

DODGING BULLETS AND AVOIDING LANDMINES: THE CAPITAL PLANNING PROCESS

By: Newt Fowler, Esq.

Positioning your Company for Growth

The Capital Planning Process

For those companies looking for working capital or expansion funding, the business planning process is at best a nuisance and at worst an unnecessary distraction. To assist you in this process and help you avoid the common pitfalls which can impede your efforts, this outline focuses on a business plan designed to guide the capital raising process.

Like it or not, most companies fail to develop a plan capable of being financed due to one of several basic flaws:

- The plan is ***unintelligible, and fails to intrigue or excite*** the investor, either by failing to present relevant information, by presenting it in the wrong order, by inconsistent messages, or by providing too much material to be absorbed.
- The plan ***fails to demonstrate that the management team can successfully implement it***. Management talent ultimately drives investments and should be clearly established in the plan.
- The plan ***fails to demonstrate a clear, convincing execution strategy and associated operational focus***. Funding depends on a belief that management is ready to execute.
- The plan ***fails to simply and clearly communicate***. Investors will not work that hard to understand an opportunity. The path to an investment decision must be easy to follow. Investors look for reasons not to invest.
- The plan ***fails to demonstrate a clear planning process, and that the company is organized to execute on that plan***. The investor senses that the plan is merely a fund raising document and it doesn't demonstrate an ingrained commitment to shared focus and execution.

Why Now?

The first step in the planning process is to answer this question. Why do you need additional working capital? Why now? What is it that is triggering this discussion today versus 6 months ago or in the future? The first challenge is to be specific beyond the tactical:

- Fund development

- Hire talent
- Expand sales
- Implement marketing
- Acquire a target
- Fill a “pothole” from the past

Another challenge is to be specific about the “strategic”, by explaining the drivers behind these funding needs:

- Market opportunity has evolved for new/enhanced product
- Expand the bench of company talent for growth
- Take advantage of certain [describe] sales growth/channel opportunities
- Window of opportunity for shifting marketing/messaging for product
- Explain why a target acquisition is timely and necessary
- Describe why the past challenges are surmountable and how the lessons learned will accelerate new growth

How?

The Hook. You need a compelling description of your company that includes the important understandings in the critical areas of your business. A reader must immediately understand what you do, why it is compelling, and why your company will succeed.

The Line. The remainder of the plan should support and expand on “the hook” – focusing in a structured manner on

- Market
- Products and services
- Customers (Go to Market strategy)
- Competitive position
- Management and operations
- Financials and use of proceeds

Market. This section describes the market opportunity, the landscape you compete in, and the market drivers that speed adoption of your products. You need to cite third party sources that support your description of the market opportunity and provide market forecasts that support your predictions of a high-growth market. You need to relate these market drivers to product capabilities you offer and activities you actually see in the market. Finally, document the barriers to entry that will prevent competitors from eating you alive.

Products and Services. Customers buy products. Analysts track products. And investors and acquirers bet on products. Therefore, you absolutely and completely have to describe your products clearly and succinctly. Here is what you need to cover:

- A clear and brief overview of your products that articulates what the product does, the value it brings to customers, and why it is unique in the market
 - A description of the major components, capabilities, and benefits of the product or service
 - Your unique intellectual property:
 - How the technology is different from and similar to existing technologies?
 - How hard is it replicate?
 - Could it become "the standard" for the market? If so, how?
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- The status of product or service development
 - How the product or service will evolve over time, including a brief description of the features or skills that will be available in the future
 - If partners are required to deliver the product or service, the type of partners that are required and briefly provide examples of potential partnership candidates
 - An overview of how you currently implement- or will in the future implement - your product or service for customers. For products, this usually means building a professional services organization that follows specific implementation procedures
 - How your product or service is positioned and priced in the market
 - Sample case studies - if you have them - that describe the benefits of your products or services in the real-world

Most entrepreneurs love to rave endlessly about their products, service and technology and experience. It's better to make sure that your plan is crisp, clear, and concise so an investor "gets it".

