Before the Negotiations:

What Entrepreneurs Need to Know About Seed and Early Stage Venture Capital

A White Paper Primarily for Entrepreneurs in Upstate New York

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"Companies that have received venture capital financing outperformed
their industry peers — in job and revenue growth — during the 2000-2003 economic slump,
according to a study to be released today by the National Venture Capital Association….
Venture-backed companies generated 10.1 million jobs and $1.8 trillion in revenue last year,
or 9.4 percent of all U.S. private sector jobs and revenue.
Job growth was 6.5 percent versus a 2.3 percent decline in U.S. employment from 2000 to 2003.
The revenue rose 11.6 percent compared with 6.5 percent nationally."

Sheryl Jean, Pioneer Press
"Venture-Backed Firms Out-Perform Peers"
July 2004

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I. Introduction

This white paper is directed primarily at high-tech entrepreneurs in Upstate New York who might have an investable business case, i.e., a high risk, high potential opportunity that could benefit from the capital and business experience that professional "risk capital" investors provide and that can generate significant returns on their investment.

Entrepreneurs who don't have an investable business case might still have a business. There are many very successful "non-investable" businesses in our area. These are typically slower growth "life-style" enterprises, with fewer employees and lower revenues. Family members and friends generally provide funding to launch the business and/or the entrepreneur "boot straps" the organization. These companies have a slightly different orientation than an investor backed business. They must reach operational self-sufficiency early and focus more on cash flow rather than profits. The company is generally owned by the entrepreneur or by a small group of friends and family.

On the other hand, if an entrepreneur has something "investable", then pursuing the support of professional investors, such as institutional venture capitalists (VCs) becomes an option. But entrepreneurs must understand that venture capital is not free money from the state or federal government to start businesses, and VCs are not like the NIH or other government granting institutions. Neither are they philanthropists. VCs are venture fund managers in the business of selling money. Their capital is exchanged for some ownership and control in a company. VCs work hard at mitigating risk at every stage of a company's development to ultimately exit with a high return on their investment. They are extremely selective and invest in only about .1% of all the companies started annually. They're looking for the big home runs.

If an entrepreneur needs the capital, is willing to share some ownership and control, and values the management expertise that a VC brings, then they should engage a VC in dialogue. But VCs have specific objectives and speak a certain language that, while universal within the industry, might be foreign to the uninitiated entrepreneur.

The objective of this white paper is to help prepare entrepreneurs for conversations with VCs. It tackles some of the most fundamental issues that entrepreneurs should understand preferably before a first meeting with a venture capitalist and certainly before entering into any negotiation, *i.e., company valuation and co-ownership issues, including equity sharing, dilution, exiting, and board control.* The concepts in this paper can be reviewed and validated with other community professionals that have been on either side of the fence, i.e., as investors or as investees. Some of the entrepreneurs and coaches at the local high tech incubators might be quite experienced in the art of raising capital and could serve as a good source of validation, as could professors at the local business schools and lawyers who specialize in start-up businesses. An entrepreneur familiar with the concepts discussed here will likely be more comfortable and effective in any negotiation.

This white paper is also written for those community members, e.g., entrepreneurial advisors or economic developers, who might be interested in getting a better understanding of venture capital. Lately, "everyone" in Upstate NY seems to be calling for more venture capital to

support the establishment and growth of new companies. But not everyone is fully familiar with how venture capital "works". It's not enough to just bring venture capital to Upstate NY. Our venture funds must be successful to sustain the flow of capital to our region for economic development. And the best way for funds to be successful, is if community stakeholders fundamentally understand and support this investment model.

The paper starts by reviewing the stages of a start-up company. Entrepreneurs must recognize what stage they're at before they can determine what financing options are available and can be pursued. Then it discusses some of the pros and cons of early financing options. But most of the paper, as already billed, will be focused on understanding institutional venture capital, in particular, some of the more important elements that enter into deal negotiations. The paper concludes with a general discussion of the role of venture capital in Upstate NY.

II. Start-Up Stages

Companies don't form overnight. Most investable start-up business traverse a common path during their first few years pre- and post-incorporation. A company's maturity or stage of growth is typically recognized by the technical and business milestones it may or may not have achieved.

Likewise, funding occurs in stages as a company's financing requirements and options evolve over time. As such, an entrepreneur must first recognize their stage of development before they can determine what financing option they should pursue, what they can ask of an investor, and what they can expect to receive. The table and discussion below outline the company growth or development stages generally recognized by the entrepreneurial and investor communities.

Concept Stage. Most companies, in the beginning, start out as a concept, i.e., as an idea in an entrepreneur's head. There's likely been and continues to be significant technical research activity around a new product or service offering. In some cases, the lead researcher may have already spent many years in his/her laboratory developing this technology. Usually, there has been little or no business development. If the company is a university or corporate spin-out, funding of <$1M up to $10M from government grants (like the NIH or DARPA) or the technologist's employer (like Kodak or Xerox) may have already been invested in the development of the technology. There are no venture investors at this point.

Development Stage	**Concept**	**Pre-Seed**	**Seed**	**Early Stage**
Technology Milestones	research	pre-prototype	lab prototype & feasibility	commercial grade prototype & validation
		pre-molecule	molecule & cell lines	optimized molecule & pre-clinicals
Business Development Milestones	----	first-cut idea analysis	opportunity analysis & business plan; validation of customer interest	executing business plan, securing customers and strategic alliances
Funding Requirements	<$1-10M	~ $50-100K	$250-500K	~ $1-2M "Round A"
Time to Achieve Milestones	<1-10 years	3 - 6 months	6 months - 1 year	1 year - 18 months
Funding Sources	Government and Corporate Grants, Founders	Grants, Corporations, Founders, Family, Friends, Angels, SBIR Phase I	Angels, Seed Investors, SBIR Phase I/II	Venture Capital, Strategic Partners, SBIR Phase II
Investor Risk Level	----	phenomenally high	extremely high	very high

Table 1: Company Development Stages

Pre-Seed Stage. The pre-seed stage has been grayed out on Table 1 because many entrepreneurs will discover a "molecule" or develop a laboratory prototype during the research/concept phase of the company and skip over the pre-seed stage. But some companies get caught in the pre-seed stage if their academic grants run out, if they leave their host university or corporation prematurely, or if the technology is something they're developing in their "garage". Only about $50 – 100 K may be required to achieve certain technical milestones (e.g., development of a laboratory prototype). And it might only require about three to six months. But at this point, an entrepreneur may be having a very difficult time getting the money because the risk is so phenomenally high. The best way to avoid this situation is to try to ensure that government or corporate grants cover the technology development through this phase. If that doesn't work, the entrepreneur might have to rely on friends and family for a while, use personal financing, find an angel, and/or apply for a Small Business Innovation Research (SBIR) Phase I grant. The chances of a "regular" VC coming in at this point are virtually nil. A VC with a *seed* fund might consider it but this is not their sweet spot or preferred space.

