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A Biz-Dev Look at the Valley of Death

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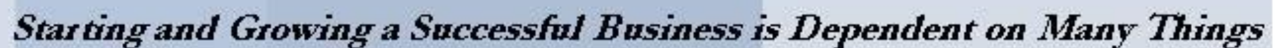

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The Concept of the 'Valley of Death'

This paper takes a look (and hopefully a new and helpful look) at how startup companies (especially technology based ones) can bridge the conceptual 'Valley of Death'. The conceptual gap in time and money between a company's starting point, to where it is generating enough revenues to support its operations. Bridging the gap is generally only (but not exclusively) possible via the help or assistance of outside influences, e.g. Angel investors, Venture Capitalists (VCs), etc. The pursuit of VC money tends to be the traditional approach for most hi-tech startups. This paper postulates and considers other (maybe more likely ways) for companies to cross the Valley of Death using a modified bootstrap approach. Bootstrap means using minimal funds and resources to get to a point of self-sustenance, meaning they made it across the valley.

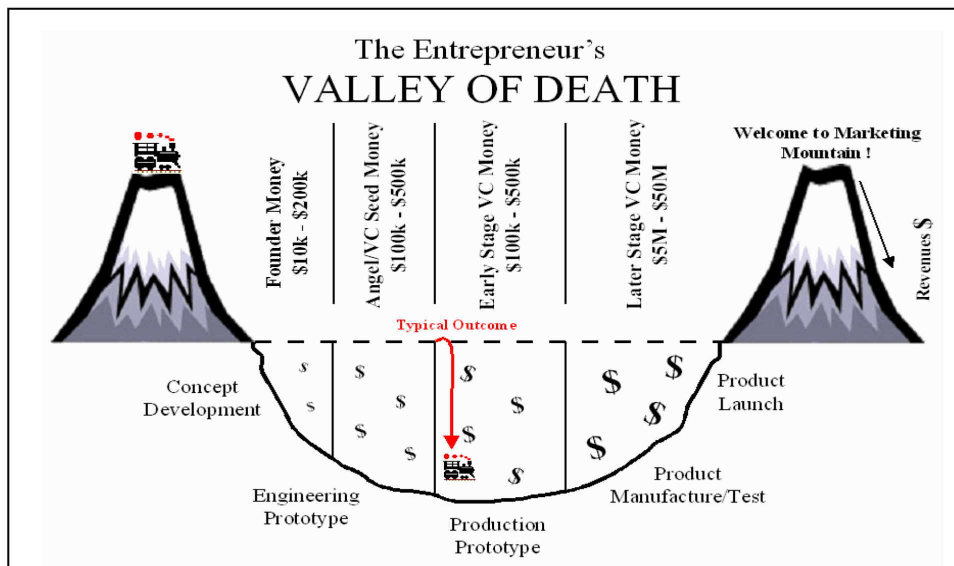

Figure 1 the Traditional Valley of Death

From 'day one' early-stage entrepreneurial companies' risk being victims of this so-called Valley of Death. If the company, or its founders, does not secure adequate funds to cover negative net cash flow in the months and/or years of business creation and growth, they face the likelihood of going out of business. And the statistics show that 90% of new startup companies do eventually go out of business.

Obvious Sources of Capital

The trip across the Valley of Death is a three-dimensional conceptual trip; the depth of the valley implies the total cumulative amount of cash needed to get a company to self-sustainability. And its width is the difference between what the founders and friends have contributed, and what they have been able to obtain from Angel Investors, VCs; and others; the third dimension is the time it takes to cross the valley.

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These days sophisticated investors (Angels and VCs) only invest in solutions to well-defined business problems that will generate revenues; solutions that are implemented by a highly motivated team of entrepreneurs who possess an 'unfair advantage'.

The acceptable investment criteria for VCs and some Angels have changed over time and especially since the bursting of the hi-tech bubble in the early 2000's. Time has become an important criterion for investors; they perceive it closely correlates with risk. The longer the development and emergence time of a new company the higher the perceived risk for VCs (especially) and angel investors. VCs are desirous of 'exiting a deal' with about 10x their initial investment in 2 to 4 years. Most technology companies that fail do so because they cannot obtain necessary funding. However, the most important source of funding for startup companies is their founders, family, and friends (vernacularly the three Fs) which if managed correctly should lead to a positive cash flow, sustainability, and growth for the company.

