASK FOR AND WHAT TO ACCEPT?

Our recommendation is that any founder/entrepreneur entering any finance discussions with potential investors adopt a three-point strategy and be prepared to amend your objectives, if the amount(s) on offer are not going to match your expectations.

- 1) **A MINIMUM** amount necessary to continue (and grow) the business (WORST CASE)
- 2) **A realistic ACCEPTABLE** amount, possibly midway position/value
- 3) **An ideal BEST CASE** amount outcome

To put amounts into context, normally to cover off the first 1-3 years of a startup business, one is looking at a significant amount of seed funding, usually a six to seven figure investment sum, although as expenditure is probably phased over the period, so funding could be set against key milestones? Obviously in such cases a supporting cashflow forecast (CFF) becomes a critical document.

For a small pharma/biotech, due to the uniqueness of the industry and its regulatory overview, it could well be expected that the sum initially sought is much nearer to the quoted top end figure than the lower, even with very tight control of expenditures!

INVESTOR ENTRY/EXIT POINTS

As you move from Concept to Startup and Startup to Growth phases, then these would typically be the points where an existing investor can exit or agree on updated terms and/or where new, fresh investments/investors can be sought and fresh funding arranged. Such exit points are where investors can leave taking with them a useful profit, to set off the risks that they have supported. It is important to show such a payoff as an indicator both of business integrity and to encourage new (and retain old?) investors.

The Minimum Investment must cover the costs that must be met, in any circumstances, for a period or to a milestone where more funding is necessary. It might then cover say Launch, and Survival, being the least amount needed to meet your immediate goals. It should only allow for the barest amount of Growth (if no Growth, then everything is at a standstill, perhaps even negative allowing for inflation. So, ask yourself, should you continue, especially if little, or no prospect of building a profitable business?) On occasion, this option is adopted by founders/owners, if their issue is one of timing and they have a Plan B or alternative strategy to pursue, but it is neither a desirable, nor comfortable strategy.

Realistic /Acceptable Investment. How much is likely to come from where? Sources like own funds, Family and Friends and Angel/Other Investors? The available funding will obviously impact on your objectives and capabilities to meet your aims. Do you need to settle for a lesser sum and if so, can you amend your objectives/plans to fit in another round of funding, when you should have an improved, more solid proposition? Knowing how much capital you need and your 'burn rate' is essential.

Ideal Investment. This is the result that will enable you to meet all the objectives in your plan, provided you stick to any associated timetable! It should also allow a reserve against contingencies, for any unexpected and usually negative events. Such a successful fundraising conclusion is very rare in George James Ltd's experience!

Having these three options in your head will provide a roadmap during any investment negotiations and enable you, hopefully, to achieve a sensible outcome. At a practical level, if there are potentially multiple investors, then you should use what is likely to be invested for certain, to determine your round amount (and fix your plans accordingly. It is usually easier to interest investors when a round is potentially 'oversubscribed, then the opposite scenario, when doubts will creep in...

A final point; please do not forget the likely costs of the investment round. It's likely to involve staff time, professional fees etc and it's expected that the company will meet these, not the investors! If in doubt, include estimates (say up to 10% of the funding amount sought) in your costings.

VALUATIONS AND SHARE/EQUITY OWNERSHIP

How much share capital/equity, are you as the founder/owner/entrepreneur prepared to hand over to investors against their capital investments? A Rule of Thumb is that a founder

should be prepared to relinquish up to 20% of their shareholding, for each round of capital raised.

Otherwise, it's a simple question with all too often a complex answer!

Company valuation is fraught with difficulties, being more of a judgement call/opinion than an exact science. That often means that there are multiple valuations (and valuation methods) in play.

What do you believe your company is worth?

What do your potential investors believe it might be worth? Be mindful, the ultimate test...a company is only worth what someone, is able/prepared to pay for it!

There is always a difference between these two valuations, so we suggest that you have a lower/higher figure in your head, to provide scope for a negotiation, when needing to persuade possible investors as to the accuracy of your figures.

Some ways in which an owner/entrepreneur/founder can usefully improve their positions are;

- Have a well-structured and thought through/tested (if possible) Business Plan.
- Support this with a thorough set of market research/ analysis.
- In tandem, provide a financial forecast.

PRE-MONEY VALUATIONS AND POST MONEY VALUATIONS

Your business will have a pre-valuation worth before any investment/financing and a different post valuation after the investment.

External investors, such as venture capitalists and angel investors will use a pre-money valuation to determine how much "equity" to ask for in return for their cash injection to an entrepreneur and his/her startup company. This is calculated on a fully diluted basis – this term refers to all shares issued, plus shares allocated to the option pool and any other shares which the company might be required to issue via, options, warrants, convertible debt or other

The post valuation is equal to the pre-valuation plus new capital invested.

Pre. and post investment valuations will apply to every round of funding.

OPTION POOL

The issues around valuation of a business when its equity consists of not only Ordinary Shares, but also Convertible Loan Stock and various other financial instruments are to be examined by George James Ltd, in a proposed separate future paper. However, one common feature of a funding, whether in existence before or after a capital injection, is the creation of an Option Pool.

The investor normally proposes the establishment of an option share pool, the better to reward and retain key team members, or the extension of same, if a pool already exists. It will be necessary to be very clear about how this option pool is treated re the impact on investor shareholdings and any prospect of dilution, so this is an important aspect of the Term Sheet agreement. – see Section 7.

THE FINANCIAL FORECAST AND YOUR COMPANY VALUATION(S)

Investors will only become interested in your business if it has a strong financial tale to tell. If you cannot demonstrate why this is an opportunity not to be missed, then you are obliged to support your case with a set of financial accounts and projections.

This is not an easy task, especially for anyone not used to fund raising and the objections/negatives that investors will be raising. We recommend that anyone in this situation should obtain professional advice and support to be properly prepared, for this critical element.

You should, as a minimum provide;

- Income projections, up to (say) the next 3 years
- Expenses projections – over the same 3 years
- Expected growth (may be multiple scenarios, with one being your firm selection), with any associated evidence. Some investors may want projections over a longer term – 4-5 years but for a startup/early stage company, that might effectively become too speculative?

Consider your need to support;

- The company's financial viability.
- Identification and provision re any mitigations for an/all Risks that could arise/impact these projections

- A map of your projections against your Business Plan, to clearly display the future financial status and when/and for how much any additional funding will become necessary.
- Any investor analysis of your financial projections against your Business Plan (What Ifs) and be ready and prepared to adapt both to meet changing objectives, arising out of the funding conversations.
- Clarity around the entrepreneurs/owner/founder's financial commitment.

NOTE these total figures should also align closely with the requested funding totals, to demonstrate financial integrity.