Seed Stage. If an entrepreneur decides to start a company, the first "real" stage is the seed stage. The entrepreneur has a laboratory prototype that demonstrates feasibility or a molecule that's being validated in cell lines (in the case of a biotech company). Most entrepreneurs at this point will need to become serious about conducting a comprehensive opportunity analysis and assembling a business plan. Entrepreneurs typically need (or can ask for) about $250-500K to convert their laboratory prototype into a commercial grade prototype or "clean up" their molecule. That money generally lasts about six months to a year and possibly can be secured from angels and seed investors or through SBIR Phase I or II grants. The investor risk at this point is still extremely high.

Early Stage. An early stage company typically has a commercial grade prototype. Evidence exists that the prototype works outside the lab and its manufacturability has also been validated. If this is a biotech company, the entrepreneur is probably in the process of optimizing his or her molecules and entering pre-clinical trials. The business plan is being executed and the management team (consisting of maybe a CEO, CTO, and VP of Business Development) is looking for customers and strategic alliances. At this point, an entrepreneur might need about $1-2M. It'll take the company a year to eighteen months to achieve predetermined milestones. If there is a strong investable business case, the entrepreneur can get venture capitalists or strategic partners to enter into the first "real" investment round called the "Round A". And/or they can apply for an SBIR Phase II grant. Investor risk is still very high.

Funding Strategy. As entrepreneurs become serious about launching their business, they must also become serious about developing a funding strategy that will carry them through the earliest stages of a company's growth. They must determine exactly how much money they'll need, when they'll need it, what milestones will be achieved, who they can go to, and the pros and cons of engaging various funding sources. (If this sounds daunting to the uninitiated, entrepreneurs should seek out "venture development" professionals in the community to assist.) Funding sources such as angels, SBIRs and VCs can be tapped in the earliest stages of a company's development, and these entities will be discussed in the following section. However, here are some general principles that apply throughout the early financing stages and that should generally be considered in developing a funding strategy involving investors.

- Entrepreneurs must always keep in mind that the earliest money is the hardest money to get because the risk is so high. They might be very confident in themselves and the opportunity. They might not think there's a lot of risk, but when they walk through the door asking for money, all a professional investor sees is risk. VCs are trained risk assessors and managers. In every entrepreneur, they see technology risk, market risk, and management risk.

- Entrepreneurs should not ask for money too soon because the earliest money is the most expensive. They should use research grant dollars for as long as possible. Sometimes using personal finances for a while may be necessary. But this is not a bad option. In fact, investors like to see that an entrepreneur has put his/her own "skin in the game". It demonstrates true commitment to a company's success.

- Entrepreneurs should not ask for or expect too much money out of the starting blocks. There may be exceptions, but usually $2M is too much for a seed stage company. Investors are more interested in what can be achieved and how risk can be mitigated with the first $250K.

- Entrepreneurs must have realistic expectations about the "big" VCs in Boston or NYC, i.e., those with larger venture funds that are looking for more established plays. It might be too soon to talk to them. We hear a lot of professors turned entrepreneurs with concept stage companies tell us they're talking to the Boston VCs, and that they're "really interested". However, major Boston VCs historically have not invested in pre-seed or seed stage companies in the Upstate New York area and (except maybe during the late 90's telecom bubble) relatively few investments have been made in early stage companies by outside firms. VCs tend to be polite. Entrepreneurs shouldn't mistake being polite as "interest".

- Entrepreneurs must have realistic expectations about strategic partners, i.e., large companies that might have a "strategic" interest in the company. If there's no prototype or validation that the technology works yet, it might be too soon to expect a check. Validating their interest is important, but their likely response will be "come back when you have something to show us".

- Entrepreneurs must have the same view on exit strategy as VCs. VCs aren't interested in a long term marriage and they want to know from the very first meeting that neither is the entrepreneur. If an entrepreneur is not willing and interested in selling his/her company in five to seven years, they shouldn't even start down the path with a VC.

- Entrepreneurs need to remember that the objective of all start-up companies is to increase the value of the company, as much as possible, as quickly as possible, by achieving critical milestones with as little money as possible. This allows the entrepreneur to optimize the balance between retaining ownership for themselves and maximizing the value of their company.

- And finally, entrepreneurs must remember that "cash is king" for all start-ups. Ask any seasoned entrepreneur and they'll reinforce that statement because prior to any success they might have achieved, they had to live with this reality for a long time. Financing must be staged wisely, i.e., take what you need, manage it carefully, and don't run out of money.

III. Early Funding Sources

Besides family and friends, angel investors, SBIRs and Seed VCs are the earliest sources of financing for start-up companies. They can be pursued simultaneously or sequentially. This section provides a bit more information on each option.

Understanding Angels. Angels are accredited high net worth individuals with an appetite for start-up investing. They play an extremely critical role nationwide in supporting the establishment of start-up companies. A funding gap exists "everywhere" for pre-seed and seed investment because investing in the earliest company stages is so high risk. Fortunately, angels go where VCs fear to tread. They are providing the bulk of pre-seed and seed capital. In a typical year 500,000 companies are started in the US. Angels invest in over 50,000, while VCs invest in 500. A typical angel investment might be between $25K and $250K with an average investment size of $40K.[1]

There are many potential angels in Upstate NY. In Rochester alone, there are over 5,000 millionaires and over 500 households with income over $500K.[2] Entrepreneurs find angel investors by word of mouth or by networking at country clubs and other social gathering places. However, it's much easier to find angels when they're organized. There are 200 angel organizations nationally. In Upstate NY, we have a few networks and forums. Several local organizations have recently been involved in various angel identification and education efforts.

While this appears to be the only section in this paper that talks about angel investors, keep in mind that discussions about valuation and equity sharing relate to both VCs and Angels. Many angels watch the VCs and co-invest with VCs on similar terms. Others call the shots according to their own rules.

Understanding SBIRs. While there are several federal and state government grant programs that provide early funding (check with a local high-tech or economic development organization for a complete list), the largest and most established is the Small Business Innovation Research (SBIR) program from the federal government. SBIRs are intended to support early stage R&D projects in small technology companies. There are two types of grants. Phase I grants are six to nine- month awards of $70 - $100K to test the technical feasibility and commercial merit of an idea. These are very valuable for pre-seed and seed stage companies. Phase II are two year awards of $500-750K to further develop the concept, usually to the prototype stage. These are very valuable for entrepreneurs with a seed or early stage company. "Phase III" is commercialization, possibly through the award of a government contract, but this is not formally supported through the SBIR program.

The federal government generally allocates about $1.5B each year for SBIR awards. They are available from the Departments of Agriculture, Commerce, Defense, Education Energy, Health and Human Services, Transportation, plus the EPA, NASA, NSF, and NIH. However, 50% of the awards come from DoD. Every quarter, the Small Business Administration (SBA) and each agency issues Requests for Proposals (RFPs) which tell inventors what kind of technologies

[1] *National Association of Seed and Venture Funds*
[2] *High Tech Rochester summary of Arthur Andersen report, 1997*

they're looking for. This paper will not attempt to cover the ins and outs of how to apply for SBIRs. A good resource is the Handbook of Proposal Preparation which can be found at www.sba.gov/sbir/indexsbir-sttr. html. In addition, local incubators or business and economic development organizations sometimes hold seminars on how to apply for SBIRs.

