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General News

Three mistakes to avoid when taking other's money

By Adam Borden - **09.2008**

As a food industry venture capitalist, I come into contact with hundreds of food entrepreneurs a year. I review their business plans, listen to their growth strategies and very occasionally invest money in them. There are many reasons why I choose not to pursue a particular opportunity, but I notice three recurring mistakes among many entrepreneurs seeking growth capital:

1. They want money for nothing. This is to say that they want money without any strings attached. 'Give me a check but don't tell me how to run my business' sums up this school of thought. Alas, we outside investors pick your company over countless other investment opportunities precisely because we expect returns adjusted for the situation's risk. We expect you to deliver what you promise and are required to contemplate what happens if you do not. That typically means some sort of control over the business, and we would like you to listen to us at least occasionally.

2. They overvalue the company. With publicly traded stocks, checking the share price is as easy as looking online. Most small food companies, however, do not compare to the likes of Kraft or Pepsi and so should be valued very differently. Many entrepreneurs look at how much control they are willing to relinquish and base their valuation on owning at least 51 percent of the company after they take in outside capital (pre-capital value + cash = post-capital value). Others use public transactions as guideposts for their own situations, even if the brands purchased by Coca-Cola or Kellogg's were 20 times bigger (or more) than their own. Overvaluing one's company frequently results in either taking longer to raise the capital or having an unhappy situation at a later round when new investors tell the old investors the company is worth a lot less than they thought. Imagine having to tell your family and friends after selling them shares for $0.50 each, then $1.00 each, that their shares are really only worth $0.20 each. That kind of result happens when entrepreneurs take in money at the valuation they want without paying heed to what the company should be worth based on other comparable deals.

3. They need more money than they actually think they do. We all have seen our businesses go sideways instead of growing progressively more profitable at some point. Entrepreneurs must have financial resources to weather those storms or else they will go under. They should have a plan in mind of when next they will require additional funds but be sure to build in a contingency if the next round takes longer than expected or things don't work out quite as planned. Partnering with an investor whose deep enough pockets can write a check at that crucial moment is imperative for any emerging company.

For each of these rules, exceptions invariably exist, but they are just that--exceptions. Solving these three mistakes will not necessarily make for a foolproof investment, however doing so will get entrepreneurs a lot closer to being "in the money."

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