COMPANY VALUATIONS (AGAIN)

These are, as above, best considered as a fluid concept. Valuation of startup and early stage companies is an art, not a science as the usual valuation approaches, used for more mature businesses rarely apply.

To support your valuation, it is necessary to consider;

- 1) How much money you need versus the valuation – remember Section 2. Assessing the Proposition. Remember the question "Who effectively owns the business?"
- 2) The investor type – Family & Friends, Angel Investor, Micro Seeder etc.
- 3) Your experience and previous success as an entrepreneur
- 4) The valuation/market rate for similar companies...will be impacted by economic prospects, current and future Interest rates, inflation, Forex projections etc.
- 5) Anticipated growth rate in your market/sector
- 6) The prospect of your actually achieving profitability, i.e. surviving beyond the "Valley Of Death".
- 7) Current revenue and profitability levels.
- 8) The strength and expertise of the team you have established within the business
- 9) Actual/potential customer acquisition and distribution...ideally a wide spread of clients with no single major risk/point of failure!

TIMINGS

In Section 6, we indicate that investor rounds are rarely quick to achieve. Time is always the worst enemy of the entrepreneur/owner/founder. There is constant pressure to move quickly as opportunities change and with-it valuations, financial projections etc.



Conversely, time works for the investor, allowing them to delve deeply into your business, understand and question your plans and thereby begin to minimise the risk to them and their capital. We don't have any slick answers to this, except to say, "Expect that this process will take longer than you anticipate and/or perhaps worst case – even longer than you can accept!"

Section 6: Typical Stages of Investment and Funding

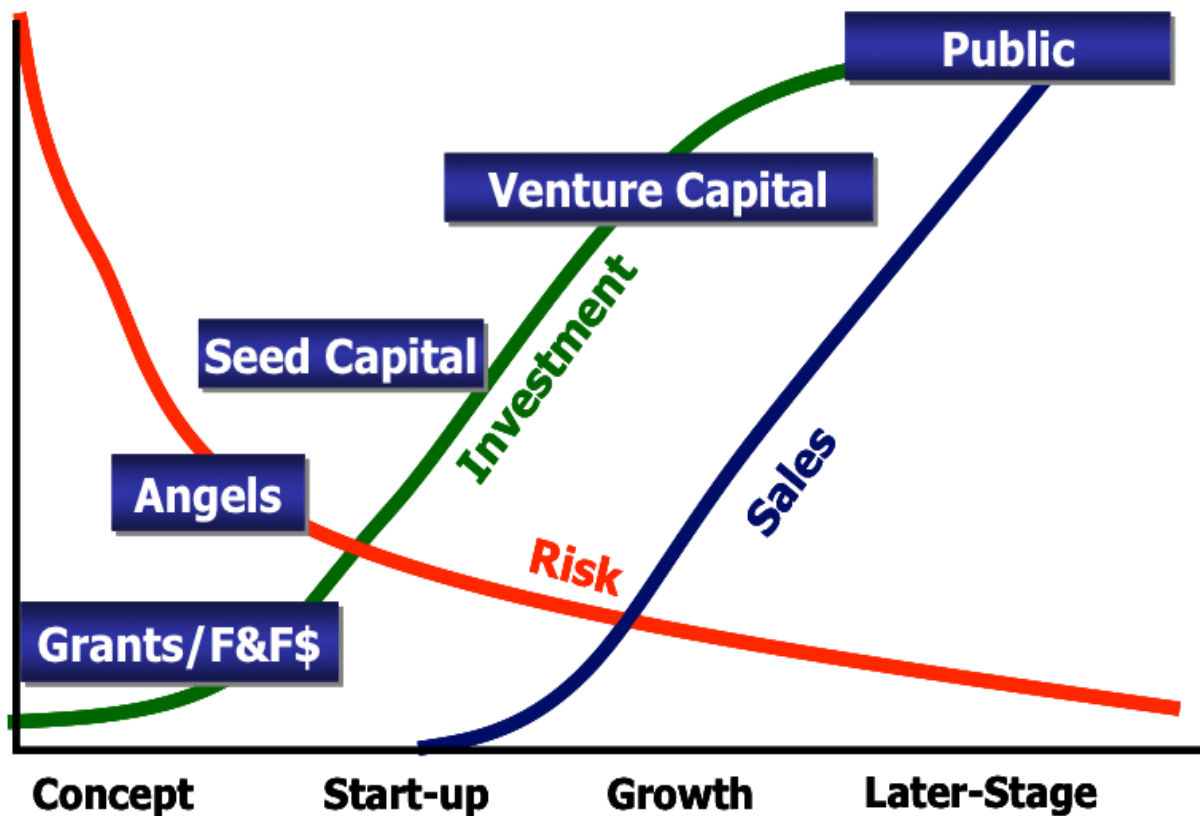
INTRODUCTION

The stage of your company's development, within its natural lifecycle determines the best type and source of funding for that business.

george james ltd consulting uses the following image because of its simplicity but also because in addition to the standard chart of increasing capital requirements versus time/company development stage, it displays the associated risk profile, for any financing.

It particularly reflects the high level of risk/corporate failure associated with businesses in their initial stages of growth, possibly the science/technology is still unproven or for pharma/biotechs, this represents the period between discovery and proof of concept, which equally is considered extremely risky and where adequate funding has historically been difficult to find.

Even if successful, a return on any investment might still be a long way off! These factors have combined to produce a restrictive impact on potential sources of funding.



