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The Corporate Advisor

INNOVATIVE EQUITY

7 Common Mistakes Committed by Entrepreneurs Seeking Investors

1. Unrealistic Valuations

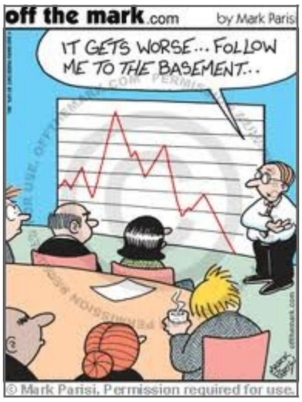
This is probably the number one deal breaker for entrepreneurs seeking external financial backing. Too often entrepreneurs have unrealistic valuations of their business. This is quite often accompanied by overblown sales forecasts. Private equity being conservative in nature will try to lowball the valuation to reduce their risk. The entrepreneur having invested so much emotion and sweat into the business feels he is being hard done by.

When I had my very first advisory client of my illustrious career, I was the advisor to an internet start-up business back in the dark ages; when the internet began to take off. I had all the ducks lined up. The management team was a very successful IBM executive. The venture fund even knew the new chief executive personally. But the main shareholder baulked when he was only offered $500k for a 30% equity stake. The shareholder thought his company would be worth $100m because of all the internet millionaires being minted in the US. This shareholder remained obstinate and thus the deal was scuttled.

Rather than try and extract so much blood from professional investors with hyped up promises of riches. Put your money where your mouth is. Strike a deal where you would get a higher percentage of the company if you achieved your touted financial goals within a time frame. But be prepared to lose a substantial proportion of the business if you fail to achieve those lofty goals.

Thus in such an arrangement the investor gets to minimize his risk of a loss on exit because he has a larger portion of your company to sell should things turn sour. But you get a chance to prove that your assumptions were right!

2. Failure To Clarify What Problem You are Solving



Many a presentations I have heard where the entrepreneur waffles through a 20min pitch extolling the whiz bang features of the product but the investors ends up clueless as why people would want to buy. Quite often, the investor is bamboozled with technical jargon and acronyms. And as the presentations rolls on, you feel that the investor's attention drifting towards the view outside a window. You have just killed your chances.

You need to tell investors what problem you are solving for a buyer and you need to tell them pretty much at the start of the presentation. And you need to talk in a language that the investor can understand. The investor is not a technical person. He probably came from an investment banking or funds management background. He only wants to know how much money you are going to make for him and what are the risks involved.

Leave the technical mumbo jumbo for the investor to bring up in the Q&A session should they desire to do so.

3.Using Company's funds as a Personal Credit Card

Many entrepreneurs use company funds to buy a car or yacht. But this will have to stop if the business wishes to secure financial backers. Private Equity Funds are not interested in funding your lifestyle. They will demand a very detailed list of what you will be spending their money on and they will be drip feeding you the money over the course of several years based on the achievement of milestones

So don't be expecting a sudden injection of funds to solve your personal overdraft problems. Look to see how you can separate that car loan from your company's finances. Show them a plan on how this is going to be achieved.

Also don't tell investors you need to be paid a large salary because you need to pay for private school fees for your kids or you need to payoff that second property. Investors are not interested in your lifestyle. They only interested in how you are going to make their money grow.

4. Don't use bullet points

Research has shown that using bullets points is the best way to lose an audience's attention. But through force of habit this still remains by far the most common method to introduce a topic in a powerpoint presentation.

The best way to hold a customers attention— and which has been scientifically proven is to display one short sentence which captures the essence of what else you wish to convey and nothing else on the screen. Continually replace each sentence or heading with another sentence or heading as you progress through each new idea. Have a plain colour background and different colours for each new idea your introduce. Use contrasting colours that can be easily discerned.

Use graphs if you have to but don't clutter the screen with too much detail. And make sure that the font size is legible. It is so easy to forget that mature-aged investors may not have quite have the vision that you as a Generation Xer might possess.

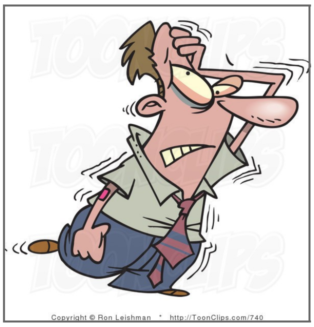
5.Not Willing to Invest Your Own Money

It is most unimpressive if an entrepreneur expects investors to stump up all the cash for a business and is not willing to risk his own money. Investors want to know that you have some skin in the game. That you will feel the pain if the business fails; and that the potential loss will spur you on. They don't want to be left holding the baby if you have the option to walk away from the business at will. They have no expertise in your business and need you to manage the business.

Once I had a client with a tremendous business idea to solve the high cost of housing in Australia. He had $2m in the bank but wasn't willing to risk any of it to get the business going. Needless to say, the venture got no traction with investors.

6. Not Having Tested the Market With Your Product

Quite often, inexperienced entrepreneurs would stand in front of an investor promising $X of sales but have no evidence to back it up. They didn't go test the idea in the market place. It's just an idea. This does not impressed investors. It would be better to have had lengthy discussions with potential customers and obtain pre-commitment to buy or better still, a purchase order. This provides proof that there is actually demand for your product and give investors reassurances that they will have a chance to recoup their investment.



If you have a pre-commitment in writing, check that it is not just a letter of support . And don't claim that you have a purchase order when the wording of the commitment to buy is optional..

7. Financial Forecasting Based on Market Share

When foreign companies entered the China market lured by the promise of 1bn consumers, they would say "If only we capture 1% of the market, the revenue will run into hundreds of millions." Unfortunately, they found it very difficult to achieve that 1%. Any financial forecasts based on HOPING to get a small percentage of a big pie shows that you have not drilled down to actually count where each dollar is going to come from. You haven't identified who are your target customers, research on the characteristics of your target market, didn't consult with distribution channels on what was possible. In other words, you don't really understand where you sales are going to come from.