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2975, boul. St-Charles, suite 255, Kirkland, (Qc) Canada H9H 3B5
Tel: 514-425-0412 Fax: 514-694-1125

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"This paper is intended to present the reader with a practical guide to understanding the Venture Capital market.

As discussed in Internet Business Basics, your company's business plan is the single most important business proposal you will ever write. It is the template for your endeavors and explanation to potential investors as to how you will make money.

I also reiterate, "finding money takes time and energy. Be diligent, and above all be patient."

- John Shenton, President

1 HOW TO DEAL WITH BANKS (FROM A BANKERS POINT OF VIEW)

Build Personal Relationships

Relationship banking means finding an individual within the bank that wants to grow with your business and can offer advice and consultation. The entrepreneur should contact the business or loan offices of the bank, then find the individual with a good depth of experience who is willing to work with the business on a daily basis. This person should also be someone who is knowledgeable concerning all aspects effecting businesses. We also make the following suggestions:

1. After preparing your documents (business plan), do not send them in the mail to your banker. Make a personal appointment with the bank instead.
2. Sit down with the banker and walk through your business plan. Bankers evaluate not only the documentation, but also the person(s) behind it. Give the banker an opportunity to get to know you. The better the banker understands your business, the better equipped he/she is to respond favorably to your loan request.

1.1 Banking Basics

Banks are businesses too. They have stockholders to whom they must report and they are highly regulated by federal and state agencies.

1. Remember that banks only make a profit for their stockholders by making sound loans where they can collect up front fees (points) and also collect interest on the loan as well as recoup the loan principal.
2. In order to have money to loan, they must maintain adequate reserves (regulated) and may not be able to lend more money until more deposits are made. (This is one reason they ask that all your accounts be lodged with them.)
3. The SBA (US) or BDB (Can.), does not lend money. It only provides a guarantee to banks on loans. In the event that you default on an SBA/BDB guaranteed loan, the bank may have the (federal government) make good on all or some of the principal.
4. Banks may be prohibited or will not lend to certain industries based on their corporate policy, so be sure to ask the following questions before formally approaching a bank:
   - ***Do you lend on these kinds of projects?***
   - ***Are you lending now? (Can the bank actually make more loans now?)***
   - ***Under what conditions are you making these loans? (Interest coverage ratios, etc.)***
   - ***What information do you need to consider my request? (Obtain their checklist)***
   - ***What is the time frame usually associated to complete a loan of this type?***
5. After you have this information, proceed to develop your business plan and associated documentation.

1.2 Establishing Credit

If you have not already done so, obtain copies of your personal credit history from the various reporting agencies in your area and be sure to include the national services such as TRW and Equifax. Also obtain a copy of a Dun and Bradstreet Report on your business. These will give you valuable insights into your potential for obtaining financing.
If there are errors, omissions or incorrect entries, each agency will provide you with a means of correcting these items.

Many times, a divorce, natural disaster, or major economic recession where your customers left you large un-collectible fees have caused you problems. You are allowed to have each agency place your letter of explanation in the file so that it becomes public record. Note: do not fudge or obfuscate here; filing a false financial statement can have serious criminal consequences.

Credit cards, while a valid need in today's society affects your credit rating, even if they have a zero balance. The bank must consider those potential liabilities even though it is unused. So $100,000 in available credit at the 19.8% level on your cards can prevent you from obtaining a much lower interest rate loan at the bank. Establish a credit line with your bank and then eliminate the cards.

To establish or re-establish your credit rating, first find a commercial lending officer you can work with comfortably. Next arrange a small business or personal loan and pay it off early. Continue this process with two other banks in your area. If you can get all three loans at once, simply use the money from one to pay off the others. You can use this technique to obtain progressively larger loans. At one point in the future, you may be able to get a signature loan for $100,000,

1.3 What Does a Bank Look for in its Decision Making Process

After numerous meetings with bankers, we offer the following insights into what the bank looks for in order to make the decision to grant a loan. Key points included:

1. What type of industry are you involved with?
2. Is it new, emerging or growing?
3. Is it dependent upon other industries?
4. Factors that impact the business risk, such as management experience, depth and integrity. How long has the business been in existence? Also, include market share, size, product line (supply, sales, and distribution), and profile of customers.
5. What is the legal form of the business? Is it a partnership, proprietorship, corporation (what type), joint venture, etc.?
6. Quality of management. What type of experience does the management team have with this specific industry, and what is the commitment? Are the owners involved directly with the business or are they absentee owners? What assets or liabilities are involved with the business? How does management take out their salaries/bonuses?

7. What facilities are used and where are they located? What are the terms of the lease? How does it compare to competitors' facilities? What are the capital expenditures, insurance coverage, etc.?
8. Existing financing. Do you presently owe trade suppliers, other banks, principal shareholders, relatives, and others?
9. Who are your sources of suppliers, including history and discounts?
10. What are your existing loan arrangements, bank relationships, borrowing/repayment history, estate planning?
11. Provide a financial analysis, which includes accounts receivable/payable, credit policy, collections/bad debt experiences, conditions of inventory. Are your taxes current? How is the company capitalized compared with the industry? What is your marketing plan and sales projections?
12. Also include balance sheets, income statements, expenses vs. sales, operating profit margin, asset management, liability management, cash flow summaries, and projections and sensitivity analysis.

    In your ability to answer the above questions, you help the bank answer the most important questions:

1. What is the purpose of the loan?
2. What are the sources of repayment and quality of those sources so that the bank can devise a program of repayment that makes sense to the small business owner?

1.4 The Four C's of Commercial Lending

1. **Concept:** What you are selling the banker on, what exactly is involved in the business situation, such as the type of service, management expertise, and marketing strategies. Some industries are off limits or not currently supported by lending institutions. It is important that you know the current status of your industry.
2. **Cash flow:** Prove that there is cash available to repay the loan. Prepare a business plan that shows an equal balance of equity from principals, equity from outside investors and equity equivalents (build out allowances, supplier financing or flooring, etc.) in place. Then have your business plan always have a coverage ratio for interest and principal of 1.3 or greater.
3. **Collateral:** Banks aren't venture capitalists or equity participants. However, some banks in Silicon Valley and other high tech areas will co-investor, or lend money for startups is there is already a known venture capital company or other major investor.
4. **Character:** What are the credentials of the parties requesting the loan. Do they have positive track records in this industry, do they have positive banking relationships in the community, and are they known quantities?

1.5 Types of Financing

There are many different forms of loans available. Use your advisors to determine what form might be appropriate for your business.

1. **SHORT TERM.** An example of short term financing would be a retailer involved in a seasonal business. He may borrow money for 90-120 days, pay interest during that time, and then pay off the loan in full.
2. **LINE OF CREDIT.** The entrepreneur can borrow against it when needed, but repayment would be for a longer period of time.
3. **FACTORING OF RECEIVABLES.** Here the bank controls the collection of the company's accounts receivable, either through direct deposit or through monthly loans as receivables are presented.
4. **REVOLVING CREDIT.** This is not seasonal, but for businesses that are in up and down cycles, for example contractors. This type of loan should not be used for the purchase of assets.
5. **LONG TERM LOANS.** This would be used to buy assets (trucks, equipment, etc.). The repayment period is usually 3-5 years. But typically, startup operations have paybacks of 5-7 years.
6. **COMBINATION OF LONG AND SHORT TERM.** This is called "the revolver that turns out". Typical uses for this type of financing would be a high growth phase company to help finance receivables or build up inventory. Loan is set up for repayment in 3 years, until the business levels out.

If you don't understand the terminology or jargon of the banking industry, ask the banker to explain. Find out exactly what you are getting into. The borrower should ask lots of questions.

1.6 After the Loan: Maintain Communications

The KEY on how to maintain excellent banking relationships after a loan has been received. A banker should take care of all your banking needs and you should always keep the line of communications open. Some ways to accomplish this are:

1. It's in yours and the bank's interest to keep your business going.
2. Be aware. Regularly take your banking partners to lunch, usually monthly just to keep them up to date, and to provide current financial information on the business, in your geographic area and business segment.
3. Bankers should have a broad business orientation, based upon experience.
4. Exchange industry trends, marketing information and other issues that affect your business with your banker.
5. You should review your business plan quarterly with your banker. This is a good way to monitor against projections.