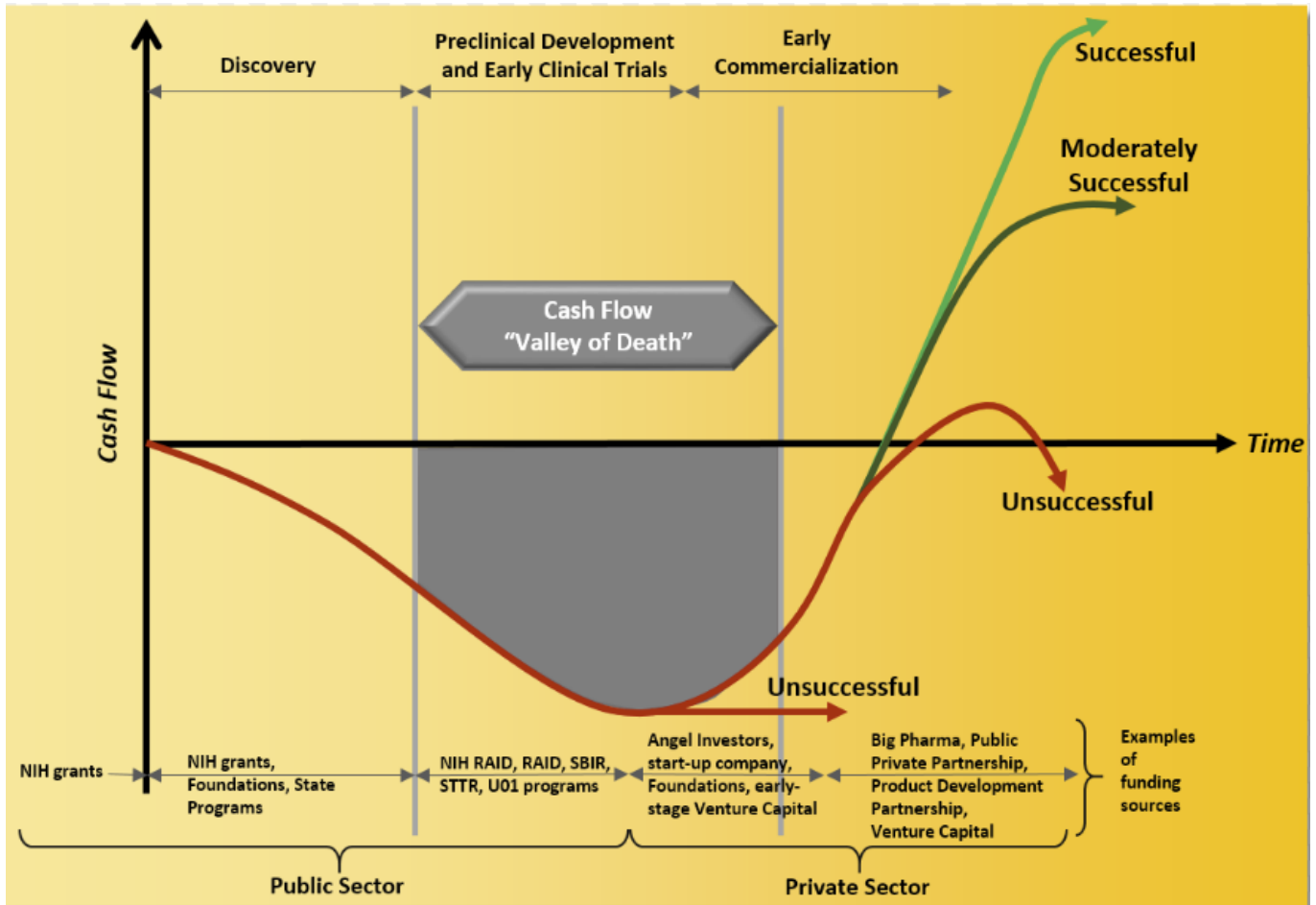
Source: The Company Financing Lifecycle – Primaxis Technology Ventures

NOTE: Other similar lifecycle diagrams, but mapping Revenues against Time are often seen. These graph the initial period;

- 1) Running until the business is trading and has at least reached a break-even point.
- 2) For an equivalent small pharma/biotech company – this equates to the funding gap in the period between basic discovery research and late-stage development in which lies the critical step of proving the utility of a proposed drug/science.

In both cases, it is commonly known as the 'The Valley Of Death!' - see Figure 2 following.

Figure 2: THE "VALLEY OF DEATH" IN PHARMA FUNDING - ref: https://partnersinbpc.com/14_june_nl.php.



RAID: Rapid Access to Interventional Development; SBIR: Small Business Innovative Research; RAPID: Rapid Access to Preventive Intervention Development; STTR: Small Business Technology Transfer.

Conventionally, there are a sequence of finance stages, that need to be followed by a growth minded business. There is a plethora of names for these stages, but they basically break down as follows;

CONCEPT	START UP	GROWTH	LATER STAGE
PRE-SEED CAPITAL	PRE_SEED AND SEED CAPITAL	SEED CAPITAL	IPO ETC.
Self Funded	Angels	VC Seed Firms	VC Seed Firms
Family and Friends	Accelerators	Angels	Angels
Grants	Incubators	P/E Companies	P/E Companies
Incubators		Hedge Funds	Hedge Funds
Angels			Other External Investors

STAGES OF INVESTMENT AND FUNDING

What quickly becomes apparent to would-be entrepreneurs is that after their usual sources of personal funding become exhausted – so bank overdrafts/loans, credit cards et al are not available, then further facilities are only generally available against ‘granting’ a portion of the business shareholding.

The only possible exception to this is Family and Friends, but even so, if longer term support is needed, then thought needs to be given to this debt/equity issue. NOTE the terminology in common usage here is confusing and often used inter-changeably!

Pre-Seed, Family and Friends.

Obviously, funds are needed to get the business ‘up and running’. Some founders/entrepreneurs can afford this stage themselves, others quickly find/realise the need for additional financial assistance. Alternatively, it can help in supporting the testing of your concept/science/technology and allow your startup to reach a point where it’s more attractive to external investors.

Grants

Typically, only available against equivalent funding from the founder/entrepreneur. Variable availability and usually, it can be expected that some conditions will be applied.

Pre-Seed, Micro Seed Round – (Incubators, Angel Investors, Micro VC’s, Accelerators, Crowdfunding)

A modern funding model akin to the Family and Friends approach, but involving 3rd party participation. The aim is to supply just enough capital to allow the founder to work fulltime on their project, usually for about 3 months, although it may be for longer, with funding set against specific milestones.

At the end of the period, the founders need to show a potentially profitable product/science/technology, to qualify them for additional support or they might need to seek out potential, additional new sources of funding.

This initial period also allows for;

- Research/refinement of the product in its chosen market(s)
- A greater understanding of the competition and any regulatory/similar hurdles.
- Any demographic matters.
- Establishment of a core team

Supporting Collateral might be a portion of the shares, say 15-20%, but will be variable – investors will look at each company on an individual basis.

Seed Round

The older version of funding. Can be considered as a larger scale version of Micro seed round, with same purpose – enabling a startup to achieve its early goals. Founders will need to demonstrate business structure, including established team, and if not a final product, then a design/established science and/or technology.

Still 'high risk', usually involves larger investments by bigger investment companies/angels, typically as part of a wider, managed portfolio of investments, following strategy that 'Some companies/investments will fail, others will survive and a small few will prosper'.....these latter profits enabling the continuance of the portfolio approach.

Supporting Collateral might again be a (further?) portion of the shares, say 15-20+%, but again will be variable – investors will look at each company on an individual merits basis. Alternatively, it might be that Preferred Stock is issued, , which provides investors with a fixed dividend return and also some priority, to protect capital, if a company fails.

Series A Round

Difficult to define precisely, as often interchangeable with the earlier Seed Round. It is though possibly the first time that a business will encounter professional, institutional investors (VC, PE firms, hedge funds etc) and so is equally likely to involve the first time raising of substantial sums.