Entrepreneurial Challenges

Entrepreneurs face many challenges and need to make many critical decisions before they even start to tango with VCs or other investors. Starting and growing a successful business is dependent on many things, over and above acquiring capital. A new business and its outcomes can be mathematically modeled (and equated to) by differential equations. Largely the output states (over time) of a differential equation are determined by its 'initial conditions' chosen before the input is active.

The results achieved by many businesses come from the initial conditions chosen by their founders! In the business case, initial conditions <u>are not</u> parametric values but are things like, the type of company, its market and product focus, its growth and profitability objectives with time, its startup organizational structure, etc.

And these decisions don't even consider the value of the idea or the clarity of the vision, of the founders when they postulated starting the company. Remember the Valley of Death is a conceptual trap described in dollars; those needed for a company to be successful. This raises the question, what is success? Success (this paper postulates) will be determined by the initial conditions chosen by a company's founders, as well as the capital acquired! This is where the problem begins for many companies, and they end up failing (90% of startups). Many entrepreneurs fail to understand that the decisions they make and the objectives they set and accept, when they launched their company, determines the eventual outcomes achievable by their company.

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Startup Needs and Wants

It is at this point that many businesses determine their own destiny, which in most cases is failure! Many companies do not set initial conditions that are realistic for the results that are achievable with the capital available! It is very common for a company's founders to write and structure their business plan hoping to appeal to VCs and to receiving that all important 'term sheet' and a big pot of dollars; the acceptance criteria of most VCs is widely published. This situation is the economic analog of 'needs and wants'; what an entrepreneur needs can be wildly different from what he/she wants. Often a business gets launched based on 'wants' which can be translated to meaning 'hopes.'

The point of this discussion is that most entrepreneurs sow the seeds of their own demise even before they start dancing with investors, and before they take their first step into the Valley of Death. It is so easy to create pro-forma income statements that show the company growing through the roof and breaking even in an unrealistically short time. This is what frustrates VCs!

Many companies should set realistic goals for themselves, not every startup can become $100 million company within 2 to 4 years; not every company can assemble a star-power management team, or even have a super-visionary idea. To become a profitable $20 million company would have been a much better goal for many of the companies who have tumbled into the subject valley and gone out of business.

Even estimating that a startup company will significantly under-achieve its revenue targets and over-spend its expense dollars (by at least a factor of 2x) and doing the best possible job of 'Due-Diligence' VCs miss-invest 80% of the time. This is why it is difficult to get VCs to invest in a startup venture, especially if people who are not stars in their industry, or senior managers from a Fortune 500 company are starting the venture. And this is why today's VC is waiting more and more until a company's later development stages before investing.

The Funding Gap

The funding gap; best described as the lack of capital available from sources outside of the three Fs and generally exists for companies seeking less than $500,000 in exchange for equity. This gap is arguably due to the risk perceived by institutional investors in making an investment in a less than a stellar startup company. For institutional investors who might be willing to accept the risk, they see that managing this kind of investment would take way too much time and effort, i.e. there are bigger fish to fry for the same effort! Angel investors, the only investors who will invest in the entrepreneurial growth areas that other investors are reluctant to fill, usually fill the 'Funding Gap.' Angel investors use their financial wealth and experience to help these new entrepreneurial firms grow.

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These Angels tend to prefer investments with deal sizes under $1.0 million, and in the earliest stages of a company's growth with expected growth rates in the range 20%– 40%. Angels actually provide 84% of rounds under $250,000 and 58% that are in the range $250,000 to $500,000 and they typically invest a small potion of their wealth in these new companies, typically about 15% which is relatively small when compared with VC funds.

Table 1
The primary sources of startup funding

Source	Share
Founder Financing	74%
Family and Friends	5%
Angels	7%
VCs	5%
Partners	6%
Banks (various)	0%
Stock Issues	3%

Unfortunately, Angels are often 'under looked' by entrepreneurs and startup companies because of the bigger potential prize of getting a 'term sheet' from one of the influential venture companies. Most startup companies will try to obtain Angel funding but they tend to skip past this opportunity because of the smaller investments made, and by the fact that Angels can be as equally discerning as VCs even although they don't go to the same extremes of due-diligence. However, the typical entrepreneur plods (or races) along eager to take on the valley of death, many of them oblivious to the funding gap just described. Their head-long scramble is to maybe get to an IPO, the initial public offering of a company's stock (which happens infrequently).

