Special Report

Top 10 Mistakes That Cause Investors to Shoot Down Deals

You've written and rewritten your pitch, you've tweaked your financials and presented your idea to investors, but you haven't raised money yet. What went wrong? Why did the investors pass on the deal? This report polled several leading entrepreneurs, venture capitalists and investment bankers and compiled this critical list of WHY investors say no and how you can avoid these pitfalls.

Mistake #1: Your financials aren't what they should be

While the narrative slides introduce critical elements like your concept, the competition, and the team who'll be working on the project, investors are first looking for a return. So, the financial projections are the meat of the matter and many investors skip straight to the numbers to see if they are interested in a deal. Plans that show revenue exactly doubling or tripling each year show that the team hasn't fully thought out product and pricing details - a red flag to any potential investor. Other overly optimistic plans implicitly assume that the company can go from zero to capture 60% of the market in three years in a mature space. Still others make it clear that there is poor understanding of the cost structure needed to run the business as it scales. In any case, savvy investors spot these issues in a minute and send your business plan to the circular file. Make sure your numbers have been well thought out and are consistent with other industry statistics if you want your reader to think you're competent and capable.

Mistake #2: Business owners don't give themselves enough time to get their deal funded

Too many business owners think they can go through the funding process in as little as three months and think they have enough cash to get them through that time period. Get prepared and give yourself enough time to not only find the right investor, but for the investors to go through the due diligence process to get your business funded. Depending on the quality of the idea and the business plan, the average business deal takes 4-6 months to fund so your cash reserves need to be sufficient to get you through this period of time without an influx of new cash. Dan Frydenlund, CEO of Skyetek, said *"I often see unrealistic timeframes discussed around the board room or at happy hour. The usual statement I hear is 'I'll get a term sheet in 90 days and close it in 30.' Deals never happen that way, more so now than ever, which is why I start and end with the need to be brutally honest with yourself and others."*

Mistake #3: Your target market is too large and unrealistic

All business plans have to discuss the target market, but don't make the mistake of being too positive about or overestimating who is in your target market. A market that is too broadly defined is a "turn off" for an investor who already knows that the "$2.5 Trillion healthcare industry" is too large and completely impenetrable for any business effort. (Companies that say "If we just get 1% of this market, we'll be a billion-dollar company" think they are being conservative because they believe there is no number less than one. However there is: zero.). It's OK to mention an "overall market" as long as you quickly hone in on the more specific target market that your product or service will capture and reach. An investor will react more positively to a business plan that targets a well thought out, carefully determined market even if it's smaller.

Mistake #4: Not being realistic about your competition

Too many businesses say "we don't have any" when asked who their competition is. Even if you have a new product that creates a new product category, you still have competition. When search engines emerged there was no competition on the Internet, but Yahoo! and Google were competing against the local Yellow Pages. If your widget replaces some other item that people frequently use, then list all those companies as competitors. If your product creates a new product category, then think carefully about what products people might have bought instead and those products then become your competition, even if they don't compete with your product directly. Be creative and research competition extensively, as it's better to lay it all out on the table in advance versus letting the investor find it and make a fool out of you in the process. Credibility is a recurring theme throughout the investment process and it's better to be upfront about who else is out there rather than to try and sweep your competition under the rug. Don't forget that if you don't list any competitors then you are going to have to explain why no one else wanted to tackle this type of product offering. Competition validates the market. Then you need to show how you will win against them.

Mistake #5: Focusing too much on features instead of benefits

No matter what type of product or service you are looking to have funded, don't forget that the most important thing is *if there is a demand for that product.* Some entrepreneurs are so excited about their process in getting to this time that they tell all about the product (what it does, which parts are patented) instead of convincing investors that people are willing to pay for the product. In order to correctly evaluate this issue you need to discuss what demand your product fulfills and how. Be sure and underline the fact that your product or service not only satisfies a large unfulfilled demand but also describe the strength and history of how this demand level came to be and why now is the time to address it. Understanding the needs of a target market and outlining a plan to penetrate that market are essential elements to a successful pitch.