There's another kind of grant that entrepreneurs should know about called a Small Business Technology Transfer (STTR) grant. They are intended to support cooperative research between small businesses and universities. However, there's only about $100M allocated annually to this program. Again, the website mentioned above will provide some direction.

SBIR Pros and Cons. The best thing about an SBIR is that it's a grant. It truly is free money. It's not a loan or an equity investment. The company receives exclusive rights to any IP developed. The only catch is that the government retains royalty-free, non-exclusive rights to use the IP. And, if the company doesn't commercialize the technology developed, the government can force them to license the technology to another company. Also, the money must be used exactly as proposed. There is very little flexibility. Probably the biggest drawback though is the long cycle time. It can take months to a year to apply, to hear back, to get the money, and then the money might be gated, e.g., $750K spread over two years.

Entrepreneurs must also be forewarned that there has to be a good match with an RFP. For many companies, there simply isn't a match between their product offerings and what the government is looking for. Also, just because an entrepreneur applies, doesn't mean he/she's going to get the money. These are very competitive grants. Only about 15% of all proposals are awarded Phase I. Only about 40% of those Phase I projects are subsequently awarded Phase II. On the other hand, if an award is secured, it represents a great opportunity to establish a positive reputation and set the stage for future government contracts that can be very lucrative.

SBIR Success Story. There is a successful precedent for using SBIRs as a funding source for Upstate New York start-ups. Impact Technologies in Rochester is the top DoD SBIR winner in New York state and they are among the top ten in the nation. They have won 63 Phase I and 38 Phase II awards over 7 years, totaling $34M. In 2005 alone, they won 14 Phase I and 12 Phase II awards, totaling $9M. One of the reasons they're winning these awards is because their core competencies align well with the DoD RFPs. They are an engineering firm, specializing in the design of software and sensors used to predict and detect equipment problems on military platforms (e.g., jet engines and ship propulsion systems). Not all companies are so well aligned. In summer 2004, Impact won a "Phase III" contract with the US Navy that could be worth $25M for new sensors.

Seed Investors. Finally, VCs with seed funds can be a source of early money for seed stage companies. Paradoxically, while venture capital investing is a game of high risk, VCs are always looking to minimize risk. One of the ways they do that is to avoid investing in seed stage companies. Most VCs prefer to "let the system work" by having the angels go first. There are a few VCs though, generally those with some commitment to local economic development, that have elected to establish a seed fund. Or some states are stepping in to fill the gap with state-supported seed funds. A state may have somewhat different expectations on the returns for the fund, but otherwise, all the same rules of venture investing apply.

IV. Understanding Venture Capital

Venture capital is probably the least understood funding source for early stage companies, especially in those parts of the country like Upstate NY which historically have not been centers of high risk investing. The following section reviews some of the most frequently asked questions about venture capital.

What is venture capital? Venture capital is direct financial investment in emerging firms that have the potential to develop into significant economic contributors in a relatively short period of time. The investment is in exchange for debt convertible to equity or equity, i.e., ownership in the company. VCs invest solely to make money.

Whose money is it? It's surprising how many people think that this money is the combined personal wealth of the VC partners and that they are positioned to dispense the funds philanthropically. The money in a venture fund actually comes from "limited partners" (LPs), i.e., public and private pension funds, university endowments, foundations, corporations, banks and high net worth individuals who seek to diversify their portfolio. The contributions of the LPs are not charitable; rather a significant return on investment (ROI) is expected proportionate to the level of risk. This is high risk investing, so a high reward is expected.

Who are VCs? They are generally successful business managers and entrepreneurs turned fund managers. They are professional investors.

What do VCs do? They invest "other people's money". They analyze hundreds of potential investments and choose only a few per year. With the few companies that VCs choose to invest in, they enter into negotiations to determine the terms of the investment. After an investment is made, VCs become active in the venture to help ensure company success. They take a seat on the Board of Directors. Some take interim executive management positions and get involved in strategic planning or oversight. Since many investors are "hands-on", they prefer to invest locally or move companies to their locations. (This is why it's important to have local VCs.)

VCs are not free agents. They must provide accounting to their fund advisory board for making sound investment decisions and properly guiding "portfolio companies". They are also responsible for providing profitable returns to their limited partners regardless of the economic climate.

How do VCs (and LPs) "make money"? VCs earn a management fee to administer the fund. But the "real" money is made through building value in their portfolio companies and exiting through a liquidity event, usually through a merger or acquisition by a larger company or possibly through an IPO. Most funds have a ten year life cycle so investors are seeking to exit from their investment in three to seven years.

What do investors expect for their money (in five years)? Seed investors look for 7-25 X ROI on each deal, which equates to a 50-90% compounded annual Internal Rate of Return (IRR) over five years. Investors in Round A expect 5-7X ROI or an IRR of 40-50% per deal. And Round B investors seek 3-5X ROI or 25-40% IRR. Wow! Doesn't that seem pretty high? Why do

investors need such high returns? Why can't they be satisfied with doubling their money, maybe tripling their money, even quadrupling it? Well, the reason is as follows.

Out of every 100 opportunities VCs look at, they only invest in one or two. They do extensive homework or "due diligence" on these companies. Nevertheless, it's very difficult to predict the real winners. Only about 20% of the companies VCs invest in develop into the big "home runs" they're hoping for. It's known in the industry that *five in ten* investments fail, *three in ten* investments breakeven, and only *two in ten* investments succeed in a major way. The number is even lower the earlier the investment, i.e., only *one in ten* "hit big" at the seed stage. That means that only one or two companies will produce almost all of returns for the entire portfolio. Thus, all portfolio companies must demonstrate the opportunity for high returns. And VCs must make sure they've got a large enough equity stake in the ones that succeed to make up for the ones that fail.

So, what exactly are VCs looking for in a company or business case? VCs that invest in high tech want new and exciting **technology** that can result in "revolutionary" **products** or **services**. The foundational technology should be well protected with patents. They prefer a platform technology that results in a portfolio of products or services. (They usually don't invest in one trick ponies.) It's always best to have research that's been well funded by credible sources. The fact that DARPA or NIH has already invested millions in the development of the technology is huge validation.

Relative to the **market**, they like to see significant market need and that the introduction of the technology is well timed, i.e., the window of opportunity is now. The market size should be greater than $250M. It should be a growing market (the camera film market is big but headed in the wrong direction). Relative to **competition**, the competitive advantages of the company's products should be well identified and well articulated. Value propositions statements should be compelling. Competitors should be manageable and there should be adequate barriers to new competitor market entry.

