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Austin Business Journal

From the March 28, 2005 print edition

Funding 101

Following tech bust, companies must be on solid footing to capture interest of private investors
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Not so long ago, it was as easy to secure venture funding in Austin as it was to find a rhythm guitarist. Times certainly have changed since the days of the bubble, but capital is still out there for those bold enough to look for it.

"Funding is not as crazy as it once was, but there is still lots of funding available for good companies," says David Gerhardt, managing partner of CapNet Ventures, a local firm that provides a range of services to help companies build their businesses.

One of the most intimidating hurdles an entrepreneur faces is raising start-up capital. But the process can be made less daunting by simply understanding the basics of funding.

Funding plays a vital role throughout the life of a business, and venture capitalists stress the importance of understanding the stages of business growth to determine the appropriate source of capital per stage.

"A company's growth and eventual transition from stage to stage often corresponds with its success in developing its business, selling its products and gaining revenue," says Bob Martin, CEO of JumpStart Partners Inc., an Austin-based merchant bank that focuses on mergers and acquisitions.

The first growth stage of a company typically involves concept and product development. This is when seed capital is sought.

"At the seed stage, people are looking for capital as they're coming out of the garage with a great idea," says Jim Hoover, managing partner for IDM Partners, a local company that provides seed stage capital to proven entrepreneurs.

At this early stage, the "three F's" -- or "friends, family and fools," as they are affectionately known in the venture capital community -- are the primary sources of funding. This level of funding can raise anywhere from $5,000 to $100,000.

"I've seen a number of companies started with MasterCard and Visa. Friends and family can provide the earliest capital when an entrepreneur has an idea, but it hasn't necessarily been validated or proved in the marketplace," Gerhardt says.

As an idea progresses into a true entrepreneurial venture, investment is sought from "angels." Not the kind with wings, but the kind with money.

Angels are usually professional investors or retired executives with significant business experience and money to invest. By providing funds to emerging entrepreneurial ventures, angels can serve as a bridge between the self-funded stage to the level of business necessary to attract venture capital. Funding levels from angels range anywhere from $50,000 to $2 million.

"Besides wanting to make money -- which they do -- angels invest because they once had an advisor that helped them when they were starting up, and they want to give something back. And, they love the game," Gerhardt says.

When a company matures and is ready to launch its product, venture capital is sought. Venture capital investments typically range from $500,000 to $5 million. In some cases, they can go as high as $20 million. In addition to bringing in investment money, venture capital firms also can provide an infusion of business expertise and the right connections to help a business take off.

"Venture capital firms are professional investors managing other people's money," Gerhardt says. "Typically, they raise a pool of money for seven to 10 years. Their goal is to find very high-growth companies, invest money, grow the companies and divest."

"A person seeking venture capital must be ready to give up equity. Usually 15 percent to 40 percent of equity is 'sold' per round of venture capital," Martin says.

Finally, in a company's "maturity" and "decline" stages, private equity comes into play.

Private equity is capital invested in private companies.

Investors in private equity deals generally expect a return on their investments through an initial public offering, merger or re-capitalization.

"Private equity money is capital that is flexible. It can be used for things like recapitalization of a business, a management buyout, or to spinout a division," says Peter Huff, co-founder and managing member of Blue Sage Capital. Blue Sage Capital is a private equity firm that buys out or provides growth capital to established small and midsize companies.

By simply understanding the distinct types of entrepreneurs and the specific amounts of funding one can expect during a business's start-up, growth and maturity stages, getting funding can seem to be a less-daunting task.

"I often hear about entrepreneurs frustrated because they've approached some angels and expected $10 million. Angels typically don't do $10 million rounds of capital," says Laura Kilcrease, managing director of Triton Ventures, a local venture capital group that focuses on spinout companies.

Kilcrease also advises that it's best to make sure your interests match those of the groups you approach for funding.

"If you have a biotechnology company, there's no point in going to someone who only funds semiconductors," Kilcrease says.

But no matter what funding you seek, professionals advise entrepreneurs to be ready to give something to get something.

"Raising equity money is like getting married. You're bringing on a partner, so you need to be willing to work with that partner. You need to be willing to be part of the team, even if that means you're no longer running the show," Gerhardt says.

But along with his cautionary advice, Gerhardt also encourages entrepreneurs to go for it.

"Texas has a very good entrepreneurial climate," he says. "There are good resources here and a lot of smart people. It's a good time to start a company in Austin."

Jason Meeker is a freelance writer.