6. Have the banker visit your place of business. Be prepared to show him your record keeping and accounting systems.
7. Banks offer an array of financial services, such as cash management, profit sharing, and trusts. Take advantage of these services.
8. The banker should take an active interest in your business.
9. Don't wait until the last minute before asking for financial help. It may be too late by then.
10. A good banking relationship takes time to establish. Don't change or evaluate banking services on just a 1/8---¼point discount. The overall loss of a good relationship could hurt your business more.
11. If you are going to have trouble meeting a payment, notify your banker in advance.
12. Banks offer work out plans, interest only plans, and other debt relief plans, so ask in advance if you have a problem. They would rather collect a little than nothing and keep your business alive.
13. Always come with a solution for your financial woes. Having a good plan and sticking to it will help you maintain that clean credit record.

2 VENTURE CAPITAL FIRMS

Venture capital is high-risk, high-return investing in support of business creation and growth. In pursuit of high returns, a venture capital ("VC") firm raises a fund of anywhere from $10 million to $350 million in size.

The legal structure of a VC fund is a limited partnership. Those who invest money into the fund are known as limited partners (LPs). Those who invest the fund's money in developing companies, the venture capitalists, are known as general partners (GPs). Generally, the LPs contribute 99% of the committed capital of the fund while the GPs contribute 1% of it. As returns are made on the fund's investments, committed capital is distributed back to the partners in the same percentage.

VC firms receive compensation for their investment and management activities in two ways.

First, they receive an annual management fee paid by the fund to a management corporation, which employs the venture capitalists and their support staff. The annual management fee approximates 2.5% of committed capital; however; it is usually lower at the very beginning and end of the fund when investment activity is low.

Secondly, the VC firm receives compensation through the allocation of the net income of the fund. The fund's primary source of net income is capital gains from the sale or distribution of stock of the companies in which it invests. The GPs typically receives 20% of net capital gains while the LPs receive 80%.

A venture capital fund passes through four stages of development which last for a total of ten years. The first stage is fundraising. It typically takes the GPs of a venture fund six months to a year to obtain capital commitments from its LPs. LPs include state and corporate pensions funds, public and private endowments, and personal investors.

The second stage lasts between three and six years and is comprised of sourcing, due diligence, and investment. When a VC firm sources a company, it simply means that the company has been brought to the attention of the firm. Sourcing occurs through reading trade press, attending trade conferences, and speaking to those with industry familiarity. A junior member, a.k.a. an Associate or Analyst, spends the majority of his/her time sourcing companies. After a GP or junior member sources a prospective deal, extensive research is done on the company and its market. Occasionally this process called due diligence, leads to an investment. Companies in which VC firms invest become "portfolio companies."

The third stage, which lasts until the closing of the fund, is helping portfolio companies grow. The Portfolio Company and the VC firm unite to form a team whose goal is to increase the value of the Portfolio Company. The VC firm becomes an equity participant in the portfolio company through a deal structure typically comprised of a combination of stock, warrants, options, and convertible securities. In return, the VC firm provides financing and a representative who sits on the portfolio company's board. As a board member, the VC

representative offers strategic advice to the management team and assures that his/her firm's interests are considered.
The fourth and final stage in the life of a venture fund is its closing. By the expiration date of the fund, the VC firm should have liquidated its position in all of its portfolio companies. Liquidation usually occurs in one of three ways: an Initial Public Offering (IPO), the sale of the company to a third party, or Chapter 11. Typically an IPO realizes the greatest return on investment.

2.1. Investment Evaluation Criteria

VC firms judge potential investments on the basis of four fundamental criteria: management, market, products, and financial opportunity. They evaluate each criterion from the perspective of minimizing their risk and maximizing their return.

2.2. Expected Annual Rates of Return

KPMG Peat Marwick, the international accounting firm, has compiled a list of annual rates of return expected by institutional investors. These institutional investors are the ones who invest in venture capital firms. A separate Asset Class for Venture Capital of 5% of most institutional investors portfolios are invested in venture capital funds in the hope of increasing the institutions overall performance. Here are the average expected rates or returns for various types of investment classes over the next 25 years.

3% Gold

6% T-Bills

8% U.S. Bonds

8% Convertibles

9% Real Estate

10% U.S. Stocks

11% NASDAQ Stocks

12% Oil & Gas

13% International Stocks

17% Venture Capital Funds

The reason Institutional Investors expect only 17% and the venture capital companies try for 40%, 60% and even more accounts for the risk, failure rates of new ventures, and profits for the venture capitalist or private investors.

2.3. Management

A strong management team is comprised of individuals who have successful track records in relevant industries and have gained a superior understanding of their market. The team must work well together and have an extraordinary drive to make their company grow. The team must also have the "Big 5 Managers" either on board or selected by the owners. They are:

CEO - Chief Executive Officer: The Leader, Visionary and Great Communicator

CFO - Chief Financial Officer: The Money Man

COO - Chief Operating Officer: The Operations Man

R&D - Director of Research and Development: Mr. Inside (usually the founder in a technical company)

S&M - VP Sales and Marketing: the Sales and Marketing Guru

The most critical factors that will be evaluated by the venture firm with respect to this management team are:

67% Can the team maintain a sustained effort?

67% Does the team have extensive market familiarity?

51% Does the management evaluate risks well?

48% Is the team intimately familiar with the product?

39% Is this an attractive market, is it growing or will it decline in the future?

37% Does the product fit the company's goals?

31% Is the product proprietary?

31% Is the entrepreneur a leader?

28% Can I get at least a 10 times ROI in 5 to 7 years?

2.4. Market

The ideal market is growing rapidly and has the potential to become enormous. If strong direct competition exists, the market opportunity needs to be large enough to sustain two or more successful companies. The management team needs to understand and establish relationships with the key distribution channels in their market.

An effective way to establish a profitable channel often includes both a direct sales force and relationships with **V**alue **A**dded **R**esellers (VARs) and **O**riginal **E**quipment **M**anufacturers (OEMs). Government regulations, if they affect the dynamics of the market, should enhance a company's position.

2.5. Products

The ideal product has few technical risks and has many proprietary features that differentiate it from the products of competing companies. In addition, the product should achieve above-average gross margins, have a short sales cycle, offer repeat sales opportunities, and demand a limited amount of additional capital. Because the fate of the company should not be riding on a single product, plans for a full product line are important.

2.6. Financial Opportunity

Once the VC firm decides that a company has superior management, an attractive market opportunity, and excellent product, it strives to invest its capital at as low a price as possible. An entrepreneur, of course, wants to raise capital at as high a price as possible. The price of a deal is the value of the company as determined by both parties. Liquidity is the final goal; thus, an assessment of likely exit (liquidation) opportunities is made before money is invested.

VC firms rarely find an investment that suits all of their criteria. Even when they find a good deal opportunity, they are not guaranteed success. If a VC firm is both skilled and lucky, it will probably make a profit on 50% of its companies and lose money on the other 50%.

2.7. Investment Strategy

Most VC firms evaluate companies based on the above criteria. However, because of competition among their VC peers to be chosen by the limited group of entrepreneurs who are both experienced and successful, VC firms have developed unique investment strategies which center around specific industries and particular stages of corporate development.

2.7.1. Industry

VC firms focus on particular industries based upon the skill sets and experience of their GPs. A GP's market experience and contacts make him/her a valuable board member. Popular industries of expertise in the venture industry include biotechnology, computer software, communication, retail, and other specialty niche areas.

2.7.2. Stage

While most companies do not seek outside financing at every stage in their development, early-stage financing, expansion financing, and acquisition/buyout financing exist for all stages of development. VC firms often focus on one of these categories. In general, the later the stage of the company, the smaller the risks for the VC firm. Therefore, VC firms that invest in later-stage companies must "ante-up" and pay a higher valuation for their equity positions. Typically, VC firms strive to achieve a return on their investment in start-ups within four to seven years, and, in established companies, within two to four years.

2.7.3. Early-Stage Financing:

Seed financing is an initial infusion of capital provided to entrepreneurs with little more than a concept. These funds are used to conduct both market research and product development. Once research and development are underway and the core management team is in place, start-up financing can be obtained to recruit a quality management team, to buy additional equipment, and to begin a marketing campaign. First-stage financing enables a company to initiate a full-scale manufacturing and sales process to launch the product in the market.

2.7.4. Seed Capital Funds

Seed capital funds invest in the earliest stage companies and generally expect to have only about a 20% succeeded to a second round of financing. This second round will usually be a hand off to another fund or syndication of funds that now take the lead on this investment. As a result, a Seed Capital Fund will almost always demand a very high percentage of the business, do stage investments with milestones, and many times insist upon pro-active directors and officers of its choice.

