WHAT VENTURE CAPITALISTS WANT

Entrepreneurs are from Mars and venture capitalists are from Venus. So how on Earth do the two team up?

Report: Kath Walters

● Venture capital investors manage hundreds of millions of dollars, and have thousands of entrepreneurs trying to get access to it. Yet it sometimes seems as though the two come from different planets. Entrepreneurs forget that venture capital managers consider hundreds of deals, have limited funds to invest and must deliver high returns in order to raise more money. Venture capital managers forget that entrepreneurs are constantly broke, work long hours, struggle to find the right advice, and live in fear of losing it all. *BRW* talks to three venture capitalists and three entrepreneurs to find out what they're looking for in an ideal partner.

● VENTURE CAPITALIST

Fiona Pak-Poy, general partner, Innovation Capital

● With $100 million under management, Innovation Capital invests in early to mid-stage medical device, telecommunications, information technology, engineering, clean technology and biotechnology companies.

Turn-ons

1. A product or service that people really want, a large and growing market – normally international – and a compelling business case. Venture capital is not for everyone, even a person who has a fantastic business opportunity.

2. An entrepreneur who is clear, articulate, passionate and ready to listen. We don't know everything about their company, but we hope they realise they don't know everything about growing a company quickly in an international market with a financing strategy such as venture capital.

One who talks in terms everyone understands, without getting into deep technology. Let's assume the technology works. If they can't explain it to us, they are certainly not going to be able to sell it to customers.

3. All the shareholders – typically angel investors, friends and family – are aligned, or can become aligned. If the company does really well, we all get a share; and if the company tanks, everyone loses their shirt. We put in a reasonably formal level of corporate governance, particularly in the financial accounts, because we are preparing it for an exit. Our priority is to have a fast-growing company. Profit is not the main goal, and that takes time to understand.

Turn-offs

1. People who are pushy and rude over the phone, insisting the company is the next best thing since sliced bread. We will hesitate.

2. It is not a deal breaker but bringing in a huge team is not the best. We don't need to meet them all, just the top two or three people.

3. If they have too many slides and are intent on progressing through them at their own pace without listening to our questions, we worry. What counts is whether they are willing to listen to and address our questions with clear thought.

Deal clincher

Venture capital funds have investment committees. Successful entrepreneurs understand that their contact, the lead partner, must become an advocate and sell the deal to a committee that might not be so passionate, explaining why the gambles are worth taking.

You ask yourself: is the founder or chief executive really committed to success? Will they crawl over cut glass, and stay objective? It is like a marriage for the next three to seven years. They need to be objective so that if the board asks them to stand aside, they understand why.

● VENTURE CAPITALIST

Geoff Brooke, managing partner, GBS Venture Partners

● Formed in 1996, GBS Venture Partners specialises in healthcare, biotechnology and life sciences, and manages more than $400 million across five funds.

Turn-ons

1. A history of success in the relevant area is the ultimate. If someone says, "I was an integral part of the team through the various stages of development of a new company, and before that I had a successful career in product development with a big international company", that's tremendous.

2. A sensible, well-thought-through, well-articulated plan that includes what the company is about and where it has to go in order to deliver me the return they should know I am looking for. They need to say: this is the opportunity, this is how we will finish the clinical trials, raise more money and launch the product; or, this is the company we would sell ourselves to in order to make you 10 times your money.

3. Those who present themselves as leaders, who appear trustworthy and inspirational. They have other credible people on board with them, and they make eye contact.

Turn-offs

1. Outrageous claims that you can drive a

bulldozer straight through. People say silly things, such as XYZ biotech company in the United Sates is in the same area as us, and its market capitalisation is $2 billion; therefore, we are worth $100 million.
2. Putting a non-disclosure agreement in front of me and saying please sign this. It is an insult. Am I going to sign something I haven't read? The inference is that I might run off with the idea. I have been in business since 1987 and no one has ever sued me. If there are issues with intellectual property, just don't show me the secrets of the technology. I am interested in the technology, but not at the first meeting.
3. There's a fine line between establishing bona fides by saying, for example, "in our last deal, XYZ invested in it and Bill Smith and I got on well", and going the other way, where you name drop every venture fund globally.