Funds raised are typically intended to support growth and enable progress to the next stage of the business plan, e.g. entry to New Markets, Improvement of manufacturing, organisation and distribution aspects etc.

Subsequent Series B, C, D etc. Investment Rounds.

The business might have a series of 'growth milestones', each perhaps requiring a further injection of capital. In such cases, by convention, the seed rounds are 'alphabetised', hence B, C and occasionally D and beyond.

It is usual for the capital amounts involved to be larger per subsequent round, because as time passes the related product/science/technology is maturing/becoming more

embedded, so this makes sense. Possibly, Series C or D rounds might be expansion overseas or perhaps a merger/acquisition is being considered?

Initial Public Offering (IPO)

Only used by companies who are well established! The usual road to generate new investment, and public ownership, though it might take many years, say a minimum 10+ years for a fast-moving business. Allows the founder/entrepreneur to offer a percentage of the company to the public and is usually a straight forward equity for capital swap. A good route to follow, though is very onerous re compliance with reporting and due diligence standards

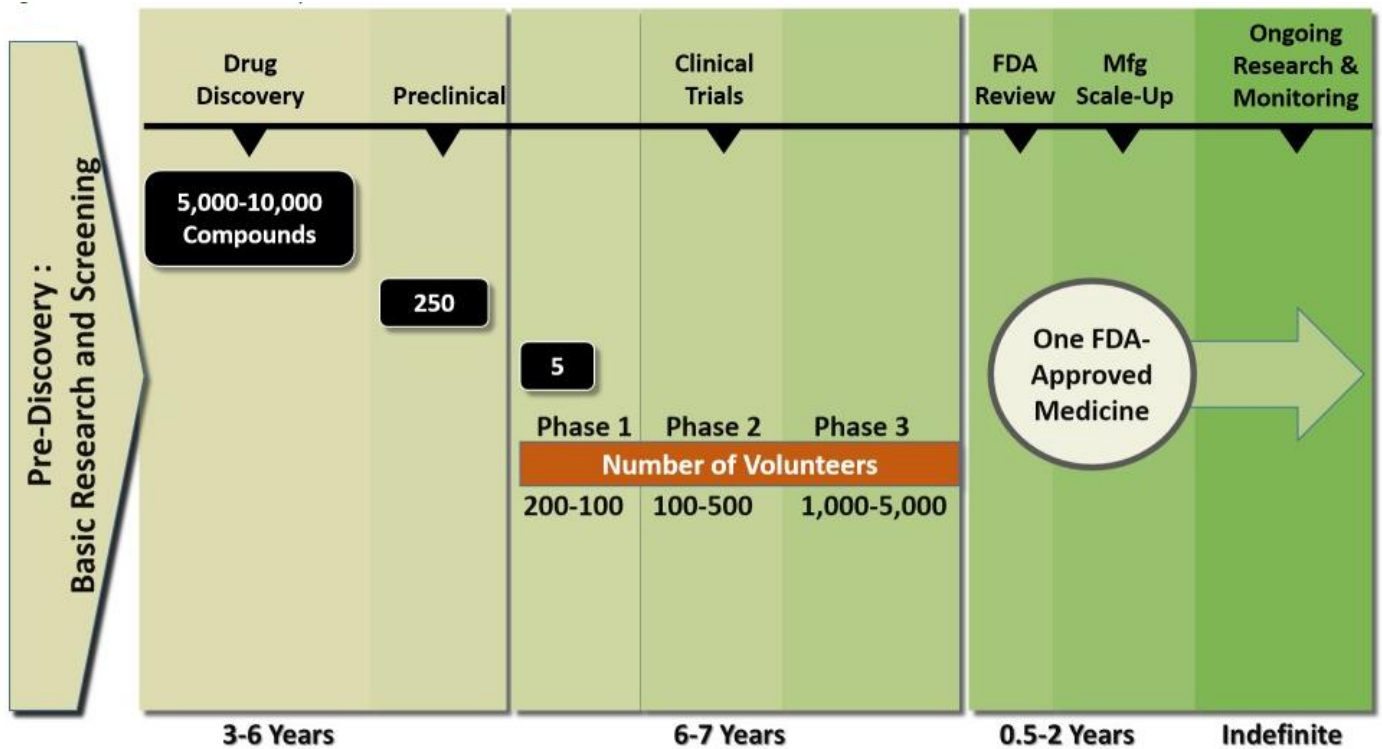
IPO BRIEF PROCESS STEPS

1. **The Intention to Float**- the company announces to the stock market that they wish to float the company by way of an IPO or new issue.
2. **Preparation of Prospectus**- the company will then prepare and release a Prospectus. This aims to be the definitive document relating to the launch and will describe the offer in detail. Applications to buy shares during an IPO or new issue should always be made on the basis of the information contained in the company's Prospectus and any supplementary documentation the company may produce, as the Directors have to give a full and fair description of the business including the risks.
3. **Sale of shares**- applications for the shares begin. The IPO will be open for a fixed time known as the Offer Period.
4. **Offer Period closes**- applications will be finalised and investors allocated the shares based on the size of their application and any relevant scaling.
5. **Shares admitted to the stock market**, usually the AIM, a subset of the main market, populated by smaller, less viable businesses. also known as the secondary market, the shares can be bought or sold during normal market hours. Once on the secondary market the price of the shares can rise and fall.

SMALL PHARMA AND BIOTECH SECTOR – EQUIVALENT INVESTMENT ROUNDS

These sectors do not follow the earlier capital round definitions, as their business requirements are different and quite specific, caused by a Health and Safety driven regulatory approach to new drug identification and testing etc.

The drug discovery and development timeline (10-15 years) and associated activity stages, are much longer than the equivalent for other companies and are captured in this image below, *ex the "2013 Biopharmaceutical Research Industry Profile", published by the Pharmaceutical Research and Manufacturers of America's (PhRMA).*