Because of the higher risk, there are far fewer Seed Capital Funds today than in previous years. The average Seed Capital Fund profile is as follows:

It has five general partners

It handles an average of 36 companies

The fund is approximately $90 million, but invests only about $30 million initially with the rest in reserve

Its "hurdle rate" (expected return on investment) is 60% per year

It reviews over 400 plans per year

It invests in only 4-6 new businesses per year

2.7.5. Expansion Financing

Second-stage financing facilitates the expansion of companies that are already selling product. At this stage a company may raise from $1 to $10 million to recruit more members to the sales, marketing, and engineering teams. Because many of these companies are not yet profitable, they often use the capital infusion to cover their negative cash flow.

Third-stage or mezzanine financing, if necessary, enables major expansion of the company, including plant expansion, additional marketing, and the development of additional product(s). At the time of this round, the company is usually breakeven or profitable.

The final step for a successful company is going public. Once a company goes public, the VC firm realizes a great deal of value from its initial investment. For example, if over the course of several rounds of financing, the VC firm has bought 40% of a company for $6 million, and the company achieves a public market capitalization of $150 million, then the value of the VC firm's investment has grown to $60 million. This provides the VC firm with a ten-fold return on its investment.

2.7.6. Acquisition and Buyout Financing:

Acquisition financing, which can occur at any point in a company's growth, provides the necessary funds to acquire another company. Management/leveraged buyout financing assists management's purchase of a product line or business from another public or private company. In buyout situations, a key area of consideration for the VC firm is its confidence in the management team's ability to assimilate the assets of the two merging entities.

2.7.7. A VC Firm's "Value Added"

Venture capital firms are not the only ones looking for value. Usually the entrepreneurs expect more than money in return for a share in their company. While it is said that an active venture capital investor is one who phones yearly to see if the company is still in business, this scenario is not typical. In fact, what differentiates venture capitalists from the world of passive investors is their long-term involvement with their investments.

As an active board participant, a VC investor offers his/her unique set of experiences and skills. A good VC firm arranges for the long-term financing of a company and aids in developing the management team, advisory board, new product ideas, strategic relationships, and key customers and accounts.

3 WHAT IS VENTURE CAPITAL?

Venture Capital; is long term equity capital invested in new or rapidly expanding enterprises, and is the lifeblood of America's entrepreneurs. Traditional debt financing is not always available to start-up and other emerging enterprises because they generally lack the collateral, track record or earnings required to obtain a loan.

Most entrepreneurs seek initial "seed" capital from family members or wealthy individual investors, often referred to as "angels," who are willing to take the risk associated with start-ups. This informal venture capital community finances the vast majority of new enterprises and plays an invaluable role in the entrepreneurial process.

The most visible venture capital money comes from professionally managed venture capital firms. These firms are funded by an informal network of investors that include: pension funds, insurance companies, endowment funds, foundations, bank holding companies and their affiliates, corporations, wealthy individuals, foreign investors and the venture capital professionals. Venture capital professionals in this respect are the primary agents between capital sources and new enterprises.

3.2. Venture Capital Professionals

Venture capital professionals are essentially managers of risk. They assess hundreds of business plans each year and invest in the most promising ventures, then become actively involved as strategic managers. They invest a combination of equity and expertise in several different ventures; usually in cooperation with other firms; to diversify the risk associated with venture investing. The returns realized by the venture capital process have attracted funds from institutional investors, and as a result the resources available to young growth companies have expanded significantly.

Venture capital organizations are generally privately held partnerships or corporations that invest alongside management in young, rapidly growing or rapidly changing companies. They invest large quantities of long-term risk capital, usually seeking capital appreciation rather than cash repayment.

Unlike other financial intermediaries, venture capital professionals add value to their investments by actively participating in the management of their portfolio companies. They function in a dual capacity as financial partner and strategic adviser, providing the entrepreneur risk capital to fund the venture's growth and expert business counsel to ensure the enterprise's survival and competitive positioning in the marketplace.
Venture capital professionals come from all walks of life.

Former Senior Corporate Managers

Investment Consultants

Engineers

Scientists

Entrepreneurs who have launched ventures of their own

These individuals provide an important source of expertise for the emerging companies they finance. They know individuals in banks and brokerage firms, attorneys, accountants, and others needed to help new companies succeed.
The balance of talents in the close relationship between entrepreneur and venture capital professional has been a crucial element in the success of emerging ventures.

3.3. Raising Venture Capital

Raising venture capital is both marketing and a sales challenge, in that, to insure your success, you must both develop a product that a large enough market wants to buy, and the selling skills to convince the dogs that they should eat your particular brand of dog food. Most professional venture capitalists are essentially in the business of screening, qualifying, and selecting venture capital investments from as large a source of quality deal flow as they can muster. A few venture capitalists are essentially entrepreneurs themselves and can work with an entrepreneur to start and develop a new company.

Increasingly, the start up variety of venture capitalist is hard to find, in that over the past decade most venture capitalists now have so much money to manage that they cannot afford the time or effort required to help develop and then invest in a start up. For all but the very few, start up capital will not come from the professional V.C., but rather from the D.D.F. market - Doctors, Dentists, and Friends, or from personal savings, credit, or family members. Some US states have incubator programs or incubator venture funds which will provide small amounts of capital ($100,000-$200,000), but once again generally only the few, the persistent, and the lucky will qualify.

To successfully raise professional venture capital, particularly for a start up, your venture will need to address a large, rapidly growing market with a unique product, which is very tough to duplicate and for which there is little or no known present competition. Your product needs “compelling economics” - twice as fast, twice as cheap, twice the margins, and twice the appeal. If the potential product is likely to gain rapid favor in the stock market after in IPO, all the better. The good news is that the D.D.F. market is about $25 billion annually. The professional V.C. market only $3-$5 billion. There are more friends and family than Venture Capitalists.

Use the following checklists as guides to raising venture and to assess the likelihood of your success.

Successfully raising venture capital is an established process and your chances of success are enhanced if all bases are covered in a logical progression.

Develop a unique product, concept, or service.

Develop an outline of what is required in people, money, organization, strategy and tactics, and other assets to build this particular business.

Assemble a management team with the ability to successfully build and operate this business.

Prepare, with the assistance of the members of the management team, a clear, concise business plan representing the "game plan" of how the business will be operated and financed.

Identify those venture capitalists that are most likely to review a business plan in your industry and stage of development.

Mail the plan, with a cover letter indicating why the plan is unique to four or five selected venture capitalists.

Call the venture capitalist in several weeks to determine the status of your plan if a reply has not yet been received.

Meet with the venture capitalist to initially present your deal.

Prepare for "due diligence" meetings with the venture capitalist to continue to sell your deal.

Negotiate with venture capitalists over deal structure and price.

Complete investments syndicate formation by entrepreneur and lead venture capitalist.

Obtain commitment by all venture capitalists in the deal. Prepare legal documents of closing (time to involve your deal-making attorney).

Officially close the deal.

Work with the venture capitalist after the sale.

Cash out for the venture capitalist through a sale, merger, or public offering.

Business opportunities are everywhere for venture capitalists. Hundreds of business plans cross their desks every month, offering myriad opportunities. However, the successful venture capitalist invests in people first and business plans second.

When considering an investment opportunity, most venture capitalists look at the obvious trends and market niches. Transcending the business elements, however, the most important factor in a decision to invest in a company is the quality of the people. In real estate, the three biggest criteria are "location, location and location." The venture capital axiom is people, people and people.

Investors focus first on the management team's background. It is essential to understand its ability to deliver on its plan. In 20 years as a venture capitalist, I've picked enough winners and suffered through enough losers to develop my own measures.

There are five major characteristics that investors look for in entrepreneurs. In most cases, one or two are dominant and all five are present in some degree. The traits, in order of importance, are **leadership, vision, integrity, openness** and **dedication**.

4 EVALUATING A VENTURE CAPITAL FIRM TO MEET YOUR COMPANY'S NEEDS

What is the best way to approach and work with a venture capital firm? What do venture firms look for in evaluating a new company? How should the entrepreneur go about evaluating that firm and any financing it might provide his company?

Venture firms are as different as entrepreneurs. There is thus, a wide range among these firms in terms of their industry expertise, business experience and, most importantly, their ability to work effectively with you.

Your process of selecting a venture firm is, therefore, much more analogous to the selection of key managers in your company than it is to the selection of a bank for a loan. With a banker, the appropriate question is "How much money will he give me?" With a venture firm, the right question is "How much money will he make me?"

This is because your venture firm, if used effectively, will be an important element in the continuous decision making process of your company. The venture capitalist can bring a broad perspective of experience to your corporate problems based on multiple other corporate situations in your industry with which he has been involved. This experience enables him to recognize patterns within your company and industry niche, which may be invisible to you.