One guy told me "you know XYZ Ventures in Boston, they offered me a partnership but I didn't take it". I knew the managing partner of that firm and I rang him. He said he never heard of the guy. If you are going to name drop, make sure it is credible.

Deal clincher

I have learned from bitter experience that if you compromise on one thing – the track record, plan, market size, IP, cash requirements and the way to get the money back in three to seven years – you are destined for failure. And particularly, don't compromise on the people.

● VENTURE CAPITALIST

Michelle Deaker, managing partner, OneVentures

● With a $40 million fund, including $20 million from the federal government, OneVentures invests in new and expanding companies in the area of clean technology, information technology and life sciences.

Turn-ons

1. An entrepreneur who walks in and builds your confidence in their abilities. We look for an engaging meeting where they leave us with a good feeling. We expect a concise pitch – about 10 slides over 20 minutes – which clearly enunciates the nature of the problem and the market, their solution, how to execute it, and the quality of their team.
2. We also want to see that the market is global, that they have a competitive advantage and the people are experienced and able to execute their plan.
3. We like fast response times to our questions and quality answers. When we check out the information, we want to find that they are doing what they say, and there is no messy stuff underneath. In particular, when you talk to customers or potential customers, you want to find a good perception of the entrepreneur.

Turn-offs

1. They walk in with 70 slides and no time for questions. This tells us they haven't thought through how they will handle the meeting.
2. Waffly, imprecise answers. Not knowing the status of their intellectual property is a classic one, but also not being able to answer questions about customers. That tells us they are not commercial.
3. We ask for follow-up and it doesn't come, comes back slowly, or isn't the information we are seeking. We talk about 'deal fatigue'. Venture capital firms get so many deals, it is the entrepreneur's responsibility to keep them engaged; otherwise they just move onto the next person who is more engaging.

Deal clincher

We want all our due diligence boxes ticked and no red lights, so there is unlikely to be anything that we cannot overcome. We look at the downside – what if everything went pear shaped, would we be able to get our money out? Alternatively, can the business deliver the kind of multiples we are looking for?

● ENTREPRENEUR

Michelle McCann interim chief executive, Spark Solar Australia

● Dr Michelle McCann has raised about half the $7.5 million needed to set up a business manufacturing photovoltaic solar panels with a twist. McCann, a scientist, will make panels that produce more power with a quicker pay-back time for customers. Her company knows how to import a generic factory line and tweak it for local (or other) conditions.

A product such as this, which improves on established market demand, is typically attractive to venture capital investors, but McCann has had to work hard to win their support. Customers have been easier and she already has an order. Importantly, "we have identified a chief executive with senior management experience in the industry", she says.

Turn-ons

1. A deep knowledge of the market and the technology, or an openness to hear about it with enthusiasm and intelligence.
2. Flexibility, and recognition that while they are putting in the money (a huge contribution) you are putting in your life. Both have to be happy and motivated to continue working – that is partly financial – and also involved in decision making.
3. Experience that can plug gaps. They have surely made mistakes and know which methods work. These are things I don't know. We might not be good at marketing; they might have contacts. We want them to bring networks and experience to the table.

Turn-offs

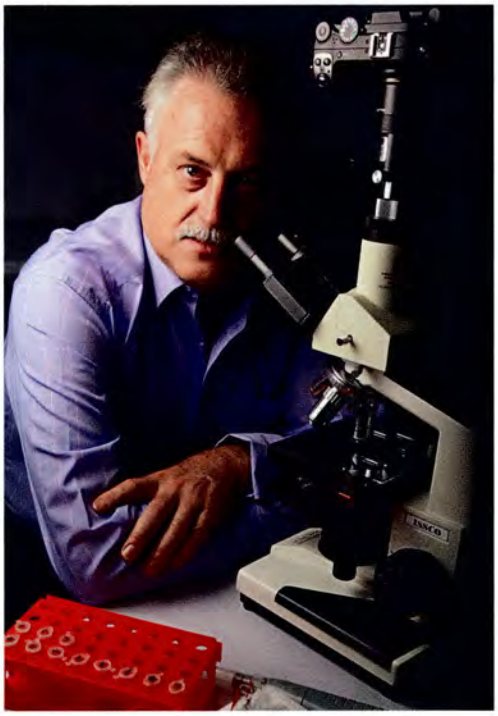
1. Closed-mindedness. From some people we get a blank statement: "Oh, manufacturing won't work." I have turned a lot of those people around so they realise our case is different. The labour cost is a small portion of our total costs. But it means taking a deep breath and thinking "here we go again". Another one I get is that I am not fully informed, that there is a massive silver bullet around the corner, something 10 times more efficient. But that is not the case. Solar is like cars; innovation is incremental.