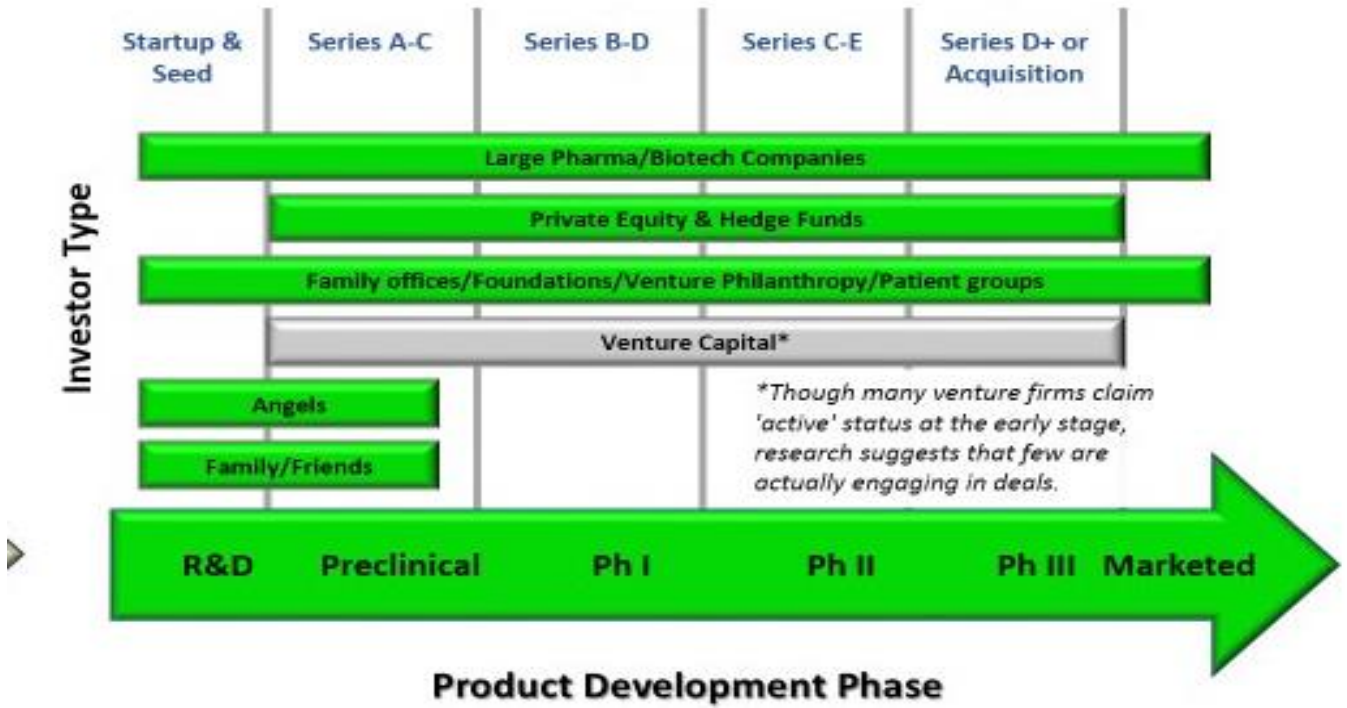


It is obvious from the chart that the number of compounds in play reduces markedly from Discovery through the Clinical Trial phases 1 through 3. This process has much to do with increasing both the time required and the chance of failure.

As the associated Risk/Reward equation has proved adverse, given the higher risk and long lock in times, the amount of VC funding for The Startup sector has plummeted in recent times, as they show preference for the lower risk appeal of later phase companies.

The second image below, displays the latest model of New Life Science investor interest and investment in this sector.

The New Life Science Investor Landscape



Section 7: Term Sheets and Terms

INTRODUCTION

Investors invest in companies that they hope will prove both successful, profitable and increase the value of their investment. One way that they control the use of the funds that they invest is via the use of term Sheets.

The Term Sheet is the name of the documented agreement, between the entrepreneur/ their company and an Angel Investor or Venture Capitalist, setting out the terms and conditions under which they will be prepared to make an investment into that company.

It covers agreements on most major aspects of the deal, thereby precluding the possibility of a misunderstanding and lessening the likelihood of unnecessary disputes. It also ensures that the expensive legal charges involved in drawing up a binding agreement or contract are not incurred prematurely.

CAVEAT: IT IS NOT A CONTRACT OR LEGAL PROMISE TO INVEST whereby the INVESTOR PROMISES TO PROVIDE CAPITAL TO THE COMPANY!

Term Sheets are generally regarded as not legally binding, so is best considered as being akin to a Letter of Intent or a Memorandum of Understanding where the action is predominately one-sided, as in acquisitions, or a working document to serve as a jumping-off point for more intensive negotiations.

The author likes Bruce Gibney's pithy description – it's the world's MOST IRRATING NOT-QUITE-CONTRACT! though that doesn't go very far to explain its purpose.

Ref:

http://web.archive.org/web/20130303042811/http://www.foundersfund.com/uploads/term_sheet_explained.pdf

Read more:

Term Sheet <https://www.investopedia.com/terms/t/termsheet.asp>

So, it's all perfectly clear then.....Yes or No? No, of course! It's not clear and probably it cannot nor perhaps should it ever be.....but the Term Sheet has a definite purpose and a very important role in facilitating the ongoing negotiations between Investor and Company.

Usually, it typically only specifies two legal aspects;

- 1) Confidentiality - That all/any negotiations are confidential...thus ensuring discussions are undertaken in an atmosphere of privacy.
- 2) Exclusivity - That for a specified time-period, the company is barred from initiating new/continuing any previous conversations with other potential lenders/investors.

TERM SHEETS ROLE IN THE FUNDRAISING PROCESS

If you haven't raised angel or venture capital funding before, there's likely a lot you don't know about it from a legal, structural, and process standpoint. The best way to explain the purpose of the Term Sheet is to examine a typical event sequence within a fundraising process.

STEP 1 – The entrepreneur/company owner completes his business valuation (called a pre-money valuation) and following this believes his business has a worth of (say) £5M. He has decided and produced investment plans based on the premise that he needs to raise £2M., for which he is prepared to sell/trade 40% of his shareholding. If his valuation is accepted.... this would leave him £2m of fresh capital, before costs, and 60% of the shares. The new investor(s) thus have acquired a 40% minority shareholding.

STEP 2 – The entrepreneur/company owner discusses this proposal with potential Angel Investor(s), setting out his version of the business case etc. expecting the potential investors to consider, discuss and agree between themselves, if more than one and then respond to his proposal.

STEP 3 – One (or more) of the potential investor(s) responds. There is an agreement to invest, against a set of specific terms and conditions. Note these are not necessarily the same terms as sought by the entrepreneur/owner, so we are in the negotiation phase.

STEP 4 – The entrepreneur/owner accepts the offer and associated terms, appointing his new potential business colleague as 'lead investor'. NOTE the entrepreneur/owner might only have raised part of the £2M he was originally seeking, so still needs to find one or more investors. However, of course, he should still have a part of his shareholding available, with which to make another deal.

STEP 5 - Once agreed by all parties, the lawyers will use the Term Sheet as a basis investment papers. The more detailed the Term Sheet, then hopefully the simpler it will be to revisit during this process, so saving costs. This can be a complicated process though

and it is recommended to work with specialist firms, familiar with VC /capital raising to minimise both time and money impacts.

STEP 6 – The “VENTURE LIMBO” stage. Be aware, although the deal and the terms etc are agreed verbally and captured/written down in the Term Sheets, note these will be multiple for ordinary equity and any loan stocks, the danger is in the 4-6 weeks delay, until everything is signed and the monies sit comfortably in the company bank account.