The **business model** should be credible and reveal clear and easy access to supply and distribution channels. The **revenue potential** should exceed about $40M annually. **Operational milestones** should be achievable in a reasonable amount of time at a reasonable costs and with a reasonable amount of financing. There should be a viable **exit strategy**. And then validation, validation, validation. VCs will "drink an entrepreneur's kool-aid" for a while but then they'll want to hear from both technical and industry experts that they also believe the company has a good chance of success.

The above paragraphs basically describe the "hard criteria". But the "soft criteria" are also important. Indeed, several white papers have been written by other VCs that discuss this topic, i.e., what VCs are looking for in an entrepreneur and vice versa. The short version is that "the personal chemistry" needs to be right since these teams will be working together towards an exit for many years.

Why do deals fall through? Remember that VCs look at hundreds of business plans. They enter into negotiations with only about five percent. Half of those negotiations collapse and VCs end

up investing in two or three opportunities annually. So, after clearing all the early hurdles, why do some deals still fall through? Here are what I perceive to be the top five reasons.

1) Many entrepreneurs struggle to "let go" of total ownership and control of their company. This seems to be particularly true of university professors turned entrepreneur. They have established successful laboratory research programs and received significant amounts of "free" money from the NIH or DARPA, never in exchange for any amount of control and equity ownership in their lab. It's not a paradigm they're used to.

2) There are not many role model companies in Upstate NY yet. Paradoxically, while the Upstate community seems to be looking for increasing amounts of venture capital, it seems that there is still a certain "skittishness" about VCs. Entrepreneurs have a natural tension between wanting/needing the capital and business experience that VCs provide and fearing the constraints that might be placed on the company by investors. As there are more success stories about venture backed companies locally, entrepreneurs will gain confidence in the VC model.

3) Inexperienced counsel. Entrepreneurs need to ensure that they get the right counsel, in general, but especially from their lawyer. It is extremely important that entrepreneurs go to the law firms that understand start-up companies and VCs. Lawyers, who aren't experienced in this area, even thought they might be a good friend and a very nice person, can single handedly kill a deal.

4) The "shoppers". Some entrepreneurs seem to hold onto the belief that there's a better deal out there somewhere. Sometimes they shop for a long time. (They seem to forget about "first mover advantage".) You can't keep people from shopping. We just scratch our heads though after two or more years when we hear that he/she is still out there "shopping".

5) Finally, the biggest reason deals fall through from most VCs' perspective is that investors and entrepreneurs can't agree on "valuation", i.e., what is this company worth? Discussions about valuation can be very touchy and emotional. So, the next section is committed solely to this topic.

V. Company Valuation

A VC literally buys a piece of a company with money in a venture fund. The ownership "slice" for the VC depends on the **value of the "pie" before the investment is made, or the "pre-money" valuation.** The question about valuation or "W*hat is this technology/ company worth?"* is so important it requires its own section.

A scientist's perspective. A lot of scientist's struggle with this question. They've been working on their technology for five, ten, fifteen years and they have a hard time reducing their life work and passion down to a monetary value. Their answer might be: "Trying to assess basic research by its practicality *(or commercial potential)* is like trying to judge Mozart by how much money the Salzburg Festival brings in each year."[3] This statement illustrates the disconnect between the way a scientist thinks and the way an investor thinks. Scientists tend to think about the value of their technology throughout all society and throughout all time (like Mozart's works). But an investor thinks merely in terms of cold hard cash. Yes, investors want to know how much money "the festival" brings in each year. So, a lot of times what happens, is that scientists will think they have a $10M valuation coming out of their research center. An investor might tell them that they're not even close, and that's not a particularly good starting point for a negotiation between an investor and a potential entrepreneur.

An entrepreneur's perspective. An entrepreneur who's been around the block a few times and has likely struggled with VCs over this question might suggest the following answer: "Don't believe anyone who says they can effectively value an *early stage* company. I ask investors this question all the time and they just look down and shuffle their feet because no one really knows how to do it."[4] I believe that a lot of VCs would probably agree that there's quite a bit of truth in that statement.

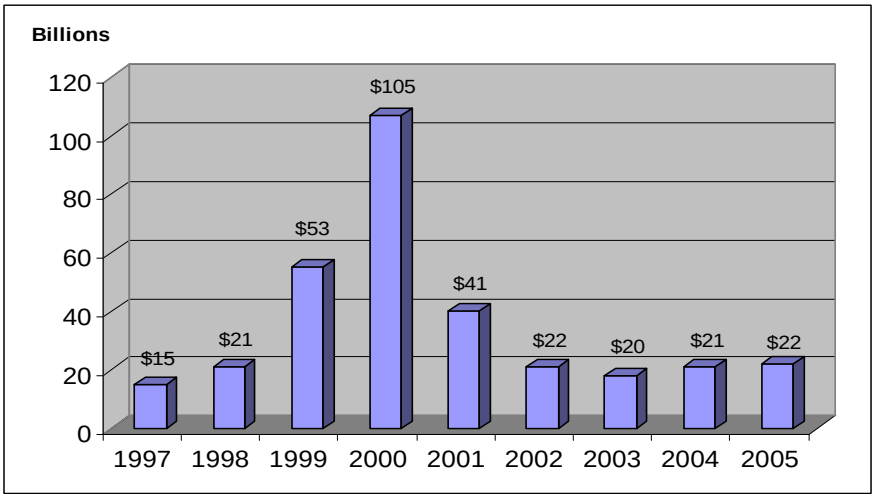
An investor's perspective. But Yogi Berra tells us: "You can observe a lot just by watching."[5] That's actually the correct answer to the question. At first it may not seem like much of an answer, but it really is. And here's why. Because VCs watch each other. The VCs in Silicon Valley watch the VCs in New York, who watch VCs in Boston, who watch VCs in Research Triangle Park, NC. And all the local and regional VCs watch the "big guys". They all receive and study the same industry reports to understand the current investing climate. They all check the same VC websites to get up-to-date data on "deals". And many if not most deals are syndicated, so several VCs might enter a deal together on the same terms at the same valuation. So, if an entrepreneur wants to know what a company is really worth, it behooves them to look at the same industry data that VCs are looking at. It's very important that entrepreneurs know what the "going rates" are for valuations of start-up companies in general before they assign a valuation to their company.

Yes, there's the math. Valuations can be calculated using a variety of methods: sales multiples, discounted cash flow, product assets, replacement value, etc. These methods are taught in business schools and/or can be found in various texts. And these methods can indeed be very

[3] *Konrad Lorenz, Austrian Naturalist Taken from presentation by Domain Associates, VC Institute 2003*
[4] *Rob Helmick, Founder and CEO, Real Education (Denver). Taken from presentation by Domain Associates, VC Institute 2003*
[5] *Taken from presentation by Domain Associates, VC Institute 2003*

useful once a company actually has sales, cash flow, assets, etc. But early stage companies only have financial "projections". In the absence of "real" numbers, valuation calculations can easily be manipulated using different assumptions to achieve a wide range of outcomes. So, if an entrepreneur wants to know what a seed or early stage company is worth, I recommend they look at "the data".