Mistake #6: Leaving out negative material information

Entrepreneurs often think difficult circumstances or problems (e.g. IRS issues, liens, or lender difficulties) should be excluded from discussions. It's understandable why they would shy away from broadcasting these problems when seeking funding, however we live in an age of transparency and most of our private lives are exposed on the Internet for the entire world to see. It's OK to not have such details in an initial presentation, but eventually they should be fully disclosed. Investors are not stupid and most of the time they figure these things out on their own during due diligence. It's better to expose whatever issues might be potentially problematic and *explain them on your own terms.* If you don't the investor may question your integrity or judgment. *"Many owner/operators, either through naivety or dishonesty, often believe things can be hidden until after a deal closes from either the investor or his own investment bank. They often believe the investment will take care of the issue 'so it will be all right in the long run' not realizing the depths and details involved in due diligence,"* said Andrew Hurry of The Yale Group.

Mistake #7: Businesses often incorrectly value a product or business.

One major issue with new business owners is that they aren't realistic about the level of risk involved for the investor and they don't understand how much of their business they'll have to surrender in order to get the funding they need. We see owners who are specialists in their area of technology or service but don't have the proper business background to correctly value their new venture. If this is you, be sure and consult with business experts who can help you in the areas of finance, marketing and business valuation so that your business plan will be as realistic as possible. *"Mapping out your financing strategy with reasonable increases in valuation based on real results is the cornerstone of a good business plan; the days of getting folks to believe in a huge pre-money valuation even on a great idea are gone,"* said Dan Frydenlund, CEO of Skyetek.

Mistake #8: Financial projections are unrealistic

Investments and valuations start with a company's projections for the future revenue from their product/service offering. If you have some track record, be sure and include that in your plan. If the business is a startup, obviously there are no past projections to evaluate and thus the project seems riskier to potential investors. Regardless of your situation, you still have to include realistic financial projections in your business plan and almost all new companies overestimate the number of widgets they'll be able to sell. The best way to craft your sales projections accurately is to start with solid, logical assumptions about who you'll be selling to, how vibrant the market is, what the market trends are and what your competition is able to sell in a similar time period to the same target market *"Oftentimes business owners believe they've created the next greatest thing and almost always overvalue their product, usually after a few beers,"* said Dan Frydenlund, CEO of Skyetek, who continued to say that *"very few look forward enough to understand the risks involved over the entire business lifecycle and their business plan has to be sophisticated enough to convince an investor to relinquish their hard earned money."* Make sure you consult with someone who's familiar with making these kinds of projections if that is not your area of expertise.

Mistake #9: Not having a realistic exit strategy

Many failed proposals lack an exit plan which shows investors how they can get their money back as the project matures. To develop an exit strategy, consider the financial and strategic value created if you execute the on the business plan. Know what EBITDA and revenue multiples prevail in the market today. Finally, do a cap table forecast so you can determine how much equity can be given up for a specific amount of capital, while making sure that all investors can make solid returns on a realistic exit strategy to increase the chances of getting your business plan funded.

Mistake #10: Not having a fully baked strategy

"Entrepreneurs are too quick to start the fund raising process," says Stephanie McCoy, a former venture capital partner. She continues, *"while it's understandable that you are eager to raise money, you'll spend more time in the process if you aren't fully ready."* Savvy investors have seen thousands of businesses and know what to look for, so if you can't answer fundamental questions about how you will execute your business and compete with competitors and translate that into financials, you'll never be funded. Your strategy must be complete, detailed, and supportable. This includes understanding what your core competencies must be, what aspects of your business you will outsource, how you will reach your customers, what important partnerships you need to form, how you'll manufacture, provide customer service, etc. These are difficult but essential questions to consider and answer. And once you have your strategic vision, this must be translated into the financial projections. Don't expect investors to patiently let you figure it out on their dime. Slow down, get it right and then you'll find success.

In conclusion, be realistic about what parts of the plan you can develop. Don't hesitate to hire a professional to help with your plan and create your financials. The more capable and experienced your partner, the more likely your business will be funded.