Additional due diligence might arise, or even attempts at the last moment to improve/renege investor terms or bring new concepts into the conversation! Fortunately, these situations do not occur that often, but anecdotal tales do occasionally circulate of such practices....

The message is that the founder/entrepreneur should be wary that time is an enemy in this situation and consistently push for a speedy conclusion, to minimise and mitigate this threat.

INVESTMENT AND NEGOTIATION OBJECTIVES

So, if the term Sheet is the recording method (and perhaps controls the discussion agenda?), what are the differing objectives of the two sides for this negotiation and how can they achieve them?

Investors:

- Maximise their situation in the unhappy event of them needing to exit/failure of the venture.
- Protect their investment, if company fails to produce growth, profitability etc. as targeted.
- Retain “veto rights” over some corporate actions that could impact their status.
- Be able to force the company to liquidate.
- Ensure founder/entrepreneur and key team members are “locked in”.

Founder/Entrepreneur:

- Obtain sufficient capital to enable company to achieve next key growth stage, whilst holding on to as much of the company ownership, as possible.
- Hold on to as many of the business “Levers of Action”, as possible.
- Protect the personal position of the founder/entrepreneur, should the investors decide he/she is replaceable!

IMPLEMENTING INVESTOR OBJECTIVES

Usually, investors will specify a new form of shareholding, as opposed to Ordinary Shares, which would only give equal rights as per the Founder/Entrepreneur etc. to enhance their position. Usually, this is achieved by the issue of new Preferred Stock, the conditions of which are widely variable and only limited by the imagination of the investors and their legal advisers!

The aim of using Preferred Stock is to;

- Enable the adjustment of investment returns in favour of the preferred stockholders, as against the rights of ordinary shareholders.
- Provide scope for a disproportionate level of control to be possible, in favour of the preferred stockholders.
- Ensure alignment of interest between ordinary shareholders and preferred stockholders.

STRUCTURE AND COMMON TERMS AND CLAUSES

It would be quite possible to write a book on the structure and content of Term Sheets, indeed there is a considerable amount of information available on a casual internet search.

One site that I found valuable (ironically ex an Australian website, usefully many terms are global in context, BUT do check local, legal interpretations!) is;

<https://cemi.com.au/sites/all/publications/BVCA%20Guide%20to%20Terms%20Sheets.pdf>

Section 8: The Investor Due Diligence Process and its Management.

BACKGROUND

So you want to attract a credible Business Partner, Angel Investor, Venture Capitalist or Private Equity provider?

Are you ready, willing and able to immediately provide/handover a comprehensive set of documents, a pack of information, facts/figures, details and the rest to meet with expected Due Diligence requirements? No...why not? See Section 10 for some thoughts here.

Due Diligence is a concrete 'Buying Signal'. It signifies that the investor wants to proceed with the deal and it is a necessary component of that deal, a component that needs to be completed to the satisfaction of both/all parties, before any deal can be finalised.

Although some Angel Investors are private individuals, other venture capital providers (firms) need to ensure they adhere to their obligations to their own investor community(s) in terms of backing businesses that meet their criteria – not only in terms of business stage and focus but also ethics, social, environmental and governance issues. The latter are now increasingly important and can have a major impact on a company's reputation and prospects.

TYPICALLY – WHAT IS INVOLVED IN DUE DILIGENCE AND FOR HOW LONG?

Again, some quick Internet research will soon reveal the common components of a Due Diligence process for Business Startups/Early Stage companies.

A sample of a few, typical website information sources are:

<http://vc-list.com/startup-investment-due-diligence-checklist/>

https://www.asme.org/getmedia/86b994d9-2faf-43b5-9b57-4cb6e727a3a2/due_diligence_checklist.aspx

<http://www.alleywatch.com/2014/02/how-to-conduct-startup-due-diligence/>

http://www.1000ventures.com/venture_financing/due_diligence_worksheet_byindiaco.html

There are no real standards, as such, investors have their own approaches and opinion as to the extent of detail which is required/acceptable.

A CAVEAT – So you’ve moved to Due Diligence, so you’re nearly there, you can relax a bit because the Deal is close to being done? Errrrr No, it’s absolutely and most definitely not! In fact, usually, because Due Diligence can prove to be the most demanding part of any investment/capital raising process....

For the next few weeks (at best!) or a couple of months perhaps, (at worst), you and your business are going to be subjected to the most intense, irritating and possibly irrational, as you see things...set of demands, you’ve ever had the pleasure of encountering, across past events/actions, current issues plus any/all your future plans/contingencies etc
Anyone who’s ever been at the sharp end of this process, usually ends up with a chest full of war stories to tell....

Experienced investors will probably have/use a set process, with a defined menu of information needs, at least at the outset, perhaps varying as the supplied data/papers etc are reviewed and investigated. For a business startup, this at least begins on a smooth path, although issues/difficulties may then emerge later in the process.
When dealing with a new/inexperienced investor/partner though....there are no guidelines!

TWO STAGES

Usually two stages are involved.

- 1) **Internal Due Diligence** will follow initial meetings with management. It might, be sufficient to allow an outline term sheet to be issued.
- 2) **Detailed Due diligence** will follow. This is a more rigorous process involving external specialists focusing on the various aspects of the business. Typically, this will cover financial, commercial, legal, technical as well as human resources and governance.

Activity-wise, it will also involve scrutiny/validation of physical information and online cyber data checks. It will involve on-site visits, informal discussions with any or all members of the team, vendors and both good/ bad customers.

DUE DILIGENCE SCOPE/OUTCOMES

Usually, an investor etc wants to obtain greater insight into four key areas of the enterprise;

- 1) The People – 2 levels – core team players and sundry employees/workforce, so involving Human Resources, Heads of Depts., CEO and Board members
- 2) The Product(s), so involving Product Teams, Operations/Commercials, Technical Dept, Support etc.
- 3) The Market, so involving Sales & Marketing, Commercials, the CEO etc.
- 4) The Deal, so involving the CEO especially and the Board, Legal and others.

Due Diligence can be a two- way communication street though. Usually the pressure is on the company seeking the funding/capital injection but angel investors and professionals have a reputation to protect, so it might be possible to manage a more open, dialogue? Also, Personal dynamics are fundamental to future investment success so our advice is take every chance to deepen relationships.

Otherwise, honesty (and integrity) is certainly the best course, as issues will undoubtedly emerge, that will need to be satisfied. Conversely though, seasoned investors know that the Due Diligence process will likely find problems and that they should not expect candidates to be perfect, only to have good answers!

COSTS

Experienced heads, who have been through this process advise that costs, including professional adviser fees etc are high...typically up to 10% of the investment capital sought!