Deal clincher

An investment proposal term sheet is a very short process, but you are building something much bigger. It is the feeling that you will be able to work together for several years, and that you are both heading in the same direction.

● ENTREPRENEUR

Rod Lewis, commercial director, Gratuk Technologies



● Gratuk Technology produces pet therapies for six common conditions. The therapies are already used for humans, but Lewis has technology to adapt each therapy for an animal market. "A therapy that works on people will not work on a dog without being adapted," he says.

With $2 million, Gratuk can get two products through trials and approvals and on to shelves, and do the scientific work on the remaining products. "The average amount animal owners spend on their pets is $US1600 ($1884) a year," Lewis says. The production costs are low.

Turn-ons

1. An investor who is familiar with and understands the veterinary market, so they will understand that when we achieve milestones, these are very technical.

2. Someone genuinely prepared to bend. Pretty soon after meeting someone, you form an opinion about whether you can work with them. What do they do when there is a problem? If I have made an error I will admit it, but I still want to make this company work.

3. Introductions to people who can flog the stuff. Everyone talks about the exit [returning the money to the investor, plus returns]. Well, we are really keen to get in, get out and move on. A venture capitalist that is connected in the space, who is credible, would be highly desirable.

Turn-offs

1. When the first thing you do is fill in a form, and they say, 'This is how we work'. There is no chance to form a working relationship under these conditions. If they are locked into their own ways of working, I assume they are locked into an attitude of how to handle problems.

2. One-way ratchet clauses. [This means that if the entrepreneur misses a milestone the investors get more equity.] I am happy with two-way ratchet clauses. I think that when I then achieve the milestone, I should get the equity back.

3. Overseas venture capital investors. It is not a deal breaker, but what does that mean for the process of reviewing the progress of the company?

Deal clincher

When the relationship develops well, suitably quickly, but not in a bum's rush, and I can see they are genuinely interested in the investment. It progresses in a logical way. I met one guy for two hours, then we got comments back, on time, and they were astute. He didn't expect the world's best information memorandum, which takes ages to write. He gave us a hint about something else that may help us, whether or not he gets involved.

● ENTREPRENEUR

Paul Grogan, chief executive, Easy Foods

● A company established in manufacturing long-life ready meals that don't require refrigeration, Easy Foods also has a niche in manufacturing meals for the diet industry, including brand names such as Tony Ferguson and OptiSlim.

The company has an exclusive licence to make OptiSlim products for India, where 40 million people have Type 2 diabetes, a condition triggered in part by being overweight. There are no diet products available in India at present, Paul Grogan says. "We will be selling there next month."

The company has a distribution agreement to 700,000 shops in India, he says, and needs $3.5 million to realise the opportunity. Grogan has raised $1 million.

Turn-ons

1. Questions about everything to do with my business in India: our marketing strategy, our channels, the direct and indirect relationship we have in India, our marketing budgets, our endorsements, how we will engage with Diabetes India, what out-of-the box promotions we have, our point of difference.

2. Visionary people who see the potential in India when they hear our story face to face. We will be first to market in India, and intend to list on the Indian Stock Exchange within three years. If they have skill in helping our initial public offering in India, or connections that would help us, we'd be happy to have them on board.

3. People who enjoy our open management style, enjoy engaging and ringing me. I have no hesitation in telling them what is new, who are partners with me.

Turn-offs

1. Getting bargained down. One guy offered me $1 million for the shares I wanted to sell for $2.5 million. I am insulted by that. His agenda wasn't about growing our business.

2. Venture capitalists who don't believe the Indian market is as big as we think it is. I would like to see their evidence.

Deal clincher

An investor who believes in what we are doing, and who looks at the interest of all shareholders. BRW