Go to Market. This section describes how you get your products or services to customers. You must prove that your company has the ability to grow its customer base, that you can expand by sector or geography, and that you know how to put together an effective go-to-market team. You should cover:

- The Company's performance to date, including notable selling, partnership, and marketing highlights over the last 6 to 9 months
- The sales strategy going forward, including the use of direct and indirect channels as appropriate
- Sales goals by channel for the next 12 to 24 months
- How you currently organize your selling efforts and how this will change in the future
- The types of people you have on staff - and will recruit - to execute your sales strategy
- How you use - or will use - indirect channels to bring your products or services to market
- The marketing programs you expect to execute to help acquire new customers and influence the market

Competitive Position. This section takes the market you described in the Market Overview and describes it from a competitive point of view. This section describes:

- The major competitors in the different market segments where you compete, including who is there now, who is entering, and who could enter but has not
- The major competitive groupings that define the competitive dynamic in the market (e.g. serving large vs. small enterprise; direct vs. indirect, etc)
- The main competitors, how large and established they are
- The primary strategy/orientation of each established and new competitor entering the market
- The alternatives and substitute products and services available to customers
- Winning against the most important competitors - both in terms of classes of competitors and perceived direct competitors that can take money out of your pocket

It is very tempting to either trash your competitors large and small alike or to be dismissive of their competitive risk; after all, your offerings and approach are obviously better. It's also tempting to describe them in such excruciating detail that investors and buyers run screaming in terror. The best approach is to create a high level, SWOT-oriented view based on more on facts. Here are the rules you should follow:

- **Be fact-based** - Investors and acquirers will have their own sources of competitive information, which could be better than yours. You need to be credible.
- **Establish key competitive differentiators.** Provide a factual description and comparison of the competitors. Distinguish what differentiates your products or services from your competitors.

Management and Operations. This section details the major tasks that must be accomplished to drive your business. It highlights the capabilities of your management team and possible additions needed to execute your plan, specifically:

In Operations

- Describe the major milestones and tasks anticipated over the next 18 months, and how will they be accomplished
- Outline the employees required to accomplish these milestones
- Identify the partnerships required to accomplish these milestones
- Recognize the obstacles to be overcome to meet these milestones

In Management

- The key management personnel and their backgrounds. Present biographies (less is more) that are accomplishment and experience focused
- The Board of Directors and/or Board of Advisors and their backgrounds
- The professional advisors the company has retained

- Key future hires, if relevant

Financials and use of proceeds. This section contains financial projections, major assumptions, and uses of funds. Enough information should be provided for investors to understand the financial plan. Avoid overloading the investor in financial detail, more information will come from additional requests. Generally, the following financial information should be included:

- Actual financial results
- Projected annual financial results for at least 3 years, including an income statement, a statement of cash flow and a balance sheet
- Material assumptions that drive these projections
- Required capital and primary uses of funds

There are a series of pitfalls facing the financial projection process:

- Different investor categories have different return on investment objectives; balancing the need to meet those objectives with credible financial forecasts is a challenge – how to make the numbers significantly exciting but realistic enough to be achievable – remember if you can't achieve your numbers, in many circumstances, the investment structure may reset – this is truly one of the hardest “high wire acts” in developing a credible business plan
- Be prepared to defend your assumptions to a prospective investor – this in part deals with the first issue outlined above, but also demonstrates management's understanding of their own business, market and financials... Missing a key assumption or failing to properly model it can kill a prospective investor's interest quickly
- Ensure your revenue projections are realistic given the size of your market and the competitive landscape – the focus here is on whether the market share projected is reasonable
- Make sure your assumptions, particularly costs, model comparably to your competition, or if not, be ready to defend why the difference is supportable – industry norms are such for a reason
- Make sure you have modeled high, medium, and low scenarios and be ready to defend why the one you selected is the most probable
- Test your financial plan with advisors
- Make sure your financial projections are consistently presented in all investor material – you would be amazed how many companies show differing models to the same investor

The Sinker...

All well and good. But now, the process begins again as you focus on what type of investor is most likely to be attracted to your opportunity, and, equally important, what type of investor are you willing to take on...

- How active an investor do you want?
- What experience do you seek?
- What types of controls are you willing to concede/agree to?
- What track record does an investor have with other portfolio companies?
- What transaction structure are you willing to provide? Debt? Equity?
- What economic rights are you willing to grant? What preferences? Options? Management transfer restrictions?
- What valuation is reasonable to expect? Will this valuation vary by size of offering or type of investor?

Sounds fairly consuming and exhausting, doesn't it? It is.

If you need assistance in the capital planning process or with other business transactions, please contact Newt Fowler (at 410-727-6683 or nfowler@rosenbergmartin.com) or another attorney in our business transactions group:

Brian Cyr	bcyr@rosenbergmartin.com
Sedica Sawez	ssawez@rosenbergmartin.com
Michael C. Hardy	mhardy@rosenbergmartin.com