For example, he would be aware of external factors beyond your control which are already influencing other market niches in your industry and which your company will either capitalize on or be limited by.

When you select a venture firm, you are likely to be embarking on a relationship that will last five to ten years or more and which can be a pivotal factor in turning your company into a major enterprise. Due to the rate at which high growths venture companies' encounters new challenges, decision-making times can be greatly shortened. Therefore, the relationship with your venture firm can be critical.

A talented venture firm reinforces management's naturally good instincts on solving corporate problems and discerning industry directions. The less experience you have in some matters, the more you may need to rely on your venture firm's advice. The more experience you have, the more you will appreciate the quality of the advice.

The venture firm's investment makes it uniquely dedicated to your success. Venture firms only "succeed" if you succeed and this frequently depends on their ability to persuade you to do what is in your own self-interest. Therefore, the key question to ask in evaluating a venture firm is: do you believe that you can develop a relationship with the firm such that your confidence in it will accelerate your problem solving and decision making, enabling you to emerge as a world class competitor in your industry?

5 ANGELS AND PRIVATE INVESTORS

Nearly 80% of all investment in small startup companies comes form two groups: the FFA (Family, Friends, and Associates) and Angels (Private Investors). While it may be possible to raise money from family and friends, the emotional overhead of a long-term investor relationship can be extremely trying on one's soul. Many times these individuals are not sophisticated investors, are looking for a job, call you every week to see when they will be getting some dividends, and generally be a hindrance rather than help. If at all possible, we recommend using these funds as debt, or preferred non-voting stock. This will help isolate this group and make it easier to raise capital later from more sophisticated investors.

5.1. Where to Find Angels

Here are the profiles generally attributed to Angels:

Most are entrepreneurs themselves

Generally middle aged; 47+ looking for diversification

Have high incomes, but are not necessarily millionaires

Most are highly educated with advanced technical degrees, M.Sc., M.Ba or Ph.D.

They are all very active investors averaging 3-4 deals per year

These individuals can be reached through numerous sources. They attend trade shows, venture capital type meetings and visit universities to find deals. Finding these individuals is a matter of personal networking. Many will remain hidden from the individual entrepreneur, so using an intermediary is often the only way to meet them.

"Gate Keepers", these individuals screen projects for wealthy individuals. They usually represent three to five individuals, a trust, family investment pool, or a group of medical professionals.

Business Development Consultants: are consultants who work specifically with startup, business development, mergers and acquisitions

Bankers, finance companies and savings or investment houses such as stock brokerages

CPA's, tax, accounting and bookkeeping companies

Attorneys, bankruptcy courts, arbitration groups and others.

5.2. Private Investor Behavior and Involvement

Angels will provide equity plus loan guarantees

Angels usually invest with 2-3 others

Angels bring more than money to the table, often filling gaps in management skills

Angels usually do not want control

Angels request voting common stock or partnership interests

Angels are looking to exit their investment in 3 - 4 years

How will private investors want to be involved in your business?

21.7% Will work part time in the business as employees

27.0% Will offer consulting help, sometimes with reduced or no fees

15.1% Will agree or ask to be on the Board of Directors

19.0% Will review reports and other documents

17.3% Want to work full time for the business

Equity Investment Size and Capacity

Private investors have definite amounts they are willing to risk on certain ventures. These figures represent a 10-year study by the Small Business Administration and Coopers and Lybrand.

The total amounts listed here include debt obligations or guarantees (total risk money per deal):

21.1% Invest under $10,000

21.9% Invest $10,000 to $25,000

21.3% Invest $25,000 to $50,000

13.5% Invest $50,000 to $100,000

14.5% Invest $100,000 to $250,000

7.6% Invest over $250,000

6 ADVICE TO FIRST TIME ENTREPRENEURS

What is the best way to approach and work with a venture capital firm? What do venture firms look for in evaluating a new company? How should the entrepreneur go about evaluating that firm and any financing it might provide his company?
Venture firms are as different as entrepreneurs. There is thus a wide range among these firms in terms of their industry expertise, business experience and, most importantly, their ability to work effectively with you. Your process of selecting a venture firm is, therefore, much more analogous to the selection of key managers in your company than it is to the selection of a bank for a loan.

"With a banker, the appropriate question is "How much money will he give me?"

"With a venture firm, the right question is how much money will he make me?"

This is because your venture firm, if used effectively, will be an important element in the continuous decision making process of your company. The venture capitalist can bring a broad perspective of experience to your corporate problems based on multiple other corporate situations in your industry with which he has been involved. This experience enables him to recognize patterns within your company and industry niche, which may be invisible to you. For example, he would be aware of external factors beyond your control which are already influencing other market niches in your industry and which your company will either capitalize on or be limited by.

6.1. Evaluating a Venture Capital Firm for Your Company

When you select a venture firm, you are likely to be embarking on a relationship that will last five to ten years or more and which can be a pivotal factor in turning your company into a major enterprise. Because of the rate at which a high growth venture company encounters new challenges, decision making times can be greatly shortened. Therefore, the relationship with your venture firm can be critical.

A talented venture firm reinforces management's naturally good instincts on solving corporate problems and discerning industry directions. The less experience you have in some matters, the more you may need to rely on your venture firm's advice. The more experience you have, the more you will appreciate the quality of the advice.

The venture firm's investment makes it uniquely dedicated to your success. Venture firms only succeed; if you succeed and this frequently depends on their ability to persuade you to do what is in your own self-interest. Therefore, the key question to ask in evaluating a venture firm is: do you believe that you can develop a relationship with the firm, such that your confidence in it will accelerate your problem solving and decision enabling you to emerge as a world class competitor in your industry?

6.2. What's Your Financial I. Q.?

Take this quiz to see if your company is on the right track to raising business capital

Bankers, lenders and investors have varied criteria for what they consider prime business investments. But there are some things that make your company more investment worthy from the lenders' perspective. Find out how your company compares and how to increase your chances of raising business capital when you need it with this quick quiz:

1. **What do you need funding for?**
   a. To expand the business.
   b. To assist with business operations.
   c. To start the business.
2. **How would you best characterize your existing banking or other lender relationships?**
   a. We have several contacts in the business.
   b. We have one local bank account.
   c. We have no banking / lending contacts.
3. **Describe your company's profit history**:
   a. A steady upward climb.
   b. Even or flat, but steady.
   c. Inconsistent, or downward sloping.
4. **How old is the business?**
   a. Three or more years.
   b. One to three years.
   c. Less than one year.
5. **How well known are you within your market?**
   a. Very well known.
   b. Somewhat known.
   c. Not known at all.
6. **Describe your company's business plan:**
   a. Formal, complete and current.
   b. Informal, but current.
   c. We have no formal business plan.
7. What is your company's ratio of assets to liabilities, compared to your competitors?
   a. Higher.
   b. Equal.
   c. Lower.
8. **How profitable are you for your industry?**
   a. Above average.
   b. Average.
   c. Less than average.

9. **How do you handle financial & accounting controls?**
   a. Formally.
   b. Some formally, some informally.
   c. There are no official controls in this area.

10. **Describe your business insurance:**
   a. Coverage is for all critical areas.
   b. Average coverage.
   c. Below average coverage for our industry.

11. **For how many of these functions do you have managers other than yourself: marketing, production, human resources, administration, finance and office management**.
   a. Almost all of them.
   b. Half of them.
   c. Two or less of them.

12. **What best describes your personal and business credit rating?**
   a. Good or excellent.
   b. Some flaws.
   c. Not rated or poor.

13. **What would an objective outsider say about your key employees' competence, experience and loyalty?**
   a. It appears higher than average.
   b. It appears average.
   c. It appears lower than average.

SCORING:
For each A answer, give yourself 10 points, 5 points for each B, and no points for C's.

100+ - Hot hot hot! It won't take much to convince a lender you're well worthy of financing.

80 - 99 You are definitely on the right track. Keep up the good work and look for lenders /investors who may have financed similar size and type companies to increase your chances for success.

60-79 If you are a start-up or new company, keep your chin up and your chances will improve with time. Look to government funded programs such as SBICs, SBA Guaranteed Lenders, and even some Venture Capital (if you have a high growth potential). You may consider selling an equity position to a partner whom can assist in key management areas.

Below 50 You need to take a close look at your company and consider making some adjustments before you seriously consider seeking financing.

7 THE ECONOMICS OF VENTURE CAPITAL

When one strips away all the polish, venture capitalists are money managers who are expected to return huge profits to the institutional clients investing in their funds. Most venture capitalists play a far more active role in creating value in their portfolios than the able "money manager" would suggest. Nevertheless, as the recent shakeout in venture capital has proven, those who don't deliver big returns to their investors don't remain in the business. Venture capitalists do not have the luxury to act like benevolent Medici-style patrons who charitably deal out the dough to support promising young artisans. Entrepreneurs need to understand, in quantitative terms, the forces that shape how most venture capitalists invest their money.