Annual VC Investments. But the data on start-up valuations (especially the trend information) will not make total sense until an entrepreneur understands what has been happening in the VC industry over the last several years. The annual investing trend, shown in the following graph, is quite amazing.



Source: pwcmoneytree.com

Table 2: Annual VC Investment

Back in 1997, the total for annual VC investments was about $15B. By 1999, that number had nearly quadrupled to about $55M. By 2000, it was over $100B! This was the height of the dot.com and telecommunications bubble. Unfortunately, both of these markets imploded and VCs lost billions. VCs suddenly became "cautious". The following year investing plummeted to about $40B. By 2002, it had dropped further to about $20B and that seems to be where the market has stabilized, i.e., in the $20+B range. The money being invested today is only a fraction of the money that was invested in 2000. Keeping these statistics in mind, let's now look at trends in valuations.

Valuation Trends. The following table shows the median pre-money valuations (in millions) of US venture backed companies from 1997 to 2005. The data from 1999 through 2001 however have been grayed out because those were the "bubble years". The valuations that companies received during that time period are significantly higher than any entrepreneur can expect to receive in today's "more cautious" investing climate. Rather the data focuses on 2002-2005.

Since VCs generally don't make early seed investments, this table starts with valuations for "later" seed round companies. It basically suggests that seed companies are currently being valued at about $2M. Start-up companies are valued between $3-4M. First round companies at between $5-6M. Not until a company is manufacturing and shipping product will it achieve a

Development or Financing Stage	1997	1998	1999	2000	2001	2002	2003	2004	2005	Avg 2002-2005
Seed Round	$2.9	$3.5	$4.0	$5.0	$3.4	$2.3	$2.0	$1.5	$1.8	$1.9
Start-up	$3.0	$3.7	$5.3	$7.0	$4.7	$4.3	$2.3	$2.3	$5.0	$3.5
First Round	$6.2	$6.7	$9.6	$12.0	$8.0	$6.0	$4.8	$6.0	$5.5	$5.6
Product Development	$10.0	$10.8	$12.1	$16.0	$14.0	$9.4	$9.0	$11.7	$9.9	$10.0
Shipping Product	$15.6	$20.2	$30.9	$36.0	$19.0	$12.5	$10.8	$14.0	$18.0	$13.8

Source: ventureone.com

Table 3: Median Pre-Money Valuations ($M) of US Venture-Backed Companies

valuation of about or over $10M. Keep in mind that these are nationwide averages. This is not just in Upstate New York. Most of these deals were made in Silicon Valley, Boston, NYC, and RTP, NC. These are the going rates in high-tech hub areas.

Current Valuations. Table 4 was taken from a white paper written by a Boston VC and is based on 2003 market information. It's a bit dated but still of value since the market has been fairly stabile since then. Again, we see fairly low valuations early on and valuations reaching the $10M mark only after a company is shipping product.

Valuation by Stage

Financing	Company Stage	Data	Risk/Uncertainty	Value* (MM)
Seed	Incorporation; early development	Soft data; value proposition, etc.	Extremely high	$1+
Series A	Development	Validation, time to market	Very high	$3+
Series B	Shipping Product	Prelim revenue	High	$7.5+
Series C+	Shipping Product	Predictive revenue	Moderate	$10+
Later-stage/ Mezzanine	Shipping Product, Profitable	Hard data; EBITDA, net income	Lower	$20-50+

*Based on 2003 market information

Source: Callow & Larsen, Boston Millennia Partners
"Understanding Valuation: A Venture Investor's Perspective"

Table 4: Valuations by Stage

Another data point was collected at a July 2004 conference in Rochester hosted by the National Association of Seed and Venture Funds (NASVF) entitled "Seed Funding as a Team Sport". Fred Beste, Founding President of Mid-Atlantic Venture Funds in a video-taped presentation suggests that the value of a seed stage company in today's climate is "between $.5M to $2M."

Rule of Thumb. Early stage VCs also frequently use the rule of thumb shown in Table 5. A company that has a well protected technology and prototype is worth a $1M valuation. If a company has great market potential and a compelling business plan, that's worth an additional million in valuation. If the prototype has actually been beta tested and proven to work outside the laboratory, that's worth another million. If a company has a complete management team, add another million and if a company has customers and product sales, another million. So if a company has all five assets, it's probably a true early stage company and its valuation is about $5M. On the other hand, a company with fewer assets is probably a pre-seed or seed stage company and an entrepreneur can subtract a million in valuation for each asset that the company doesn't have.

Company Asset	**Value**
Well Protected Technology & Prototype	$1 M
Great Market Potential & Validated Business Plan	$1 M
Beta Testing Complete	$1 M
Complete Management Team	$1 M
Customers & Product Sales	$1 M
Total	$5 M

Table 5: A VC Rule of Thumb

Triangulated Data. Triangulating the data produces a table basically like the one shown below. It seems, from all the data, that valuations for early seed stage companies are currently less than $1 to 2M. For late seed stage, valuations are in the range of about $2-3M. Early stage start-up can expect valuations between $3-4M and those in Round A can probably ask for or expect a $4-6M valuation.

Development or Financing Stage	**Valuation**
Early Seed Stage	$<1 - 2M
Late Seed Stage	$ 2 - 3M
Early Stage Start-Up	$ 3 - 4M
Round A	$ 4 – 6M

Table 6: Triangulated Valuation Data

Creative Deal Structuring. But it would be a disservice to entrepreneurs to leave them with the impression that VCs just look up valuations on some generic table. It would be easier if it was

that cut and dried. That's not what happens and is certainly not what happens within our own venture firm.

Since it's so difficult to get a handle on valuations especially at the seed stage, we try to engage in "creative deal structuring", especially if an entrepreneur truly believes that expectations for his/her company are "above average" and they're onto something really hot. (Of course, every entrepreneur thinks that way.)

One creative option is to let the market set the price. Instead of setting a valuation and taking equity at the seed round, the day of reckoning can be delayed. Lawyers can draft a "convertible note" that converts to equity at the Round A. Then we all wait until the Round A and let those investors, perhaps in Boston or NYC, set the valuation. The entrepreneur and seed investor agree ahead of time that the seed investor will receive a pre-determined discount to the Round A price. For example,

- Let's say the seed investor has asked for 50% discount to the Round A valuation for coming in earlier when the risk was higher.
- If the Boston VCs determine that the Round A pre-money valuation is $7M (which would actually be pretty good).
- Then the seed investors's equity share will be based on $3.5M valuation (which is above average performance).

Another possibility is to construct a convertible note that converts to equity based on performance based valuations. For example, if pre-determined milestones are achieved, then the valuation is $XM. If not, then the valuation is $YM.