The following chart and Table 1 indicates that in the event that venture funding is unlikely the best alternates for startups are Angels and business alliance partners.

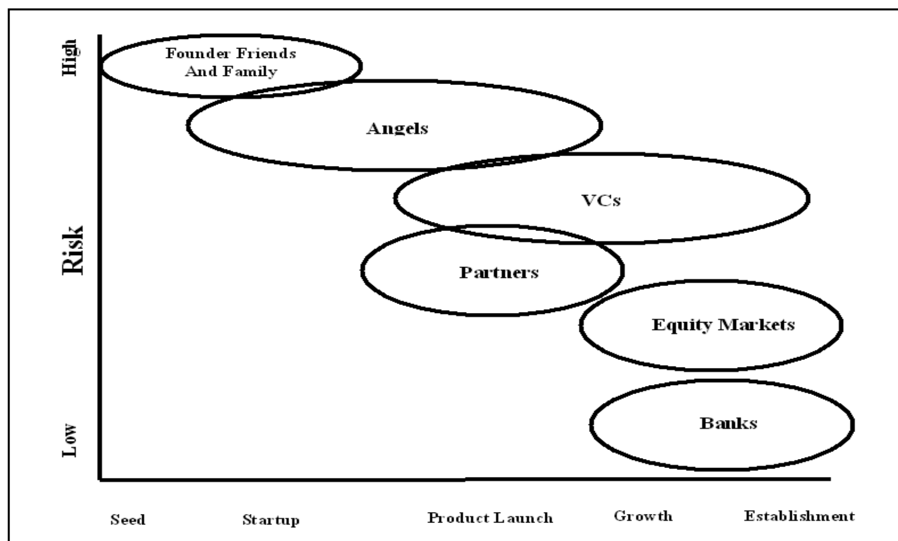

Chart 1 - Funding Providers and their Stages of Involvement

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A business alliance partner has a vested interest in your success that goes beyond a cold cash return on his investment. A corporate business partner is typically in a related industry, but not a direct competitor. Perhaps you have a technology or ideas that complement theirs. If you succeed, they succeed. They can give you lots of help beyond money. Best of all, they are often concerned with broader strategic issues as well as return on investment, which may leave more on the table for the entrepreneur.

Biz - Dev

Where does Business Development (Biz Dev) fit into all of this? Chart 1 above shows that outside of the founders money the startup's highest potential source of funds is from Angels and Partners; plus a partner will provide many more business benefits as well as cash. Business development should be a critical strategic element of every phase of a startup's business operations, because about 75% of the journey across the Valley of Death involves 'outside influences'; i.e. Independent Investors, Angels, VCs, Business Alliances, Joint Ventures, Customers, Competitors, etc. Inventors (the entrepreneurs) are not generally skilled marketers or manufacturers; the best products always need the best marketing and sales to succeed in the marketplace! For the purposes of this paper Business Alliance and Joint Venture (JV) will be used synonymously, they are similar but JVs require the joint formation of a 3rd entity.

In most cases, taking a product to market has proven to be a big challenges for entrepreneurs, hence the existence of the conceptual Valley of Death. The journey normally starts at the point an invention (and business) is visualized; to the point where it is launched into a market as a new product, or service. This is when most inventions collapse in the absence of external support; and/or they are 'not to be commercially viable'. In most high-tech companies marketing is something that follows the development of the product and is considered a requirement of the sales organization, not an integral and important function necessary for the success of the company.

High-tech companies in general (from startups to major corporations) are extremely product centric; it becomes their reason for being. And subsequently startups too have a very high degree of product focus; this is easy to understand because without a product they have nothing to sell, and nothing to tell customers about. But! There is always a 'but', the entrepreneur needs to know and understand why (or why not) customers will choose the product that they envisage making, and how a customer will use it. Therefore, 'customers' should be the startup's critical focal point, not just its products. Don't develop products in a vacuum; develop them for well researched known customers, to determine the product's value matching requirements.

Biz - Dev and the Valley of Death

The Valley of Death is all about money and the outside influences that control (or provide) that money; business development is all about dealing with the outside influences that affect the company whether it be investors, products, customers, partners or competitors. For this reason

startup companies should have a very large business development segment as part of their overall strategic and operational plan. If most startups wisely evaluated their 'positioning' when they started planning their businesses, and chose an appropriate set of initial conditions, they would probably find that venture funding and VCs wouldn't come into the picture until later in their development program.