7.1. The Average Venture Capital Firm

Our databases identify hundreds of venture capital firms located in the United States, Canada and Europe. Most of these firms manage funds that are structured as private limited partnerships. The median firm manages approximately $70 Million of capital. On average, each firm has four deal making professionals, who usually wear the title "General Partner." This means that, all things being equal, each dealmaker should invest just over $15 Million. Venture capital investing is like raising a family: the amount of attention you can give each child is inversely proportional to the number of children you have. Most venture capitalists would agree that each dealmaker couldn't effectively play an active role with more than five to seven companies. The economics of venture capital therefore dictate that $2-3 Million must be put to work in each of 20 to 30 portfolio companies in order for a venture firm, with average capital and staff, to deploy all of its funds.

"We only need $300,000!"

If every venture capitalist were to deal out their money in $300,000 increments, by contrast, they would find themselves in the unenviable position of trying to manage a nursery school of fifty companies rather than a family of five. A number of brave and prolific firms, aptly called seed funds, do just this. The vast majority of venture firms, however, choose to focus their resources and energy in order to work closely with a manageable number of deals.
In order to reduce risk, a venture firm may incubate a deal with only $300,000. But they do so with the expectation that, if things work out, the company will absorb several million dollars in subsequent rounds of financing.

7.2. Portfolio Realities

Successful venture capital portfolios will usually have a few stellar performances, several solid performances, and a bunch of duds. While every entrepreneur swears that their deal is a "sure bet," it just isn't so, and venture capitalists know it. That's why venture capital partnerships are long-term affairs, usually lasting 7-12 years. Only exceptional returns (in excess of 20% per year) will make it worthwhile for institutional investors to make such high risk, illiquid venture partnership investments.

Successful venture capitalists understand these two key realities:

- ***That in order to survive, they have to at least triple the assets they have been entrusted with; and***
- ***Given the risks involved, a significant number of their portfolio companies will fail and be total write-offs.***

To compensate for the write-offs and propel the overall portfolio to achieve high returns, the portfolio superstars have to be big winners. Big means companies that have created at least $50 to 100 million of market value or more. There must be a logical possibility for every portfolio investment to create at least $50 Million of market value and to return five to ten times the invested capital. Only a fraction actually will.

These economic realities explain why entrepreneurs trying to raise $300,000 in order to build a $15 million company find little interest from venture capital firms. They may have good ideas, which can build profitable businesses and put a Mercedes in the garage. The key issue here, however, is scale. Professional venture capitalists simply cannot afford to invest their time in small deals, which don't have the potential to become portfolio superstars. The economics of the venture business, and the constraints on their time, dictate that venture capitalists can only afford to invest in a few companies with the potential to be huge winners.

8 VENTURE CAPITAL BASICS

Did you know there is more money looking for "a good deal" than there is "good deals" looking for money?

Many entrepreneurs would receive more serious consideration from investors and financial angels if they would realize that they are selling a financial package to the financial marketplace, rather than their product or service to a consumer.

The goal of every business plan should be to address upside potential, downside risk, management, potential dilution, and liquidity issues. Investors are constantly comparing one investment against another and ranking them in numerous categories.
To properly evaluate your own project, Global Millennia Marketing recommends that entrepreneurs put themselves in the place of investors, who want to know the answers to these six simple questions:

8.2. Six Investor Questions

How Much Can I Make? (40% ROI expected)

How Much Can I Lose? (All of it plus any loan guarantees, law suits and time)

Who Says This Thing Will Work? (Third party verification of all business plan items)

Who Else Is In The Deal? (What other investor groups, banks or players are in this deal?)

Who's Running the Show? (The management team and their qualifications in this field)

How Do I Get My Money Out and When? (Exit strategy for IPO, Acquisition or Merger)

8.3. Documentation

To attract and hold investor interest, the business must provide top quality documentation:

Executive Summary (3 - 5 pages)

Business Plan (50 pages maximum and focused on the above questions)

Due Diligence Material (Market Studies, Research Papers, Patents, etc.)

Business Valuations (Company and investor pre and post investment values)

Deal Structures (To sell minimum shares for maximum dollar investment)

8.4. Funding Basics

- ***Know what business you are in! (Research and Development, Manufacturing, Distribution, Sales or Service) Attempting to do all five areas is extremely*** *expensive and risky. Each area is an independent business and has its own financial dynamics. Be focused on what you do best and out-source the rest.*

- ***Have a well-rehearsed and polished presentation. Remember that you are a "Salesman" for your business first and a "Technician" last. You are selling the investor on the wisdom of his investing with you and you must answer the six-investor questions listed above. You should not spend the bulk of your time describing your product or service.***
- ***Develop a list of private investors, venture capital firms, or possible joint venture companies. This is a research process whereby you invest appropriate targets for raising capital. During this phase, you will receive lots of feedback about your business, its market and the possibilities for raising capital. Incorporate the good ideas and modify you business plan, but remember that you cannot please everyone. Stick to your guns. Get more tightly focused and persist.***
- ***Most Seed Capital will come from close friends and associates. Startup Capital comes from Private Investors or "Angels", and the big bucks will come from Venture Capital companies after you have survived the first two stages.***
- ***Do not rush the investor! Be patient and do not expect much positive response for as long as 3 - 6 months in some cases. If possible, locate a minimum of three potential investment groups to work with simultaneously. This will allow you options and leverage against "low ball" offers. If you work only one at a time, and your best source turns you down, then you may have wasted 3 - 6 months and be back at the beginning again. In fact you may have missed the window of opportunity altogether.***
- ***Keep your eye on the goal of lowering perceived risks to the investors. Most professional investors will accept Moderate Risks with commensurate High Reward Potential.*** *Private investors and venture capital companies are not gamblers.*
- ***Do not puff, exaggerate or over-sell. Invest your time in perfecting and improving your sales prospects, decreasing future costs, and decreasing potential risks. A project that has pre-sales is much easier to fund than one with no future income stream other than projections.***

8.5. Our best advice to entrepreneurs

- ***Learn to sell, "Face-to-Face", "One-on-One". Not just your product or service, but your entire business vision.***
- ***Become proficient in all aspects of finance for startup companies. Weakness in the financial area will drastically reduce your chances of funding.***
- ***Surround yourself with a quality team. Build your network in sales, finance, and management.***
- ***Take a public speaking course and learn to give tight presentations to tough audiences. Try Toastmasters, Rotary, or Junior Achievement, Sales and Marketing Executives, etc.***

- ***Learn how to do the due diligence on those "too good to be true money sources".***

8.6. Basic Elements of a Good Deal

There are six basic elements that will entice an investor to take a serious look at your project. They are:

Do I like the feel of this project, its market area, and its management team?

Will I get my capital back off the top or the bottom?

Is there a big upside potential? Stock conversions, possible IPO, early payouts, etc.?

What assurances will I have that the business plan will be followed and can be executed?

How will I be involved?

What other opportunities are there available that are better than this one?

8.7. Critical Deal Criteria

Early investor return of capital.

Premium paid for the risks involved.

Kickers or other incentives not necessarily monetary in nature.

Options to increase equity share or liquidate early.

Tax and legal considerations including state securities laws.

Is the entrepreneur being adequately compensated so that he remains focused on the business and can afford to live during the startup stage?

8.8. Investor Returns, Timing & Cost Of Capital

Each stage has its own set of funding criteria and its own group of individuals who work in that field. The earlier the financing stage, the greater the risk, the greater expected return, and the greater percentage private investors and venture capitalists will request.

Entrepreneurs, however, are usually given the opportunity to earn back controlling interest if certain milestones and performance standards are met. Also, the earlier the stage, the more difficulty will be encountered in raising the initial capital. It may take six months to a year to locate the proper partner for your business.

