



**Taking Outside Capital: a decision matrix: considerations that entrepreneurs/
business owners should evaluate when considering taking capital from outside partners**
by Michael Burgmaier T'01

Thinking about taking outside capital for your venture? Here are some considerations:

1) **Do you have the right business and model?** By and large, venture capital and angel investors look for certain characteristics in companies in which they consider investment:

- **Strong gross margins:** Sustainable gross margins, typically north of 50%, suggest the company has a non-commodity product/service. Strong gross margins allow a company to fund growth, in part, from operating cash flow.
- **Scalability:** Scalable businesses are those which can make something once, but sell it many times: they use capital efficiently. Non-scalable examples include custom or most service-oriented businesses (make once, sell once).
- **Sector growth:** Investors like to make bets on large, fast-growing markets (or those anticipated to be so). Technology and certain consumer products sectors tend to fit this profile.

2) **Are you prepared for an active/involved business partner?** Most venture capital funds and many angel investors/groups are active, rather than passive, investors. While these investors don't wish to run your business, they often seek board seats, structure (through preferred stock agreements) approvals by the investors for certain decisions and expect to be valued and treated as partners. If you choose an active investor, make sure it is a value-add investor and one you can trust and will want to have working with you.

3) **Be ready for candid discussions about your role.** Often, investors will directly address issues which could be emotional ones for founders—whether a company's current senior leadership can adequately meet the needs of the business and, if not, how to address transition to augmented leadership/management. The management needs and skills for a growing company (especially from startup) change dramatically over time; a founder may often not be the best person to run the company for the long term. Investors must do what is best for the company and a founder should be intellectually and emotionally prepared to shift into a different, often more narrow role.

4) **Are you prepared for an exit/liquidity event?** All VC and most angel investors expect to seek repayment of their investment within a 4-7 year period. VC investors, in particular, expect management to prepare for exits from the first day of investment (actually, before investment). If you are planning to maintain a lifestyle business with no intent to exit, it is best to avoid outside investors.

5) **Understand pricing and terms:** Most entrepreneurs are surprised (shocked, angry) to learn how an outside investor values his/her business. To better manage expectations, understanding the valuation processes can be helpful. Entrepreneurs should know that investment structure (terms of the preferred stock) can often be more important than valuation when it comes to dividing up the pie at exit.

5) **Entrepreneurs are optimists which is why I like to be around them. The best entrepreneurs plan well and are realistic:** Whether in relation to valuation/dilution, your company's growth rate, your role or the time it will take to complete a financing, it is important to properly set your expectations about the odds, work, time and process required to complete a transaction. If you are in a difficult (cash crunch) situation, your credibility and negotiating power with outside investors will weaken: plan ahead, research the investment process for a given investor type (VC, angel, etc), and be conservative in your assumptions so that you have room to over perform (higher revenue, lower cash burn etc).

Getting money for your company is great, but don't forget the important elements of getting the right amount from the right source at the right terms.

Michael Burgmaier (T'01) is a Principal at [CFI Community Ventures, Inc.](#), a Portland, ME-based venture capital fund.