Another reason perhaps not to quote a specific figure for new capital sought...see previous Section 3, so better perhaps to inflate the funding requirements to cover off this prospect. Note, if the deal falls through, for any reason, it's the business that is usually left 'on the hook' for the accrued costs/charges...so check the Term Sheet!

HOW BEST, WHEN and WHAT TO PREPARE?

Returning to the question posed in the first Section. It can be time-consuming to gather all the information required. We suggest that the senior management be allotted responsibilities, that best fit their role/responsibilities, allowing them to delegate to their team(s), as needed. It might also be sensible to ensure that all data/information (sensitive obviously) collated is held/filed in the IT system, in the cloud, under Senior management control.

One plus is that investors will find it easier to work with/relate to well-organised teams that respond promptly and efficiently to information requests. It also shows off the business management ability to plan forward, a vital business asset, of course!

Regarding management. The management team can be a company's greatest asset or liability. Investors will want to know all they can about the management team and key individuals such as existing shareholders. This may involve reference calls and background/CV checks etc. It sounds intrusive but it can uncover issues of which even the management team themselves might be unaware.

COMMUNICATIONS – INTERNAL AND EXTERNAL

Obviously, both before and during such an intensive exercise, management are obliged to ensure an elevated level of communications is maintained, both within/between members of staff and with the Due Diligence personnel. This is NOT an appropriate time for the management team to be seen to be failing in this area!

It might also be a good moment for management to be visiting partners, customers and vendors alike, to allay any concerns. In fact, typically, it might be an opportunity to cement relationships and also pass on good news about the company's prospects.

POTENTIAL OBSTACLES TO A DEAL

Founders, owners, entrepreneurs need to be aware of investor "No Go's". Some insight into these areas might have emerged from your investor analysis/research into their backgrounds and how they like to operate. Investors ideally are experienced in business and as such, will probably have both formed and be prepared to vocalise, their particular Likes/Dislikes and especially any No Go's!

Some basic research into their past deals history and asking them a straight question about this is probably the way to proceed. If things work out, then you will be working alongside them as investors, so it's good to get any such issues out into the daylight.

These might be;

- Management – Financial
- Management – General
- Core Team Skills/experience
- The Product, its market, Sales & marketing etc.

Section 9: Identifying, Understanding, Communicating and Working with your Investors

Investors and their selection are the critical element in any growth oriented business and their identification, conversion into supporters, understanding of their needs, communications and ensuring their satisfaction should be a key part of any entrepreneur's ongoing objectives.

INVESTOR IDENTIFICATION

Usually, external investors will come initially from the Family and Friends circle, certainly in terms of the initial startup phase. However, as the business grows then its demand for increasing amounts of capital, to support its growth ambitions, becomes ever more vital.

At a point in time, usually the support available from the F&F circle reaches a natural conclusion, meaning the entrepreneur/founder/ owner needs to search out and convince additional investment support. If they have properly planned and prepared for this eventuality, then they should have several suitable contacts primed and ready for that conversation.

INVESTOR CHARACTERISTICS

Ideal investor characteristics would include;

- A specific interest (even better prior experience and a specific expertise!) in your chosen sector.
- Financial strength, especially around availability of capital. Should have an immediate capability to support your venture and preferably an interest in a longer-term involvement.
- This prospect is willing to listen to your pitch for funds
- A person of integrity, known to be trustworthy and reliable, with ideally an "experienced investor" background.
- Someone used to involvement at a senior level in business/commercial affairs, having an insight into the entrepreneurial mindset and an appropriate attitude/understanding of risk management
- Someone who has a strong network of contacts, be it to other potential investors and/or access to executive management /specific skill resourcing.

CHARACTERISTICS TO BE WARY OF

- An Investor who wants to retain “too much” control of the business operations side. This is not in itself a bad thing BUT how much do they envisage /will they effectively interfere in the running of your business? Usually, it is accepted by investors that new entrepreneurs need to learn to run the business their way. Hence, although many will offer to provide advice/insight, when asked, the ultimate responsibility for business decisions should stay with the owner/entrepreneur. If that is not to be the case, then it might be best to look elsewhere for an investor.
- Novice investors who seek highly detailed answers to every question. Like the issue above, “learning the investor role” but at the cost of your’s and your team’s time and lifestyles!

FINDING AND CONTACTING INVESTORS

Ok, so you know what type of individual you’re looking for, but where do you find them? They are very unlikely to approach you so you need to undertake a pro-active search process. Some suggestions include;

- **LinkedIn** - this is both obvious and a good start point. Not only does it image your business interests, roles, skills and successes, it also puts you in touch with others in your industry and supports the creation of a network of like-minded people.
- **Your Customers** – we are assuming that you are trading and have customers? If so, then this is always a sound place to network and build up a list of valuable contacts. They may also be potential investor, as at least, there is a degree of mutual interest.
- **Social Media** – Facebook etc. – If you are a regular User of online services/communications etc then you might already have been pushing out a message about your plans and intentions. That promotion might have attracted some followers, or others, interested in your offering. They might just be spectators but some might be potential investors.
- **Business Advisers, Mentors etc** – It is unusual for any entrepreneur to establish a business without any form of advice and/or consultation, whether paid for or not. Is there anyone in this space who can provide similar input/an introduction as to potential investors – a VC firm or angel investor perhaps? It’s likely that if they are involved/experienced in assisting new entrepreneurs then they may have appropriate contacts within their network.

- **Burning shoe leather/event participation** – This is the best way to both find out about current trends and activities in your industry and to become a firm part in it. Attendance at future industry events is good for your business anyway, raising your profile which might already be a key part of your marketing plans and efforts.
- **Start Up Launch and Crowdfunding etc.** – See Section 4.

COMMUNICATING WITH INVESTORS

Once you have ignited investor interest, how do you keep the communication process flowing? This needs to be an ongoing and professionally managed process. It is essential that you begin to establish a relationship based on trust,

Simply put, each investor will have their own requirements as to timing of updates on developments, whether it be weekly reports, monthly summaries or even daily contacts.

These arrangements will also change according to the situation, so if the company is reaching a critical date/milestone, then investors will want and expect more frequent updates.,

It is important that you meet any expectations, any fall back in this area risks losing investor confidence, so needs to be avoided. We suggest that you agree individual needs with each investor and then stick to it!

Closing the Deal

We talk elsewhere – see Section 7 about the need for urgency, to offset the risks, when closing the deal and getting hold of the investment monies.

We advocate the early creation of a relevant (project) schedule, and the parallel action of gaining of a general acceptance that this timeframe be adhered to. That in a little way, does provide you scope for an additional sense of control.