General guidelines for venture capital investment returns are:

- ***Start ups, 10-12 times return in 5-7 years.***
- ***Existing early stage companies, 5-7 times investment in 4-5 years.***

Cash Returns, Investment Periods & Rates of Return							
			Investment Period				
Return	**2 yrs**	**3 yrs**	**4 yrs**	**5 yrs**	**6 yrs**	**7 yrs**	**8 yrs**
2 X	41.4%	26.0%	18.9%	14.9%	12.2%	10.4%	9.1%
3 X	73.2%	44.2%	31.6%	24.6%	20.1%	17.0%	14.7%
4 X	100.0%	58.7%	41.4%	32.0%	26.0%	21.9%	18.9%
5 X	123.6%	71.0%	49.5%	38.0%	30.8%	25.8%	22.3%
6 X	144.9%	81.7%	56.5%	43.1%	34.8%	29.2%	25.1%
7 X	164.6%	91.3%	62.7%	47.6%	38.3%	32.0%	27.5%
8 X	182.9%	100.0%	68.2%	51.6%	41.4%	34.6%	29.7%
9 X	200.0%	108.0%	73.2%	55.2%	44.2%	36.9%	31.6%
10 X	216.2%	115.4%	77.8%	58.5%	46.8%	38.9%	33.4%
11 X	231.7%	122.4%	82.1%	61.5%	49.1%	40.9%	35.0%
12 X	246.4%	128.9%	86.1%	64.4%	51.3%	42.6%	36.4%

8.9. Why are expected returns so high?

Quite simply because of all the non-performing investments, or losses and the lack of liquidity and the availability of other opportunities. The compounded Venture Capital Return Rate over many years is approximately 17.8%. In order for a Venture Fund to be profitable, it must assume at least 50% of its investments will make only a small profit. Approximately 25% of the investments will be sold or liquidated. Of the remaining 25%, about half will go public and generate compounded returns exceeding 60-120%. For a portfolio of 20 companies, only one will be a “rocket” or “home run” and provide the 10 - 100 times Return on Investment that everyone is looking for.

Valuations and due diligence should be made by both parties in order to determine the amount and type of debt and equity that will optimize the investment for both the entrepreneur and the investor. Follow-on stages of financing should also be considered. The importance of the cost of capital and the eventual amount of equity dilution to you and your initial shareholders cannot be overstated.

Besides Venture Capital, there are many more methods of funding your business that do not require venture capital to finance your operations. These are discussed in the report 'InternetBusinessplans'

In today’s world, with so many new businesses searching for capital, corporate downsizing, and entrepreneurs desperately seeking funding, the opportunity for unscrupulous companies to offer money at seemingly amazing low rates is at its highest peak ever. If the bank won’t lend it to you, and the local investors won’t give it a second look. If the normal sources of financing just don’t believe your business plan. Ask yourself this question before you commit to anything. “Why would a someone from out of state or out of the country even consider investing in my small startup company, when no one else will even consider it?”

Remember, if it sounds to good to be true. It probably is!

Know the source of funds, do not accept money from strangers, and never ever pay large up front fees for any funding source or finder.

9 HOW TO FUND YOU PROJECT

9.1. How To Structure Your Deal

How do you structure your deal after all the business planning, market studies business valuations and research is done? Each deal is unique based on all the elements of the project. We feel it is best to structure a fair deal and make the presentation. The market place for venture capital deals will give you immediate feedback. You will either get funded or rejected. Always research the reasons for either event
.

9.2. Initial Public Offerings

An Initial Public Offering underwritten by a brokerage firm is the most widely known method for a company to become publicly held. The 1933 Securities and Exchange Act (US), governs the issue of "New Issue" corporate securities in general and IPOs in particular. In general, the '33 Act attempts to protect investors by requiring full disclosure of all material information in connection with the offering of new securities. Part of meeting the full disclosure rules of the '33 Act requires that issuers file a registration statement and preliminary prospectus (also know as a red herring) with the SEC. This Registration statement must contain, among other things, the following information:

- ***A description of the issuer's capitalization and the proposed use of proceeds of the offering***
- ***A description of the issuer's business and properties***
- ***A description of the principal risk factors associated with the business***
- ***The identities of all officers and directors, plus a 5 year business history on each***
- ***The security ownership of all officers, directors and principal shareholders***
- ***Any material legal proceedings involving the issuer***
- ***Audited financial statements of the issuer***
- ***Copies of certain corporate documents and all material contracts***

Once the registration statement and preliminary prospectus are filed with the SEC, a 20-day cooling-off period begins. During the cooling-off period the proposed new issue may be discussed with potential buyers, but brokers are prohibited from sending any materials (including Value Line and S&P sheets) other than the preliminary prospectus. Testing receptivity to the new issue is known as gathering "indications of interest". An indication of interest does not obligate or bind the customer to purchase the issue when it becomes available, since all sales are prohibited until the security has cleared registration.

A final prospectus is prepared and distributed when the SEC declares the registration statement effective. The final prospectus contains all of the information contained in the preliminary prospectus and any amendments thereto, as well as the final price of the issue, and the underwriting spread. The clearing of a security for distribution does not indicate that the SEC approves of the issue. The SEC ensures only that all necessary information has been filed, but does not attest to the accuracy of the information, nor does it pass judgment on the investment merit of the issue. Any representation that the SEC has approved of the issue is a violation of federal law.

One of the most confusing phrases in the securities industry is the term “firm underwriting”. In the context of an initial public offering, the term merely means that the underwriters have a legal obligation to close on the offering if the commitment is not withdrawn before the registration statement becomes effective.

Notwithstanding the existence of a letter of intent for a firm underwriting, the underwriters are under no obligation to go forward with a proposed offering and generally have the unrestricted right to back out of the offering at any time before the SEC declares the registration statement effective. As a result, it is not uncommon for a company to spend hundreds of thousands of dollars on an IPO only to have the offering canceled by the underwriters as the effective day of the offering approaches. Going public through an IPO is an all or none proposition. If an issuer is successful, the company is both public and capitalized. If the underwriting is unsuccessful, the issuers are neither public nor capitalized, and have lost a sizable sum of money for the costs of the failed offering.

Full text copies of The Securities Act of 1933 and The Securities Exchange Act of 1934, together with the Rules and Regulations of the Securities and Exchange Commission, are available on the Internet from The Center for Corporate Law, University of Cincinnati College of Law

9.3. Small Corporate Offering Registration (SCOR)

A relatively new financing device called SCOR (Small Corporate Offering Registration -USA) is intended to help small and startup companies raise equity capital through a simplified public stock offering. Under Federal Regulations the individual states have long had the responsibility for public offerings of up to $1 million. But the expense of meeting diverse state requirements has discouraged use of such small offerings. Those states adopting SCOR have moved toward standardization by adopting the registration Form U-7. Such standardization greatly decreases costs of multi-state offerings.

Other advantages include the ability of company officers to sell the stock themselves to a large number of potential investors through public solicitation. Additional offerings may be made in subsequent years. The capital raised can be used to leverage bank loans and once issued SCOR stock may be freely traded.

Just because a state adopts a simplified registration form doesn’t mean that any other corporate laws have been simplified. Moreover, the brokerage community is not yet convinced that it will be profitable to sell such stock. However, in a nation in which 57% of the private sector jobs are with companies that have fewer than 50 employees, SCOR may be an option whose time has come.

The U-7 registration form has 50 questions. In most cases the answers to these questions provide investors with adequate information about the company. Company officers answering these questions develop a business plan in the process. Thus, filling out the form is a good exercise for officers of any small firm regardless of whether or not they plan to go public. It is also the ideal document to accompany a conventional bank loan or private investment package.

Before any stock can be sold, the state securities administrator in each state in which the stock is to be offered may approve the completed U-7 together with supplemental exhibits including financial statements. On approval, the U-7 becomes the prospectus or offering circular and may then be photocopied and given to potential investors. An expensive printed prospectus is not required - an example of the cost cutting measures intended by the ABA and NASAA.

A major issue considered by the ABA and NASAA was whether or not the financial statements required to accompany the U-7 should be audited or reviewed by a Certified Public Accountant. A review provides sufficient disclosure but costs considerably less than an audit. Most states therefore do not require audited financial statements for offerings under $500,000.

Usually, the U-7 is drafted by company officers, reviewed by their attorney and submitted for approval to the state corporate commissioner. However, a task group approach would probably enhance the prospects for a successful offering. Such a task group would include the company officers to draft and control the offering, an attorney to guide the application through the state examination procedure, a financial advisor, a CPA to audit the financial statements, and perhaps the most important, a securities broker to sell the issue.

It should also be noted that though the registration process has been simplified, other state securities laws have not. A securities attorney is still needed to help negotiate the maze.

9.4. Selling the Issue

In selling the offering, the principal advantage of a SCOR offering is the ability to make a general solicitation, rather than having to follow the strict technical private offering requirements of federal and state regulations.

These regulations effectively restrict private placements to only a limited number of financially sophisticated and affluent investors. There are relatively few investors willing to risk $30,000 to $50,000 on an offering but there are millions who might be willing to risk $2,000 on a promising firm or product.