A final perspective on what is this technology/company worth? Before leaving the topic of valuations, there is one final perspective worth discussing. It's called an Art Lover's Perspective: "I don't know much about art, but I know what I like."[6] Sometimes an entrepreneur might actually find an angel investor that just loves their technology and that will give the entrepreneur a higher than market valuation because they love it so much. The entrepreneur might think that's really great, when actually they could be setting themselves up for a big disappointment.

Let's say an angel gives an entrepreneur $200K for his/her seed stage company at an $8M valuation. But nine months later, the entrepreneur needs another $1M. The entrepreneur might approach a VC, who says "no way" to an $8M valuation. They propose a $4M valuation instead. A follow-on investment round at a lower valuation than the previous round is called a "down round" and no one is happy during a down round. The entrepreneur is not happy because they thought they had a company worth $8M and now a VC is telling them it's only worth $4M. The angel is upset if the entrepreneur takes the new money because that would mean he or she's came in earlier at a point of higher risk and got a worse deal. The VC is not happy because they're just trying to cut a fair deal and everyone is mad at them. So, what generally happens is that a VC won't touch a deal like this because it's already "screwed up". Entrepreneurs need to be aware that there can sometimes be a major disconnect between enthusiastic angels and professional VCs. Be very careful about the "down round".

[6] *Taken from presentation by Domain Associates, VC Institute 2003*

VI. Co-Ownership Issues

Equity Sharing. The whole idea behind venture capital investing is that VCs provide capital to a start-up in exchange for some ownership and control in the company. But of course, the burning question on every entrepreneurs mind is, *how much* ownership will he/she have to relinquish. This time "the math" is very applicable and very simple.

Let's say an entrepreneur has been dealing with a VC or angel and they've finally come to an agreement about "pre-money" valuation. This is the agreed-upon value of the company prior to any equity investment. They've also determined exactly how much money the entrepreneur needs or will receive in this investment round. The "post-money" valuation becomes the pre-money valuation plus the invested capital. And the VC's equity position is simply equal to the money invested divided by post-money valuation. For example:
The early stage company's pre-money valuation is $4M
The investor puts in $1M
The post-money valuation is now $5M
And the investors equity position is $1M / $5M or 20% of company

Dilution. However, an equity position is not necessarily fixed over time. Most companies will go through multiple financing rounds. As new investors come in, the equity position of all the previous stake-holders is reduced or "diluted". That's not necessarily a bad thing because the *value* of the reduced equity stake is higher (assuming of course that the company is growing successfully). Table 7 explains "the math". Again, it's quite simple.

Company Stage	**Pre-Seed**	**Seed**	**Round A**	**Round B**
Entrepreneur Ownership	100%	80%	64%	51.2%
Seed Investor Ownership for $250K		20%	16%	12.8%
Round A Investor Ownership for $1M			20%	16%
Round B Investor Ownership for $3M				20%
Pre-Money Valuation		$1M	$4M	$12M
Post-Money Valuation		$1.25M	$5M	$15M
Entrepreneur Value	--	$1M	$3.2M	$7.5M

Table 7: Example Dilution Table

Starting at the beginning, there are no investors and the entrepreneur owns 100% of the company. Let's say the seed investor comes in with $250K at a $1M pre-money valuation. That makes the post-money valuation $1.25M and the seed investor gets 20%. The entrepreneur's ownership is now 80% and his/her *value* is $1M. In the Round A, another investor comes in with $1M at a $4M pre-money valuation. That makes the post-money valuation $5M. The new

investor gets 20% of the company. The seed investor is diluted to 16%. The entrepreneur's ownership is now down to 64%, but his/her *value* is significantly increased to $3.2M. In the Round B, another investor comes in with $3M at a $12M pre-money valuation. That makes the post-money valuation $15M. The entrepreneur's ownership is now down to 51%, but his/her *value* is now up to $7.5M. For the entrepreneur, there has been a dramatic increase in the value of their Company and the value of their share. The same has occur with the VCs "piece of the pie".

Frequently, many entrepreneurs focus only on the first row of Table 7. The thought of their equity stake dropping has a negative psychological impact. It would seem however that they are not doing "the math" and literally not watching the bottom line. The more relevant concern should not be "how much of the pie do I own" but rather "how big is the pie". According to Harvard Business School, "Financing Entrepreneurial Ventures": "The name of the game … is not to minimize dilution at each stage of a company's existence but rather to maximize the value of your share at the end of the process."

Control. Once a VC commits to invest a quarter million to several million dollars in the company, they are contractually obligated by the terms of their funds to ensure high returns on that investment. One way they do that is by being involved in company oversight. VCs will require that the company be governed by a Board of Directors and they will ask for a seat(s) on the board. For starters, it will likely be a "balanced" board with either 3 or 5 members. The entrepreneur usually picks themselves and maybe one other person to serve on the board. The investor usually picks themselves and maybe one other person. Both agree on one "outside" value added person. Note that many entrepreneurs mistakenly equate percent ownership with percent control, whereas in this model, all board members have equal voting rights. Also, board composition and number of members can change at each investment round.

Successful Exit. VCs are not interested in a long-term marriage to an entrepreneur and his/her company. In fact, investors look at a venture with an exit in mind. They work to build value in a company, but as soon as they can get a lucrative ROI, they want out. The typical life of a venture fund is ten years, so VCs would like to get their returns within about 3 – 7 years. An IPO (or initial public offering) is one option but this occurs infrequently. The preferred and generally easiest way to get necessary returns within that period, is if a successful small company is acquired by a larger company for a large sum of money.

Again, "the math" in Table 8 illustrates a good exit scenario. We'll continue with the example from Table 7 and assume that there is no further dilution in this hypothetical company and that the company is sold to an acquirer for $50M *seven years* after the seed investment is made. The entrepreneur, who has 51% of the Company exits with $26M. The seed investor exits with $6.4M. Since the initial seed investment was $250K, the value of the investment has multiplied 25.6X and the IRR (at seven years) is about 60%. The Round A investor exists with $8M and an investment multiple of 8X. The Round B investor exits with $10M and an investment multiple of 3.3X. IRRs for the later investments will depend on when exactly the investments were made but they should end up between 40 and 50%.

The bottom line is that everyone should be pretty happy with this exit outcome. The entrepreneur might retire in Bermuda or look to start another company. And the VCs have one less company to worry about and a good report for their limited partners.

Stakeholder	Investment	Final Ownership	Value	Investment Multiple
Entrepreneur Ownership	--	51.2%	$26M	--
Seed Investor	$250K	12.8%	$6M	26X
Round A Investor	$1M	16%	$8M	8X
Round B Investor	$3M	20%	$10M	3X
Total	$4.25M	100.0%	$50M	--

Table 8: Example of Successful Exit Scenario

It might be fitting to conclude the white paper at this point, but there's just one more thing.

VII. Venture Capital in Upstate NY

Upstate New York in Transition. Venture investing is not just about the entrepreneur and the venture capitalist. Venture investing also needs to be understood in the larger context of the community, in this case Upstate NY.