And maybe not even until after its product is launched into the market, and maybe not at all. However, the company still has to get itself across the Valley of Death; mainly by wisely choosing a set of objectives and an appropriate set of initial conditions, then the company can narrow the width of the valley and its depth. The valley has dimensions in dollars, and since the company (by its wise choices) now needs fewer dollars for success; it has more options available to assure a successful journey across the valley.

Central to the Startup Company's success are its potential customers! The only reason for a company being is to serve its customers (Peter Drucker). An initial condition for a startup company should be to choose a set of target customers (and their key characteristics) and one or two of them that could be critical to the company's success.

If a business-alliance is formed with one or more of these companies, a very important bridge could be established that would help the company get across a significant portion of the valley. Business alliances are formed using intensive Biz Dev activities.

Intellectual Property (IP)

Taking advantage of techniques that narrow or conditionally bridge the Valley of Death (such as the one we have just touched on) will require that the startup owns its IP and is able to demonstrate a working prototype. Even if the company does not use business alliances as a strategy but continues to pursue VC funding it is (in most cases) an absolute requirement that the company can demonstrate a working prototype. And most VCs will look for IP ownership, a patent or patent application being the most likely indicator of IP ownership.

Chester Carlson, in 1937, invented Xerography, which he patented in 1939. It took almost eight years for Carlson to find an investor who was willing to invest in his invention. Finally, the Haloid company (which later became the Xerox Corporation) successfully made the invention commercially available in 1950. It would be fair to suggest that the existence of a patent (confirmation of IP ownership) held by Carlson significantly contributed to the Haloid Company's decision to support his invention.

Business alliances should be one of the early considerations for a startup company! In the situation where a variety of progressive developments are being made, and the product is being taken to market with the assistance of an alliance partner, the ownership of IP provides a strong

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negotiating position in the conduct of the partnership. Both parties should avoid conflicts over ownership of IP; any issue should be resolved with clarity during initial negotiations.

Valuation (VC talk)

The value of a startup company (what a company could be sold for) is known in VC lingo as the company's 'pre-money valuation'; i.e. the value of the company before the VC invests any money. After the VC invests in the company, its value is known as its 'post-money valuation.' VCs will value a company using a number of financial tools plus judgement; Internal Rate of Return (IRR) and Discounted Cash Flow (DCF) are techniques which will color the VCs judged valuation based on the entrepreneurs projected financial cash flow for the company.

These two numbers describe mathematically the share and ownership of the company. The concepts involve quite simple arithmetic but when couched in the colloquialisms of the VC they can be confusing. Even sophisticated entrepreneurs (on occasions) don't necessarily grasp how VC valuation math works. VCs talk about pre-and post-money, and share price as if it is a defined terms that the average American understands.
VC terminology and mathematics can seem confusing at first, particularly given that the VCs are usually able to calculate the relevant numbers in their heads.

The concepts are actually not complicated, and with a few simple algebraic tips, you will be able to do the math in your heads as well, leading to more effective investment negotiation. The per-share value of the company before the investment transaction (the 'pre-money valuation') translates to an individual share price. This is just the Pre-Money divided by the shares outstanding. Where outstanding means the total number of shares that may have been issued and held in the company treasury, or held for some other reason like hiring key employees. This is unlike buying publicly traded shares; the shares purchased in a venture capital deal are new shares and these shares change the number of shares outstanding:

Post-money Shares = Pre-money Shares + Shares Issued; and
'Pre-money Valuation' = Share Price x Pre-Money Shares.

The total amount invested is just the share price times the number of shares issued (i.e. purchased).

'Amount Invested' = Price per Share x Shares Issued.

And since the investment increases the amount of cash the company has, the immediate effect is to raise its overall valuation by the amount of the transaction. The fraction of the company owned by the investors, after the deal, is the number of shares they purchased divided by the shares outstanding.

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'Fraction Ownership' = Shares Issued/Post-Money Shares.

VC shares are usually C-Corp preferred that are convertible to common stock at any time, especially before an IPO or some other liquidity event. Preferred stock can be converted into common stock, and it has dividend and liquidation preference over common stock. It also has anti-dilution protection, mandatory or optional redemption schedules, and special voting rights and preferences.

VCs negotiate all kind of terms of conversion of their shares; a startup needs to engage with a lawyer who specializes in these kinds of negotiations and transactions. If subsequent rounds of VC investment take place, varying degrees of dilution of ownership take place, and the entrepreneur needs to assure that his terms are being met; i.e. what relative share of the company he/she will be losing.