Through advertising, then, a SCOR offering can reach a much broader investor pool. In addition to the simplicity of the U-7 registration document, the speed with which an offering can be assembled and the ability of the company to sell its own stock combine to make it a very attractive equity raising device.

In most discussions of SCOR, the role of the securities broker is neglected. Their services are typically viewed by the offeror as expensive - up to $200,000 on a $1,000,000 offering.

Brokers for their part see such offerings as unprofitable and will invariably work only on a "best efforts" basis.
It is estimated that more than 90% of all SCOR offerings are currently being sold by company officers. Unfortunately this is not always by choice. If promising small and startup companies are to gain adequate access to capital, the broker-dealer community must find a means. SCOR presents an opportunity.

So finding a good broker will not be easy. But, by including the broker from the beginning, the task group can receive valuable input on what it will take to sell the issue. The market will dictate the selling methods and the roles that brokers and company officers will perform.

For example, an entrepreneur seeking to open a fast food franchise might rely on his or her own contacts and through advertising sell only within the local community. Others may rely entirely upon securities dealers who will market the shares in several states.
In most instances both the company and the broker have potential investors. The company typically will have vendors, distributors, and customers who know the offeror and may be eager to buy the stock. The broker will usually have a "book" of clients to whom the issue will appeal. In developing a sales strategy the task group should identify these potential investors and structure the offering accordingly.

9.5. Responsibilities of Officers

A public company is created by the sale of a SCOR offering. As such, the company will be required to prepare and distribute an annual financial report. Investors may want to periodically talk with management or visit the company's facilities. If things don't go as planned, management will be expected to explain to investors who may not be sympathetic.

Thus, before seeking public investment, owners of closely held corporations will have to decide how much they are willing to reveal to their shareholder. Some perks may have to go. The company's financial information will become available to competitors. Board meetings will become formal and the company will be expected to focus on increasing shareholder worth.

Sole owners should remember when giving up some of their privacy, however, that most of the increased value of a publicly held company will go to themselves as majority shareholders. Aside from the additional capital, there are other major advantages. Due to increased credibility, the company will likely have an easier time obtaining loans.

As a publicly held company, smaller firms should find it easier to hire professional management - a matter of interest to those owners of small firms who expect to retire within a few years. Most entrepreneurs spend their lives building a company only to find themselves at retirement faced with the perplexing dilemma - how do you let go of the tiger? Becoming a public company could be a part of their "exit" strategy.
N.B. Use of Proceeds. In most states the proceeds from the sale of the offering may be used only for the operation of the business. *In California for example, the money may not be used to retire previously existing debt.*

Contact your attorney, accountant, or other professional advisor for more information on this form of investment vehicle.

9.6. Private Placements

Typically used to restructure short term notes by longer term debt instruments and to raise additional capital, private placements provide an alternate means of accessing a widely used segment of the capital markets when the public market may not be appropriate or available. These transactions involve institutional investors with an appetite for fixed rate long-term obligations. Private placement issues can be structured with less restrictive covenants than public issues and can carry significantly lower transactional costs. Such issues can be structured at various points along the debt ladder to meet specific requirements of the issuer as well as that of the investors with maturates ranging between 2 to 30 years.

Equity transactions and hybrids are also common. A private placement candidate company typically has a net worth of at least $15 Million with annual sales of $30 Million. This may not always be the case, however, because private placements can be used in smaller startup or seed capital rounds.

Private placements are the issuance's of securities in transactions, which do not occur on a public exchange. A Company does not have to be public in order to complete a private placement; private companies do them all the time. In fact by definition, all stock issuance's by privately held companies are privately placed. But it is not widely known that a public company can issue shares from its treasury in the form of a private placement as well. Why, you ask, would a public company issue its shares in a private placement rather than offer them directly to the market on an exchange? The are several important reasons which are outlined below.

- ***Ease of raising cash.***
- ***Private placements are the number one method in Vancouver of raising funds for public companies.***
- ***The required documentation is considerably less for a private placement (when an exemption to the prospectus requirements is available) which means that it is less expensive and simpler to complete.***

With the lower required documentation, private placements can be completed very quickly. Private placements allow firms to raise equity capital in smaller increments than might otherwise be practical with a public offering. Another key benefit is that stock of a publicly traded company can be issued in a private placement at a discount to the current market price. This provides the potential for a built in capital gain to those investors buying the stock.

Balancing the benefits of lower documentation and the pricing discount is the requirement that the stock be held for up to a year (longer in other jurisdictions) before it becomes freely tradable on the exchange. This hold period protects the new investor as well as other existing shareholders from a flood of discount shares hitting the market.

Private placements provide an excellent way for management and other insiders associated with the company to maintain a high degree of ownership in the listed company when they are the investors purchasing the stock. It is also a frequently used method to compensate executives (by allowing them to purchase discounted stock) and at the same time inject funds into the coffers of the company.

9.7. Shell Mergers

A common financing method that has both utility and value in certain cases is the reverse takeover of an existing public company. In this financing strategy, a privately held company conducts a private placement of its common stock and then immediately combines with an existing public company in a transaction where the shareholders of the privately-held company exchange their private company shares for newly issued stock of the public company.

The public company may be in a related business or may have little or no assets. Due to the large number of public company shares that are customarily issued to shareholders of the privately-held company, those shareholders end up with a controlling interest in the public company and are then free to appoint their own slate of officers and directors. Since the original shareholders of the private company obtain control, the term “reverse takeover” applies.

By using an existing public company, a privately held concern that wants to establish a public market for its stock can start with an existing shareholder base. In addition, there are usually several brokers who will have an interest in the newly reorganized company because they have stock on their books.

There are several potential problems that arise in connection with a reverse takeover. First, there may be large blocks of stock in the hands of individuals who are eager to sell at any price, thereby making it difficult to support the market during the period immediately after the reorganization. Second, in addition to inheriting the shareholders and brokers associated with the public company, the shareholders of the private company will also inherit the business history of the public company.

Accordingly, a thorough due diligence investigation of the public company and its principal shareholders is essential to ensure that there are no unreported liabilities or other legal problems. Finally, it may be necessary to perform catch-up audits and do corporate cleanup to make the combined companies ready for trading.

In general, both the financial community and the regulatory authority view reverse takeovers with some skepticism until the reorganized company has been active for a sufficient period of time to demonstrate credible operating performance. Until this performance is demonstrated, it can be very difficult to raise additional money for a company that went public through a reverse takeover transaction.

Therefore, the reverse takeover strategy is most appropriate in cases where the immediate financial needs of the privately-held company can be met by the pre-combination private placement and the purpose for establishing a public trading market is not related to a perceived short-term need for additional capital. If a privately held company believes that substantial additional capital will be required within the next 6 to 12 months, a reverse takeover transaction may not be the best alternative.

9.8. International Relocation

In recent years, certain some foreign stock exchanges have become notorious for questionable reverse takeover transactions involving existing public companies that have spent all of their available capital on unsuccessful ventures. In these transactions, a promoter promises to raise substantial capital for an operating U.S. company on the condition that the shareholders of the U.S. company agree to enter into a reverse takeover transaction with an existing public shell that is listed on the foreign exchange.

Typically, the reverse takeover transaction proceeds without a hitch, the promised funding never materializes, or is significantly less than promised, and the promoter runs the stock price up, promptly dumps his holdings into the market and then moves on to the next venture. The net result is often an undercapitalized U.S. company stuck in a foreign shell with no meaningful ability to raise additional capital for its business.

To assist U.S. companies that find themselves in this unenviable position, attorneys have developed liquidation and re-domestication strategies for U.S. companies that are designed to:

(a) Restore the U.S. company's ability to seek investment capital directly, rather than indirectly through a foreign parent
(b) Provide for an orderly transition during the liquidation of the foreign shell, and
(c) Result in a publicly held U.S. company with no ongoing linkage to any foreign companies or stock exchanges.

Typically, in connection with the implementation of the liquidation and re-domestication strategy, the shareholders of the foreign company are asked to approve a plan of liquidation that provides for the distribution to shareholders of units consisting of stock and short-term warrants of the U.S. Company. Then, prior to the date of shareholders meeting, the U.S. company files a registration statement under the '33 Act for the shares of common stock underlying the warrants. The contents of this '33 Act registration statement are also incorporated by reference into a 'registration statement' under the '34 Act.

Upon shareholder approval of the plan of liquidation, the units in the U.S. Company are distributed to the shareholders of the foreign shell and the U.S. company proceeds with a public offering to ensure the prompt exercise of all warrants. Thereafter, upon completion of the warrant exercise offering, the securities of the U.S. Company are listed for trading on the NASDAQ Stock Market.

