

Venture Capital: It's scarce but still available

The five venture capitalists participating in the recent Annual Venture Capital Forum of the Los Angeles Venture Association observed that financing for early stage ventures was not readily available from venture capital funds today.

They confirmed what most entrepreneurs already knew: Seeking institutional venture capital is a difficult and arduous task unless one can "walk on water."

Professional venture capitalists for the most part have been shifting their focus into later stage investments, in particular, leveraged buyouts and expansion financing for existing companies. The returns are as great or greater than investments in early stage companies and are achieved in a much shorter time frame with significantly less risk.

Where then does this leave the entrepreneur who is seeking to raise the investment capital necessary to translate his/her vision into a marketable product or service? What alternative sources of financing are available to the entrepreneur?

Business enterprises are funded by many other ways. However, one has to work diligently at unearthing them.

Without a doubt "angels" represent the largest source of financing for an entrepreneurial venture. They are successful entrepreneurs-turned-investors who generally will take an active role serving on the company's board of directors. In a book commissioned by the Small Business Administration, Robert Gaston estimated about \$28 billion is invested annually by "angels." In contrast, professional venture capitalists annually invest between \$1 billion and \$2 billion in early stage companies.

Most "angels" invest informally on a one-on-one basis although there is some institutionalization of the process. An example of the latter is the New England Venture Network, which last year arranged investments in more than 50 projects totaling in excess of \$23 million.

Private equity placement, limited partnerships and sale of securities directly to "qualified" investors provide one of the greatest opportunities for the entrepreneur to get a large block of investment capital.

FRANZ VON BRADSKY GUEST OPINION

Generally, the typical investors in these types of securities are wealthy individuals who are rarely active in the company's business affairs.

Governmental institutions such as the Small Business Administration can be a source of funds. There are a number of sources at the state and local level, too; you just have to unearth them.

One that I recently came across is the California Office of Competitive Technology. In its first year, 1989-90, it funded 28 projects ranging in size from \$6,400 to \$1.2 million. Total funds invested during the first year were \$6 million.

Corporate partnering has been around for quite a while and is a trend that has been starting to grow recently. For the most part these are minority equity investments where large corporations see a strategic potential to be gained by allying themselves with smaller companies that are creating new markets or developing a proprietary product or technology.

There are numerous benefits to both the entrepreneur and the corporate partner from such a liaison.

Banks, while not a major source of financing, are yet another possibility. They typically will offer only secured financing, usually a percentage of the face value of accounts receivable, inventory and in some cases fixed assets.

Some banks also have SBIC subsidiaries. Such small business investment companies make investments in promising early stage ventures but extract both a high rate of interest as well as a piece of the equity of the risk taken.

Venture leasing is a relatively new concept of financing for fledgling business enterprises. Instead of buying capital equipment outright, leasing fixed assets will prevent capital from being tied up in

longterm assets and make it available for working capital purposes.

Several financial institutions, primarily insurance companies, offer this program through their subsidiaries.

Initial public offerings are a source of financing available to the entrepreneur but truly are available only to a very few select companies. This is particularly so when market conditions for IPOs are very poor.

Generally companies that are able to complete an IPO have certain characteristics, a very strong management team, a very high growth rate potential, a highly defined business and, in most cases, a history of earnings.

Mergers and acquisitions are yet another source of financing available to the entrepreneur. Again, like IPOs, it is only available to a limited number of companies.

Generally only companies that are growing very rapidly and have a voracious need for capital are able to use this approach. The entrepreneur needs to find a partner with a common vision, a compatible philosophy and the resources both financial and managerial to support continued rapid growth.

The most common form of financing and the one that undoubtedly is familiar to almost everyone who has started a business is going it on your own, often known as "bootstrapping." This method was around long before the formation of the venture capital institutions of today. Bootstrapping has many forms and may consist of any or all of the following, as well as many more that I haven't thought of:

- Taking a second mortgage out on the house.
- Borrowing from friends, relatives, in laws or business associates.
- Selling your personal assets.
- Obtaining a personal loan from a bank.
- Depleting one's savings and borrowing on credit cards.

CMS Enhancements, which today is a \$200 million, New York Stock Exchange-listed company, was founded by its chairman in 1981 when he used his credit cards to purchase the initial inventory.

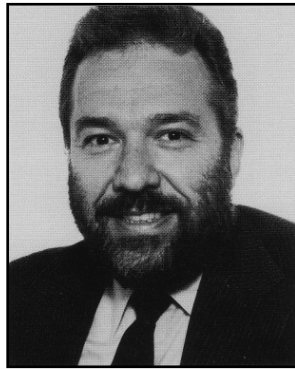
Capital: Well-conceived business plan a must

A word to the wise: Before approaching prospective investors, develop a well thought out business plan that will demonstrate to them that your proposed business enterprise is a worthwhile investment opportunity. A well conceived business plan must articulate your vision of what the enterprise will become in a number of years and how you are going to accomplish those objectives.

When writing your business plan, remember prospective investors, whether professional venture capitalists or private investors, are deluged with requests for financing. Your plan should be comprehensive yet concise, people have great respect for those who can tell their story quickly and succinctly.

To ensure that your plan has the greatest chance of being read, keep it to a maximum of 10 double spaced pages. If it can't be read in five minutes, it is unlikely to be read. And if it isn't read, enough said!

Investment capital truly is available for persevering entrepreneurs who are willing to leave no stone unturned in pursuit of their dream to turn their bright, innovative ideas into reality.



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