Our major cities, Rochester, Syracuse, Buffalo, and Albany have historically been big company towns, but in recent years, the downsizing of our major corporations e.g., Kodak, Xerox, Carrier, and GE has had a hugely negative impact on our regional economies. Now, there is a buzz about transforming our area into a high tech hub region by capitalizing on the enormous strength of our local R&D organizations, particularly our universities, i.e., U of Buffalo, U of Rochester, RIT, Cornell, Syracuse U, U of Albany, RPI, the SUNYs, etc. The formation of start-up companies based on new technologies emanating from our universities is being promoted. Along with that, many community stake-holders are calling for more venture capital to support their formation and growth, likely because the potential impact of venture capital is recognized.

"Companies that have received venture capital financing outperformed their industry peers - in job and revenue growth - during the 2000-2003 economic slump, according to a study to be released today by the National Venture Capital Association…Venture-backed companies generated 10.1 million jobs and $1.8 trillion in revenue last year, or 9.4 percent of all US private sector jobs and revenue. Job growth was 6.5 percent versus a 2.3 percent decline in US employment from 2000 to 2003. The revenue rose 11.6 percent compared with 6.5 percent nationally."

Sheryl Jean, Pioneer Press
"Venture-Backed Firms Out-Perform Peers", July 2004

Upstate New York's Track Record. Successful venture backed companies can potentially be significant economic assets to our community and venture capital is sometimes viewed as the

Region	$ Invest	%/Tot
Silicon Valley	$7,113	34%
New England	$3,063	15%
NY Metro	$1,453	7%
Southeast	$1,321	6%
San Diego	$1,207	6%
Texas	$1,097	5%
Northwest	$1,028	5%
LA/Orange County	$978	5%
DC/Metroplex	$866	4%
Midwest	$770	4%
Philadelphia Metro	$547	3%
Colorado	$444	2%
North Central	$422	2%
Southwest	$330	2%
Upstate NY	$117	0.6%
South Central	$108	0.5%
Sacramento/N.Cal	$48	0.2%
AK/HI/PR	$27	0.1%
Other	$2	0.0%
Total	$20,941	100%

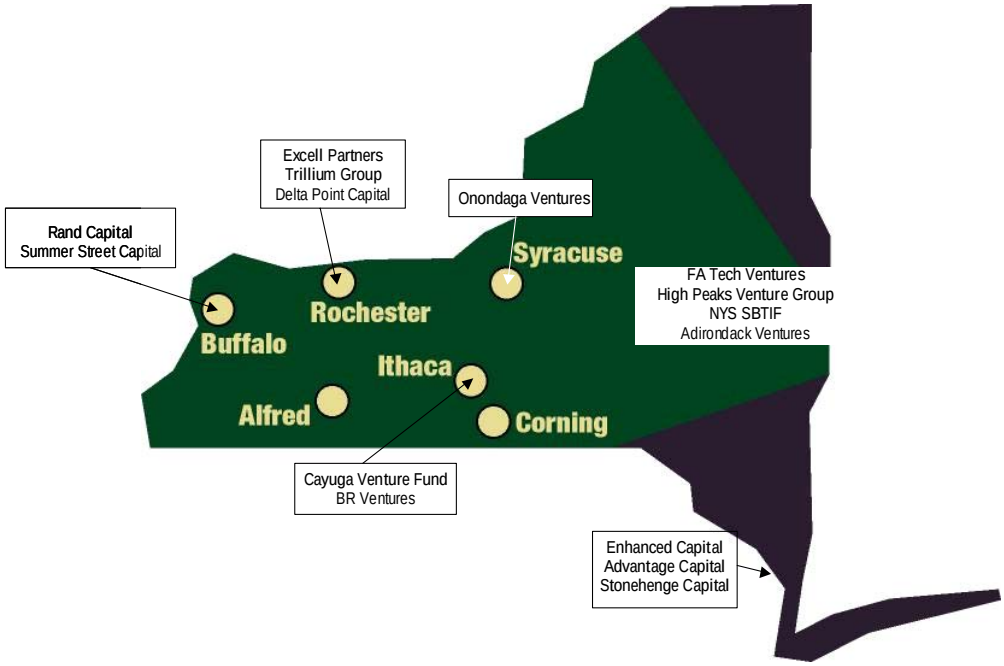
Source: pwcmoneytree.com

Table 9: VC Investments by Region, 2004 ($M)

magic bullet to cure Upstate's economic woes. However, historically our area has not seen much high-risk investing.

Table 9 shows annual VC investments by region. The total investment in 2004 was ~ $21B. As usual, one-third went to Silicon Valley. As usual, New England (which is basically Boston) came in second and NY Metro came in third. Southeast (which includes Research Triangle Park, NC) was fourth. Also, not surprisingly, Upstate NY was near the bottom. Upstate NY's share was ~$117M or .6%. And unfortunately, this is typical. Every year, Upstate is ranked near the bottom, at less than 1%. Even during the "bubble years", we held our relative position and percentage.

UVANY Membership. But things are changing. Last year, Upstate Venture Association of New York (UVANY) was formed. UVANY "seeks to advance the number, scale and quality of private equity investments across New York State. Working with entrepreneurs, companies seeking funding, private equity firms and professionals we strive to improve deal flow and facilitate greater availability of capital for all investment stages." Some of the members are shown here.



Keep in mind that venture investing is best played as a team sport. VCs don't necessarily see other VCs as competition. In fact, in Silicon Valley and Boston, most deals are syndicated with several VCs coming in on the "hot deals". If more venture capital is needed in the Upstate region, then first, our local funds must perform well. Most Upstate venture funds are fairly young. If local funds can provide the kind of returns that VCs and their limited partners are looking for, then the VCs will likely establish new funds to replace the exhausted ones and the limited partners will likely reinvest in those new funds, which could likely be larger than previous ones. Also, the establishment of successful fund track records will attract other VCs to the region and further ensure the flow of capital to and within Upstate NY.

VIII. Conclusions

It is difficult to be "all things to all people" in a white paper. This paper has focused on a particular segment of the entrepreneurial community, namely, high tech entrepreneurs with early business opportunities. As an entrepreneur begins moving his/her company forward and starts to think about financing, it is important that they understand their options, know the pros and cons, and apply their personal weighting system since a con for one person may be a pro for another. Venture Capital is one of the options. It may or may not be the right option. But if an entrepreneur wants to consider that option, he/she should be prepared for the conversation with a VC. It is very important that entrepreneurs understand the current investing climate and that they are familiar with the fundamental language and philosophy of venture investing.