While liquidation and re-domestication strategy is not suitable for all U.S. companies listed on foreign stock exchanges, order of events may vary to suit the needs of a particular client. The strategy has the advantage of breaking the foreign nexus and simultaneously providing a low-cost registered offering in the United States.

9.9. Limited Partnerships

While limited partnerships have lost much of their attractiveness as tax shelters, they do offer attractive investment vehicles for certain types of startup ventures. They also allow greater protection to investors than some forms of corporate investments such as minority shareholder lawsuits and other greenmail tactics. The Limited Partner must not become actively involved in the investment or he runs the risk of becoming a de-facto General Partner.

This form of deal structure allows a disproportionate distribution to investors and also allows you to buy out the Limited Partners at some time in the future. One excellent mechanism is to structure your Limited Partnership as follows:

- ***General Partner has 60% -80% of total equity.***
- ***Limited Partners have 20% - 40% of total equity***
- ***Limited Partners receive 80% of profits as distributions until they have received 200% return on their investment***
- ***General Partners receive 20% of profits as distributions during this period or at least enough to cover tax liabilities for the General Partners.***
- ***Following this distribution scheme, all further distributions are made based on the equity-split set up in the beginning.***
- ***The more uneven the equity split the higher the premium that may have to be paid to the Limited Partners.***
- ***Usually expenses are minimized and the General Partners compensation is fixed at a minimum level to assure the partnership can operate, and so that there are excess profits to distribute.***

9.10. Sub Chapter S Corporations

The Sub Chapter S Corporation is a unique hybrid that can be structure like the Limited Partnership, but operates like a corporation. The Sub S Corp is a tax election that allows the owners the protection of a corporation, yet the tax advantages of a Sole Proprietor. Tax losses and income are passed directly to the owners. This avoids the double taxation associated with a standard C Corporation as it distributes dividends that are taxable to both the corporation and the individual. The S Corp can be converted to a C Corp relatively simply. Changing from a C to an S is more difficult and there are limitations on these conversions.

Another disadvantage of an S Corp is that it cannot have C Corp or Partnership Stockholders. This may severally limit your ability to raise funds from larger and more sophisticated investors. The optimum strategy is to begin as an S Corp and use the initial tax losses to shelter income for you and your seed capital investors. Once you have a larger investor or begin to become more profitable you can elect to change to a C Corp.
The S Corp also allows the company to distribute both tax losses and profits in a manner that is uneven with respect to the different stockholders. Check with your attorney and CPA for detailed information.

9.11. Limited Liability Companies

Limited Liability Companies are more similar to C Corps, in that they allow corporate stockholders to be investors. Secondly, the company can still make uneven distributions of both losses and profits without a second class of stock. And finally, the entrepreneur can now have the full range of employee benefits available as a tax deduction to the corporation that were not available to the Sub S Corp.

The disadvantage of an LLC is it becomes more difficult to go public or be acquired by a major company. This form and the Limited Liability Partnerships are becoming increasingly popular with tax, legal and accounting firms where by individuals working in a group wish to protect their assets while enjoying the overall profits of the enterprise. Check with your attorney and CPA for detailed information.

9.12. Founders Stock As Earned Equity

Stock can be allocated to both investors and to the principals on an as earned basis. Often the earnings can be in several stages. The following example shows how stock is calculated for a two-stage earn-in with both investors and principal putting in money. The principals also are rewarded for exceptional work as well as penalized for slow or non-performance.

In step one, all stock is set at $1 per share. A valuation of stockholder compensation was obtained from a large accounting firm. In this example the founders accept no compensation only expense reimbursement and the initial seed capital is also given a premium. This project is a large international real estate development. The goal was to maintain a minimum of 51% of control in the principal's hands until the time of a final buyout by an international real estate company.

In Stage two a larger startup investment is made and the principal is invited in as both a Director and Officer, with a bonus for unpaid work. At this stage, substantial additional capital has been required to continue the project. Also additional expenses and some salaries are now being paid.

10 PREPARE YOURSELF FOR THE VENTURE CAPITAL INQUEST

While the Spanish Inquisition has historically been identified with physical torture to achieve spiritual conversion, the venture capital interview can be likened to a mental Spanish Inquest. That is, even though you don't die, they put you through the mental grinder, and you'd do almost anything to convince them you're on the same ideological page.

You can prepare for your VC inquest by learning what types of questions venture capitalists will ask, what intrigues them, their motives for asking specific questions, and what they want to hear.

Venture Capitalists are not untouchable people, but they are very busy. Telephone conversations should be friendly, but succinct and to the point. Many times the venture capitalist will require a review of your business plan before talking with you. Be willing to send your plan in advance of any conversation, and follow up on the stated date and time mentioned in your cover letter. There are many sources for venture capital and you as the entrepreneur should be willing to solicit several firms. The initial response time is usually several weeks, with the entire deal taking several months. Remember that this is a long-term relationship you are developing.

10.1. Documentation

Be sure to have all of the following documents on-hand and ready for review before soliciting venture capitalist for funding. They will judge you by your preparedness and knowledge of how to work with them.

- Business summary - a succinct document that outlines management, profits, strategic position and exit.
- Business Plan - a detailed document of the company including business strategy, marketing plan, financial document, and competitive analysis.
- Due Diligence - a study about the background and financial reliability of the company, management team and industry.
- Marketing Material - any document that directly or indirectly relates to the sales of your product/service.

The process of venture funding will take several meetings. During most of the meetings, you and the venture capitalist will be dealing from the business proposal you previously sent him. It is necessary for the venture capitalist to understand your product or service.

Bringing along a prototype or the actual product will go a long way in this process. Stay focused on your business plan. Meetings can sometimes last several hours and you may become talkative. Avoid mentioning any grandiose plans you may have for the future. Also, do not mention any products that were not covered in the business plan. Such conversation could present you as a dreamer, or someone who is trying to run before learning how to walk.

10.2. Venture Capital Do's and Don'ts

There are some general guidelines that can help you significantly in your search for venture capital. You may want to cut out these do's and don'ts and paste them somewhere you can study them before embarking on you're first meeting with a VC.

Don'ts:

- Do not avoid answering questions.
- Do not give vague answers.
- Do not hide significant problems.
- Do not expect or press for immediate decisions (this works both ways).
- Do not fixate on pricing.
- Do not bring your lawyer.

Do's:

- Be positive and enthusiastic about your company and product/service. Know your minimum deal and walk away if necessary.
- Remember this is a long-term relationship.
- Negotiate a deal you can live with.
- Do your homework on the Venture Capitalist. Know the previous deals he has funded and the current structure of his portfolio.

10.3. What Makes the Perfect Deal

Many factors go into making a perfect deal. A recent VC survey revealed that companies displaying a good management team, strong financials and a good story topped VC's lists of perfect deal candidates. The most sensible answer was from a Canadian venture fund, which answered the question.

"What make a perfect deal?

-

"One you're out of with a profit."

11 ABOUT GLOBAL MILLENNIA MARKETING

Global Millennia Marketing Inc. is one of the first of a new breed of integrated Internet marketing communications companies and is comprised of four on-line divisions. Our ability to work closely at all levels optimizes synergy between the different divisions from the strategic planning stage right through to tactical execution of all our projects.

John Shenton B.Eng., President of Global Millennia Marketing, is a dynamic, adaptable and results driven Senior Executive with many years experience in building and operating companies in N. America & Europe, creating market presence and increasing sales throughout domestic and International markets worldwide.

His strong technical and analytical background is supported by comprehensive sales, marketing, operational, and general management skills in the computer, Internet and telecommunication industry.

He has a great deal of International experience, having lived and worked within the United Kingdom, Germany, Switzerland and Canada.

As the use of New Digital Media such as the Internet, CD-ROM's, DVD's, increases, the importance of coordinating its use with traditional printed media becomes paramount. We are uniquely placed to address this need, having evolved from genuine specialists in both fields.

We work with our clients to develop effective, long-term partnerships, which encompass every facet of the management and marketing functions, from initial project consulting through creative design and production, to corporate presentation management.

Our teams have many years' industrial experience in the fields of Sales & Marketing, Finance and Information Technology in North America, Europe and Asia. This background allows us to quickly empathize with our clients to understand their markets, their objectives and to identify their business needs.

Through strategic planning and the creative application of our skills and experience, we deliver effective total marketing communications solutions, which meet, and typically exceed, their pre-defined goals and expectations.

Operations are controlled from Montreal, Canada.

From here we are able to provide service on a global basis in English, French, Chinese and Arabic to a diverse range of companies from start-up to established corporations.

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...Taking your site in the right direction
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