FINANCIAL POST

Brad Cherniak: What investors today really want

Brad Cherniak, Financial Post · Mar. 14, 2011 | **Last Updated: Mar. 14, 2011 9:36 AM ET**

Two questions weighing heavily on the minds of owners of small to mid-sized businesses today are: What do investors really want? And is raising capital a waste of time and effort, or is it a realistic pursuit?

There are lots of checklists out there for SMBs looking to garner the favour of institutional investors. Some of them are pretty good general guides and starting points. But whether you are considering looking for venture capital, private equity, or angel capital, I would winnow it down to a handful of key items that are either door-openers or show-stoppers. Everything else is secondary.

The market opportunity It is not enough to be going after a hot market niche with a wing and a prayer. You should identify one or a couple of highgrowth niches you can make the case for a defensible market position in. To establish credibility, you need a small existing position in at least one of them. Blue-sky "hockey stick" forecasts of global domination across a wide swathe of business lines or market segments are not taken seriously today.

Be realistic and specific about your execution plans in the niches you choose. Tie these plans specifically to your existing team and resources — this is critical. Focus on tangible steps and sensible short-term performance milestones, then build off that. Track your performance against the plan and explain variances. And show a positive trend.

Investors generally won't back the "build it and hope the customers come" business plan. They want to have evidence of a customer base "in hand" and receptive to your product or service. Only then are investors willing to support spending the money necessary to build the full staff and infrastructure to deliver on the promises made to the full target customer base.

Bottom line, run very lean until your market proposition is proven out to some extent. If this means a less aggressive and explosive forecast in the meantime, so be it.

Finally, unless you are Facebook or Twitter, be able to tie your forecast metrics at least roughly to historical performance. Show how you have obtained your current customers and what the cost has been to get them. Show how profitable these customers are, to the extent possible. Then show how you plan to get more.

The team Have your core team in place and fully committed, if possible. If key employees are shareholders, all the better. The team can be spread thin, even very thin, but have at least your absolute core competencies "in-house" to execute on the strategic plan.

Be very specific when you talk about the qualifications of your team -professional and technical. Previous entrepreneurial experience on the team is a major asset, if not a requirement. And be ready to convince prospective investors what the core competencies required in your business are -sometimes they are obvious, sometimes not. Don't presume they are.

Current operations/run rates In most cases, it is essential to have historical revenue, established customer relationships and at least some evidenced "repeatability" in your sales. Being profitable and/or cashflow positive is also more than nice to have outside a small number of market niches.

Understandably, this is a major source of frustration for early stage entrepreneurs, who counter if they were profitable with established revenues and customers, they wouldn't need outside capital. Fair enough, but this is the world we are in -it doesn't need to be fair or reasonable.

The money talks, and it generally is saying it doesn't want to fund cash burns, or infrastructure builds, or pure R&D. It wants to fund expansion. It wants to take market risk, not company risk.

One last point. Investors expect companies to utilize IT, software and web technologies to reduce their operating costs, expand their reach and conserve capital.

Bottom line, it remains much harder today than in recent memory to obtain funding of any kind. And this will remain true for the foreseeable future, even as the private risk capital industry works out its fundamental challenges, the pool of available capital replenishes itself and investment activity continues to rebound. There is increasing activity in the small cap segment of the private equity world, which will be helpful to increasing the overall supply of capital to SMBs.

Today, in terms of the best uses of proceeds for financing, investors are looking to expand the sales funnel, make strategic tuck-under acquisitions and accelerate established historical growth trends.

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