VC Needs and Wants

VCs have a consistent code of behavior; they don't invest in Ideas, Technology, Business Plans, and Hype, or New paradigms even though most entrepreneurial startups labor intensely on their business plans. The BP should be short distinct and to the point, clearly outlining the deal being offered; especially the exit strategies being considered. For a VC to consider funding a business, an entrepreneurial company must have clear and distinct answers to the following questions.

1. What is the problem(s) that the business and/or its products are going to solve?
2. What is the business's 'unique advantage' in solving problems versus other solutions?
3. Outline and describe the target industry and market (customers, competition, size, growth)
4. What is the company's positioning strategy to penetrate and win in the target market?
5. Describe the qualifications of the management team (and their motivations) and the special set of capabilities and/or experience that will make the business to succeed
6. Describe the key pivot points for business success; how will the company address them?
7. Describe the formative state of the company?

What is the problem the business and/or its products going to solve?

If there is no problem to solve, then there can be no business. Clearly state whether the proposed company is a business-to-business (B2B) company or a business-to-consumer (B2C) company? Business buyers primarily purchase products (solutions) to either enhance (more performance or lower cost) their current product offerings. Or the solution allows them and their customers to solve problems in a more satisfactory way; better, cheaper, easier.

If a service or product falls into the second category, it is important that the entrepreneur understands the 'customer needs' to be filled - satisfied B2B customers have their problems solved. On the other hand, B2C buyers buy to solve social needs. Also, remember that it is not

good if 'you' can see the need, but your customer can't. It is vital that prospective buyers are aware of the problems that your product can solve (and has that problem) – otherwise the chance of fulfilling their need is slim.

The 'Unique Advantage'

Since a successful business addresses the needs of its customer's-customers as well as the needs of its customer, it must offer its primary customer a 'unique advantage' and the ability to fulfill their customer's needs better than any other solution in their market space. Some of these 'unique advantages can be:

1. Technology - advantages that are in your IP that would be difficult to replicate
2. Cost – your solution saves target companies considerable amounts if adopted
3. Process – your solution provides user a new way to conduct business
4. Manufacturing – your solution significantly simplifies the manufacturing process
5. People – employees with very special insights or design capabilities
6. Customer Service – a customer satisfaction process that is core to your business
7. Timing – beating all competition to market by a significant amount of time (years)

The entrepreneurial business must offer its customers a 'must-have' 'Value Proposition'.

Describe the business's target industry and market

Describing and analyzing the target market and industry is fundamental to the success of any new business! The industry that the new company will be part of consists of all the companies serving its target market. These companies are in fact the new company's competitors; they supply the buyers in the target market; i.e. suppliers form industries, buyers' form markets. The industry should be analyzed in terms of each supplying company's size (revenues-employees), products/services, advantages/disadvantages and their implied go-to-market strategy; i.e.

1. Gross annual revenues; estimated gross margin, market CAP
2. Company structure and organization
3. Their share % and sales $ in the target market
4. The Company's pricing structures and strategies – Channels of Distribution
5. Company strengths, weaknesses and implied marketing strategies

The Gross Market should be analyzed in terms of:

1. The market, its segmented structure and the buying characteristics of the segments
2. The size in $ and growth rate CAGR of the market and of each segment
3. The marketing mix appropriate for each segment
4. Key customers in each segment and their estimated purchases annually

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Market Dynamics

1. Barriers to entry, by segment; the startup's entry strategies
2. The startup's barriers to copying or being ousted from the market
3. Competitor share, by segment
4. Rate of change of purchase $ by major customers
5. SWOT analysis for each major competitor
6. The startup's positioning statements and its brand positioning strategies
7. Expected technology inflection points

A startup company must assure itself and its investors that it can sustain its initial advantage(s) over other participants in its markets; i.e. expanding on 'market Dynamics' point #2:

1. Presence of proprietary IP and patents, and/or trade secrets, or other 'unique advantages' that other companies are unable to duplicate or imitate.