Remember, signing the deal and obtaining/banking of investor monies, is not an end-in-itself! Rather it is the beginning of a different process, and how you manage your new and ongoing relationship with your investor(s). You will have made a good impression, otherwise they would not have backed you, so you need to work to ensure that this good, positive start continues...

WORKING WITH INVESTORS - POST DEAL CLOSURE AND BEYOND

Under the investor characteristics section, see previous, we talked about ideal investors who can and do offer to add expertise, knowledge and perhaps experience, by working directly within the business.

CAVEAT – On occasion, such investors have sought to create a deal whereby they might commit to support a certain amount of time to a business, in lieu of actually making an investment contribution. Such arrangements unfortunately tend not to work! Our advice in these type of “setting off service fees against equity”, is that they not be pursued. So, if this is potentially on offer, we suggest you take the cash investment against shares as normal and then arrange to pay separately for any required consultancy.

INSTITUTIONAL SHAREHOLDERS

It would be unusual for a startup/early stage business to become involved with professional shareholders. This rarely happens until the IPO stage and beyond, usually a minimum of 10+ years or more into the business lifecycle, at which point the business is much more mature.

However, as we commented in **Section6**, some VCs/PE’s have been expanding into the Micro-seed space in recent years, as fund managers have seen greater opportunity/ROI’s and as more money has become available for funding such investments. If you are offered terms, then it is highly possible these will be heavily weighted in their favour! Contract negotiation could also be difficult, so it might be better to walk away if /as issues emerge which make the deal unattractive.

In so doing, remember that such a choice is credible and professional. It should ideally leave the door open for you to reconnect with that funder, at a later stage, say an IPO, when improved terms may well be on offer.

Section 10: Raising capital – Is this process not working for you?

INTRODUCTION

Finding Capital Raising a fruitless exercise? Just not working for you?

Firstly, this is not a reflection on you or your science/technology or your business! The success rate for startups and early stage companies re obtaining adequate funding is a very, very low percentage, so the dice are loaded against you from the start!

We stressed the need for tenacity in pursuit of your fund-raising objectives in Section 2 - Preparing for Raising Capital. Many entrepreneurs report experiencing numerous failures and rejections, before ultimately, if they are lucky and their pitch and supporting material is all in place, then after repeated fails, they finally arouse investor interest.

SOME COMMON REASONS FOR REJECTION.

Is your Network strong enough?

The adage – “It is who you know, not what you know that makes the difference” is very relevant in the arena of raising capital. Gaining access to Angel/Super Angel investors et al is usually only successfully achieved via an introduction. These people don’t like being ‘cold called’, that is an almost guaranteed and rapid road to failure!

Most operate within a close set of trusted allies and similar, who filter and refine introductions, so if you are fortunate enough to be introduced to them, then they are more likely to pay attention to you and your proposal, depending on whom is effecting the introduction. Usually this would be from someone who has successfully run their own startup and then exited profitably at the end of the growth lifecycle.

This reality flows on from the comment in Section 1 about the benefits of using an incubator. If you do follow this route, then your chances of getting that introduction are improved, because the incubator management team etc will have various links into one/more suitable funding networks.

Are you pitching the right message, about the right opportunity, to the right potential investor?

Have you personalised your message correctly? Hopefully your introducer will know that your proposition will be of interest/a close match to the investor's market/sector/funding levels. So, if your approach is made in the right way (and some introducer advice might be supplied in this context) then it will enhance your prospects of an investor taking a deeper interest.

Are you able, willing and ready to prove your tenacity?

In **Section 8**, Due Diligence, we talked about investors seeking certain qualities in the entrepreneur, their team and the company in which they were being asked to show confidence and make an investment! The author has heard anecdotal tales of some potential lenders using the investor search and first contact mechanism as a test of the entrepreneur and his team's attitude to knockbacks!

It is going to happen often in your business life, so just how do you react to a failure? Do you just take it and move on or do you pick yourself up, dust yourself down, learn the lesson and then try and find a different, more innovative way to reconnect and start that conversation/make your pitch?

Investor Confidence lost?

So an introduction was made, a conversation was started and an outline pitch given and listened to.....but then silence and no signs of any pickup of activity.....

No, it's not a tenacity test, clearly something important has gone wrong and your opportunity has probably been lost with it!

Investors tell us that it could be one, or perhaps a combination of things that have worked against you; there are endless reasons here but a few possibilities might be:

The Pitch – perhaps this wasn't clear enough, did it lack detail and was it credible? Was there any investor interest by way of follow up or questions?

Have you committed enough personal finance – "skin in the game"? Are potential investors taking a greater risk than yourself, as the owner/entrepreneur? Is there an issue around the share capital allocation? Have you committed enough of your personal financial capital to the enterprise to evidence your confidence and belief in a positive outcome?

Was it true? Investors listen to many, many pitches, so did you create yours by yourself, and/or in collusion with someone else/your team? Was it copied from another pitch? What is the status of any competition?

Did you overstate the case? – Financially, organisationally, managerially, personally, do you know your and your team’s backgrounds – are there any skeletons lurking? Have you really got the IP you claimed?

Consistency – you finished your pitch, you answered the questions and then the investor met your team. Do you all have the same story? Did you all work together on the pitch, do you have a collective understanding of the business and its prospects etc? Are you familiar and have you asked them individually about their successes and failures?

Failure to deliver – until the funding agreement is signed and sealed, you are still “on probation”. Was something promised that has not been met, any missed/delayed business/development or other key milestones?

Other investors – have you given indication of any other party(ies) showing interest, whether true or not? Have they since pulled away?

Were the terms on offer, the right ones? Did the investor(s) confirm that your terms were pitched at the right business level to generate interest and were these attractive to them?

Post receipt of an offer, did you subsequently seek to alter the terms in any way?



Our conviction is that:

Nobody can fully advance their career and no company can reach its' full potential unless they:

- Recruit the best
- Train and develop these people to maximise their performance
- Retain them
- Have these people aligned with and implementing the right strategy

Our mission at george james ltd is to help companies and individuals successfully achieve these fundamentals thereby maximising company values and individual career success.

Our Customers are:

Global technology startups and small businesses to the largest international corporations looking to increase shareholder value via recruiting the best people, training and developing their employees and optimizing their strategy

Investors interested in early stage pre-qualified investment opportunities, looking to bring in knowledge and experience to existing investments to address performance issue or maximize value and seeking industry expertise regarding events such as a trade sale or IPO.

Recruitment

- Full Time
- Interim
- Free NED/Chair service
- Field based to Board Level

Training & Personal Development

- For Sales, Support & Service people
- Tailored & Open Programmes
- One to one Performance Coaching
- Field based to Board Level

Consulting

- Strategy: Formulation and Execution
- Fund Raising
- Corporate Development