This paper has attempted to inform entrepreneurs on some of the basic issues. It is not meant to be comprehensive in analyzing all of the issues and it stops short of explaining the more intricate elements of a deal, e.g., stock participation, liquidation preferences, options or warrants, anti-dilution protection, ratchets, triggers, carve outs, etc. Lawyers will get very involved in the specifics of structuring a deal and can be a valuable objective source of information regarding these issues. Or, maybe that will be the topic for another white paper. Also, this paper doesn't talk about later stage capital, i.e., Series B and C financing or mezzanine rounds. However, the "basics" still apply. Maybe a significant difference is that "the math" for calculating valuations actually works well for these rounds. Again, another topic for another time.

Finally, this paper tries to provide a community perspective. This is an exciting time to be in Upstate NY. Entrepreneurship is hot. Start-up opportunities are beginning to come out of the woodwork. "Everyone" is calling for more venture capital to support these opportunities. In fact, a serious infusion of venture capital might be essential to the survival of some. While starting a company can be very exciting, it is also hard work and typically emotionally intense and raising capital can be fraught with frustration and disappointment. Entrepreneurs with high risk, high potential opportunities might especially be in for a "wild ride". So, my final message to both entrepreneurs and the community is "be careful what ask for, because you might surely get it".

Happy venturing!

Excerpts from Related Articles

On Venture Capitalists:

From: Frederick J. Beste III, "The Twelve (Almost) Sure-Fire Secrets to Entrepreneurial Success" www.vcinstitute.org/materials/surefire.html

"Contrary to popular opinion, (VCs) are not totally worthless - they work long hours, sift through more garbage than a trash collector, and have to get used to disappointing 99 entrepreneurs for every one they please. They are veteran roller coaster riders, but never get used to those big drops. They are, above all else, risk reducers - they prospect in the land of the commercially unfinanceable, and try to differentiate the superstars from the merely enthusiastic. Most of them are pretty good at it, a result of lessons learned, mistakes made, and successes observed."

From: Frederick J. Beste III, "The Truth About Vulture Capitalist" www.vcinstitute.org/materials/vulture.html

"The investment turndown rate in this business is annihilating. Our little shop sees about 1,200 investment opportunities (charitably defined) per year. We invest in four to six of those. The resulting entrepreneurial disappointment (sometimes resentment) is, accordingly, massive; nay, near universal. Couple this with the heartfelt conviction of practically all entrepreneurs that their extraordinary, often industry record projected performance is, to use their word, "conservative" (put them on a lie detector and the needle wouldn't even quiver), and you don't make many friends. …. The end result is that venture capitalists often come off as incompetent and high-handed to teams they disappoint." …

"Obviously, it is my experience that there are great venture capital partners out there, certainly including us. You shouldn't take my or any other prospective investor's word for it, though. What you should do, in my opinion, are the following three things: 1. Check out their reputation ….2. Listen to your heart…..3. Talk to your peers...."

"Given the challenges and exigencies of turning dreams, blood, sweat, tears and money into market leaders, you should not be surprised to hear a story or two which gives you pause. Companies do fail; CEO's do underperform for extended periods of time and over the course of multiple rounds of funding, ultimately straining relationships with any investor. But you should be hearing a vast preponderance of comforting stories - stories of support, contribution, patience, understanding, mutual sacrifice, even friendship. If you do, you can be assured that your prospective outside partner is not a vulture capitalist."

On Venture Capital Valuations:

From: www.antiventurecapital.com/valuations.html

"You've found a potential investor after many months of searching. He appears to like your project and sees the potential for everyone to make some serious money on the deal. You

discuss your technology, marketing strategy, operational plan, and financing needs. You see eye-to-eye on practically everything. Then finally, when you are both feeling comfortable with one another, the question of valuation is finally broached. How much of your company are you willing to surrender in exchange for his investment?"

"That's when the "you know what" hits the fan—every time. In your best estimation, his money is worth 20% of your company at best. In his estimation it's worth 51%. In many cases, the discussion grinds to a halt at this point."

"No negotiating item between entrepreneur and investor creates a wider gulf than this one. The two parties may agree on every other point but will have diametrically opposing views on what the company is worth and how much equity the investor should receive in exchange for his capital."

"To put it bluntly, placing a credible valuation on a startup is impossible. Privately held companies on the sales block are typically valued at a multiple of their historical ODCF (Owner's Discretionary Cash Flow). ODCF is the cash that can go into the owner's pocket after all operating costs are covered for the year. Obviously, since a startup lacks any historical ODCF, which is the basis for an objective valuation, any opinions expressed on startup's valuation by the entrepreneur will be little more than wishful thinking."

"As a rule of thumb, this is what invariably happens when a startup is seeking seed capital. The entrepreneurs convince themselves, based on discounting future cash flows, that the company is worth today, say, $5 million. So, since they are looking to raise only $500,000 the investor providing that sum should be happy to settle for 10% of the equity. Then when they start talking with a serious investor, they discover that he expects 50 or 51% of the equity for his money."

From: Dana Callow, Michael Larson, "Understanding Valuation: A Venture Investor's Perspective, www.bostonmillenia.com/_documents/WhitePaper/WhitePaper Attachment6.pdf

"You have met with several venture firms, responded to countless due diligence inquiries, and a strong lead investor is finally emerging with intent to submit a term sheet. Only one task remains—establishing a valuation."

"At the core of every venture capital financing is a mutually accepted valuation of the company by investor and entrepreneur. A valuation reflects both the entrepreneur's determination of the acceptable amount of ownership that may be given in return for the venture firm's capital and expertise, and the venture investor's determination of the risks and rewards of the investment. This dynamic is often misunderstood—and with harmful consequences. Understanding valuation from the venture investor's perspective is crucial. Realizing how valuations are determined and adjusted throughout the life of the company is critical to the investor-entrepreneur relationship and the ultimate success of the company. ….Valuation methodologies differ by the stage of investment and the availability of quantitative and qualitative data."…

"Most seasoned venture investors will value a company within 10-15% range of each other if they have exhausted all quantitative and qualitative data available. Given the consistency that is generally seen in the market, the key factor in choosing one VC over another should rarely be based in valuation."

On How to Handle the Valuation Issue

From: www.antiventurecapital.com/valuation%20negotiations.html

"Submitting a plan to a venture capitalist or other investor with a pre-determined valuation for the startup is invariably an instant kiss of death. No one will even want to talk to you unless of course they have very good reason to believe that you seriously under valued your company. But as we all will admit, if we are honest, this never happens with founders."

"So the best advice that I can give you is not to enter any discussions by announcing what your startup is worth and what percentage of equity you are prepared to exchange for capital. Instead have an idea in your mind as to the absolute lowest valuation you would be willing to do a deal at and then keep quiet about that number and let the venture capitalist be the first to throw out a number."

On the Single Best Way to Maximize Valuation

From: www.antiventurecapital.com/valuation%20maximization.html

"Show that you have traction. Traction is defined as sales to bona fide *paying* customers. Nothing gives an entrepreneur better leverage in negotiations with investors than an upwardly trending sales graph over a period of six to twelve months. *Absolutely nothing.* Forget nonsense about business plans, elevator pitches, powerpoint presentations, and patents. Traction is the ultimate validation of your claims."