2. The likely presence of superior organizational or manufacturing processes; formulas, capabilities, or resources that others would have difficulty duplicating

3. The presence of an economically viable business models that can be shown not to quickly run out of cash in the face of competition or market action. The startup must consider the following issues:

- **Revenue forecasts versus capital; projected margins and their sustainability**
- **Market penetration and customer retention and the time it will take to get them**
- **EBTI; and the company's ability to cover the costs required to run the business**
- **Cash for operations and its characteristics – working capital requirements**
- **Time to cash-break-even; total cumulative cash required**

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The Management Team

Investors ultimately back the team that can and will deliver the business plan! It is important that investors get a thorough understanding of the team's motivations when forming their company. Important gaps in the management team must be highlighted. VCs (and maybe Angels) can assist in finding good people through their networks allowing the company to build a satisfactory team.

Assessing management involves more than judging character and reading resumes. This applies to both the entrepreneurs and the investors.
Does the opportunity fit the team's business mission, personal aspirations and risk propensity?

1. Do they have significant experience in the markets they wish to serve
2. Do they have the technological and marketing skills to compete in the industry chosen
3. Do the individuals on the team have the intestinal fortitude to match their aspirations?
4. What limits the risks that they will face, and their willingness to undertake them?

Does this team have what it takes in experience and industry know-how to deliver superior performance for this opportunity, given the Critical Success Factors?

Does the team understand the Critical Success Factors relevant to a particular opportunity in the industry, in which it will compete?

Determining the team's ability to execute on a business plan is among the most compelling considerations that VCs and investors have in assessing opportunities. Entrepreneurs should conduct the same degree of due-diligence on investors as investors do on them! Is the investment team well connected; enough so that it will be quick to make changes in its approach if conditions warrant? On the flip side, 'does the management team have the ability and the willingness and tenacity to change course and deal with changes in the marketplace, or industry' when and if that becomes necessary?
By assessing themselves based on their team's ability, entrepreneurs and their teams gain in three ways:

1. If the team needs to be strengthened to better execute on a promising opportunity, the time to do it is before writing a business plan
2. Viewing investors as part of the team also builds trust and reduces the risk investors perceive in the venture; investors like to involve themselves in building the team.
3. Investors often rate entrepreneurs who admit they do not have all the skills necessary (and are willing to do so) highly. Pitching an inadequate team for funding is likely to be unsuccessful; it may also undermine the credibility and reputation of its members, affecting their future ability to raise funds.

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Describe the needs and requirements to make this business successful

In this context, success is getting the company to cash self-sufficiency! Cash self-sufficiency is the point where a company doesn't need any furthers investments to continue its developments. Investors will require an outline of the company's milestones to get a rough idea of how much it will cost and how long it will take to get to cash self-sufficiency. The quick answer should be 'it will take X months to get there and these are the milestones that must be hit'.

How far has the company come in it formulation and development? There needs to be a few words that describe the company's current formation and projects status. It should cover such information as:

1. Legal status of the business
2. How much capital has been invested thus far (do not include 'sweat equity')?
3. Current equity distribution among founders and existing investors
4. A Proof of concept exists and can be demonstrated to be at least 'mostly functional'
5. Customer commitments – to placing orders, partnering, etc
6. Status of IP - Patents, Copyright or trademarks
7. Names of other investors that have been approached

Financing Options

The first level of financing is **seed financing**, in which small amounts of capital are provided to the company for initial product feasibility studies, development, market research, refinement of strategies and other preliminary analyses. The founders, their families or Angels, usually provide these finances the wise entrepreneur will use these funds prudently and bootstrap the company to the point of positive cash flow. This should be the entrepreneur's number one strategy; the other funding options should be only 'when necessary'! The next level of financing (from VCs, or maybe Angels) is **early stage financing**, which is generally for completion of product development, recruiting a management team, refinement of the business plan and the commencement of marketing efforts.

Further financing for companies at this point in their growth and development is tough to get because of the elimination of capital gains differential by the Tax Reform Act of 1986. VCs are now investing in later-stage companies, with a greater emphasis on the company's ability to generate current income and return to the investors. Now we come to **first-stage** VC financing, which usually funds the first phase of the full-scale manufacturing, marketing and sales. It is also at this stage that any missing components of the management team are completed. Some companies will get to this point with Angel money and/or by increased contributions by the founders. It has become increasingly difficult to get VC involvement in these earlier stages of a company's development.

At this point in a company's growth, it could seek financing from key customers who are strategically interested in the product the company offers. Some large companies such as Intel, Motorola, Sony, etc have venture funds, established to make new technologies, or products, launched by startup companies available to them. Engaging with these companies and pursuing a successful investment or business alliance is another Biz Dev activity.

A business alliance is a meaningful option for many startup companies at this stage in their development. In fact, many should include this in their early planning and in setting initial conditions. A company that has begun its production and distribution, and has established inventories, contracts and accounts receivable, but now needs working capital to fuel expansion typically requires **Second-Stage financing**.

And **Third-Stage** financing is usually for a company that is already operating at a profit, but needs capital to develop new products, expand its physical facilities, or makes a significant increase in sales and marketing efforts. **Mezzanine** rounds are few and far between these days as fewer companies have IPOs as their exit strategy, the Mezzanine round occurs just before an IPO. Finally, **bridge financing**, VCs or Angels typically will provide capital to a company that requires additional working capital to bridge the gap in getting to an exit event. This type of financing is quite rare, as the number of initial public offerings (IPOs) have ground to a virtual. Investors may consider providing capital to finance mergers and acquisitions, joint ventures, leveraged management, buy-outs or recapitalization, (typical Biz Dev activities) if the return on investment meets their criteria.

Strategies and Actions to Survive the Valley of Death

Your business plan should be more than one plan, it should be an extrapolation of multiple plans, and it should start with your 'bootstrapping plan'. That plan is all about how you will get to a positive cash flow without external funding. The extrapolations should be about how the company will perform in the event outside funding is (obtained or not accepted); all of these plans should key off your initial strategies which are the descriptions of how your company will reach your carefully selected objectives (its initial conditions). Your bootstrap plan should outline how you will get your company to positive cash flow with existing funds. In this way the entrepreneur completely avoids the valley of death, however you should definitely consider building business alliance partners or key customer partners into the plan.

Don't spend 6 to 9 months writing and polishing a business plan to assuage and appeal to VCs!

Do simple things and do them well! e.g. working prototypes (ASAP), setting achievable objectives, and setting longer term goals!

Manage the business to get to positive cash flow as quickly as possible!

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Goal Setting – this can be an ethereal exercise for many entrepreneurs; how do they weigh an 'objective' versus saving money, or getting some key employee on-board? These considerations are 'war games' that the startup team must work through in detail. The two most important exercises for the startup team are setting initial conditions for the company and setting an ordered set of goals and objectives. An incremental continuum and congruence are musts for these goals and objectives.

Setting realistic incremental and stepwise goals and objectives that are measurable and that can be reached, even without additional financing is critical; along with considering all of the 'initial conditions' and how they will affect the company's performance. This is especially important for companies that don't have a star power management team and/or won't grow revenues to $100 million. Many startups have operational plans 'in their heads' they don't engage themselves in necessary 'war plans' to consider the resources needed and the time to reach their objectives.

Plans for Financing - Consider multiple financing schemes not just VCs or Angels, especially schemes that key off of FFF funding and schemes where the company can couple with a major customer or partners in its market space. Business partners can provide cash, technical help, marketing channels and branding, etc. The startup should put together a Biz Dev program to consummate this alliance; but before you do it, get your IP house in order! If the company doesn't own IP (no patents or applications); it will be extremely difficult to form a business alliance. And the startup should (during its Biz Dev activities) make sure that its technology (or product) is on that customer's RADAR screen and is strategically important to them.

Startup financing however will need to come from the founders, friends and Angels (very unlikely to be a VC); VCs especially want to see the founders 'put their money where their mouth is' commitment and passion is extremely important to a VC. And sometimes financing just doesn't come along but if the work has been done in the team's 'war plans' sessions and in setting initial conditions the company should still meet its objectives and eventually be able to generate self-sustaining revenues.

Getting a product to market and generating revenues without VC money would be a big coup for a company! With the VC's propensity to come in at the later stages of deals these days, funding is possible at a more suitable valuation (for the founders). A company should be shouting its success stories from the rooftops (shipping product making revenues), giving presentations, making speeches, press releases, articles, etc. Action will beget success; there is money out there, and there are investors who will be interested; entrepreneurs need to get their success story to them. But just a good story and Power Point slides alone will not do it, investors need to see working product and they need to see results, especially cash flow, i.e. partners (business alliances), customers, sales, contracts, etc.

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VC Funding - What has happened? Venture funds have gotten quite large since the recovery from the 'bubble'. It's no longer realistic for a VC to invest $2 million in early-stage financing and commit 10-15% or more of a partner's time working with a company over the three-to-four years it may take to reach a liquidity event (see Money Tree). For a $500 million-plus fund, it would take a lot of VC partners and a lot of deals to get the fund fully invested in early stage 3-4 year exit deals.

This makes a $10 plus million investments in a later-stage deal much more attractive, even if the cash-on-cash return potential is significantly lower than could be obtained in an early-stage deal. The risk is much lower and the time to money much shorter. This makes the Biz Dev approach previously presented much more realistic for many startups! Chasing VC dollars can be very frustrating and could get in the way of a company reaching its goals and objectives.

Despite current post-bubble conditions, there are still VC deals being made, and venture funding should clearly be part of a startup's financing mix. VCs act like they are part of an 'old boys club' they consult with each other, they watch the deals each other make, and they invest in a fairly narrow field of deals and technologies, plus there is a network of advisors and confidants that the club taps into. Take a deal to a VC that takes him out of this comfort zone and he will walk on it.

This means that the startup should look for a VC that has done deals in the market space he is targeting. Look closely at the deals that have been made, talk to investment bankers and lawyers that might know the VC, and find out if he has the expertise and a network that will help your company. The VC needs to provide more than money; he needs management expertise, be a recruiting source for key team members, and to lead future funding activities.

VCs will put a startup's business plan under the microscope (if you can get them to take a serious look at it)! To get to VCs, use networking influences (lawyers, bankers, companies they are currently funding, etc) get a referral that will get you in front of your chosen VC. At any point in the game, a VC will demand to see your business plan so it should be a very live and current document. The startup management team should be updating it monthly, especially with customer and market information.

Have a big market and a big upside in your plan. Make sure you adequately demonstrate the size of your potential market (you will need very believable substantiating data) and make it clear and believable that you understand and can access the marketing channels. The VC will be looking for significant financial rewards and healthy margins that a strong demand for your product will bring to the bottom line.

Remember, most venture capitalists want a 60% to 80% p.a. return for early-stage or pre-launch deals and at least a 25% to 35% return on latter-stage and mezzanine level investments. If a VC suspects that your product or service has a narrow market with limited demand, or thin margins, he will 'almost always' walk away from the deal. If your target market is too mature with already established competitors, then the VC may feel the opportunity is too limited and will not produce the financial returns that they expect. They are looking for a company managed by a seasoned management team that has a **'defensible competitive advantage'**, demonstrated by a balanced mix of products and services meeting market needs, domestically and internationally.

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Conclusions

Technology Startup companies almost uniformly think 'venture funding' coincident with the thoughts of their product or service ideas. Bitter experience has shown that about 90% of these companies fail somewhere along the road to being self-sustaining, and some of them never even get off the ground because they have insufficient funds to get to critical mass. Plus they get so focused on seeking funding that they don't do the management planning and the development of their operations to the point necessary to assure their existence, and eventual success.

The Valley of death is littered with them! On top of this, the venture funding community has changed significantly, since the bursting of the high-tech bubble in 2001-2002! Investors are more risk averse; because of this, the sizes of the funds VCs are managing have grown tremendously. They have more money to invest, and their risk aversion has pushed them into making larger investments at later stages in the growth and investment cycle.

Consequently, entrepreneurs have found that their sources of money (founders, friends, and family) move them only forward to the canyon's 'south' precipice, at which point they are peering down into the Valley of Death. Some are able to secure angel investors that keep them from falling into the valley.

Many startups could survive if they followed some of the tenets outlined in this paper:

1. Entrepreneurs should realize that without a star power management team, venture funding (from VCs) will probably not be available, especially in the earlier stages of their company's development
2. Startups should develop a clear concise business plan and a set of sequential goals and objectives that are achievable with the initial funding from Founders, Friends and Angels – look for and find more Angels
3. Prepare the descriptions and analysis of their target markets as outlined earlier in this document. If they seek VC funding, their target market's size must match the sizes of the investment funds VCs are managing
4. They should develop working prototypes ASAP and get them into the hands of key customers
5. Use Business Development techniques to engage with Key Customers; develop business alliances, get technical and marketing help from them, and seek investment funding from them
6. Entrepreneurs should seek all the help they can get from partners, consultants, suppliers, etc
7. Engage with targeted VCs (specialists in their space) for funding as the company develops
8. Startups should engage with VCs and/or Angels who can mentor and coach them
9. Execute! Execute! Execute! – examine, evaluate, change, the resources preventing it

The journey across the Valley of Death is harrowing for most startups but if they prepare properly (Initial Conditions), get their ducks lined up, and execute on their plans, the journey will be much easier, and less deadly.

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