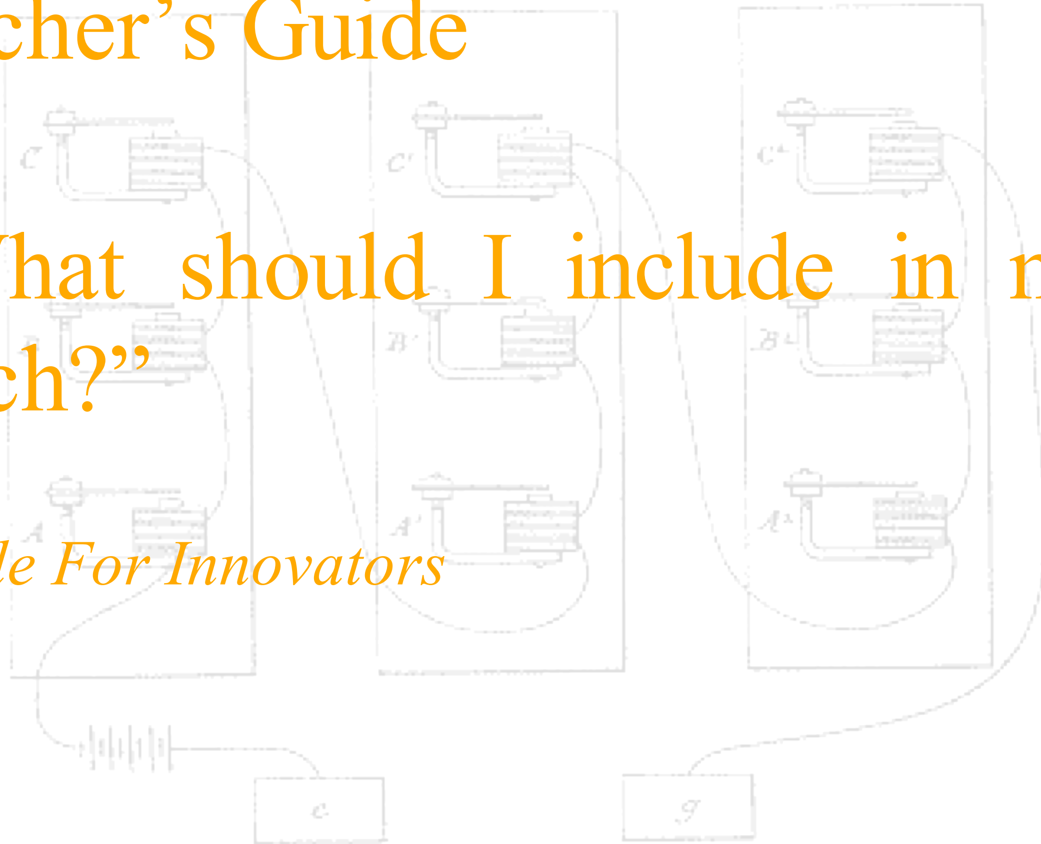
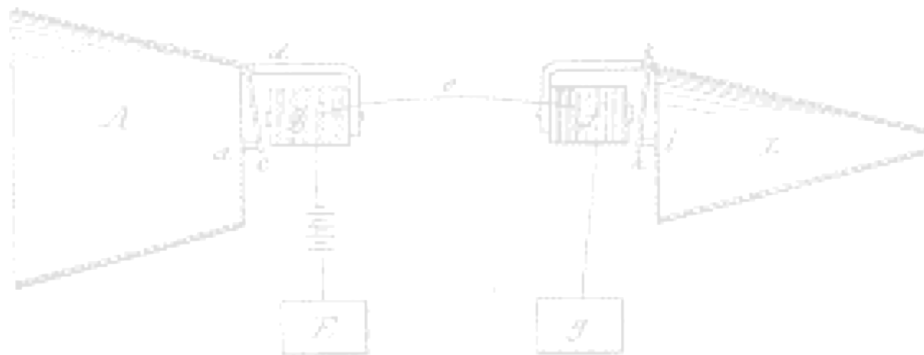
Pitcher's Guide

"What should I include in my pitch?"

Guide For Innovators





© Canadian Innovation Centre, Canadian Broadcasting Corporation, 2006

Making the pitch

Proposing a reasonable deal to investors is very important as it shows potential investors that not only do you have a good understanding of what the business needs but that you also understand how to provide an adequate return on their investment for them. Specifically investors need to:

- Understand and support the innovation, business model and market opportunity.
- Believe that you have the capability to implement the business plan and scale the opportunity.
- See how the value of the company will grow by a significant factor (usually more than 10 times).
- See how their invested dollars can ensure that they get their required return – their focus is thus on company valuation and not revenue or even profit.
- Believe that they can work with you in the long term and possibly provide some additional input to improve the quality of the resources available to the business.

Canadian Innovation Centre

What should I be prepared to cover

Raising capital is not only expensive (both in terms of the cost of the time and other resources spent raising the capital and in terms of the equity you will be required to give up) but is also challenging. It requires an assessment of how much you need and how much equity you should be willing to give up for it. It is comprised of three important aspects:

- What is the product? What does it do? Why will people buy it?
- How did you come to invent it?
- What experience or qualifications do you (or your team) have that will provide confidence that you have the ability to manage the business?
- How will you make money with this product? How much does it cost? How much will you sell it for? How much will you have to spend on other things such as marketing?
- How will you make sure it is difficult for people to copy you, once they have seen it on television?
- What are the similar products exist that show your product or service can be successful? If relevant, how will you compete with these products?
- How close are you to being able to sell the product to customers? Have you already sold some or do you have commitments from future customers? Do you still have to do some development work?
- How will you get your product to customers (direct, distribution, through licenses)? Do you have any interest from distributors or others who might help you market the product?
- How much money are you looking for? Exactly what will you do with it?
- What additional help do you need to be successful? Is there anything particularly that you feel a Dragon can bring to the table (in addition to money)?
- In addition, the negotiation must come to a conclusion that both parties can live with in the long term and more importantly, become the basis for a long term partnership. This is not an easy challenge.

We outline some thoughts and ideas to develop a process which both parties can agree to, which might lead to this type of relationship. In fact in many cases, sophisticated investors observe how inventors govern themselves during negotiations as a way of evaluating their ability to deal with complex business issues they will face in the future. It is always important to remember this as you move forward. The skills of an inventor and an entrepreneur are very different and if successful, there will always be some point at which the invention becomes bigger than the inventor. It is just a matter of when.

Three stages of negotiation process

1. It is first important to decide how much you need, whether this is to complete development, provide product to a first customer or establish a distribution channel. The amount required should include a significant contingency in case things take longer than expected or cost more than expected. (In our example following we will assume this amount to be $250,000).
2. Understand your role in the long term control of the business. If you are an inventor and have little interest or understanding of running a business, then you may chose a limited advisor or board member role. If you are a technologist, then you may wish to play a long term strategic role as VP technology. If you are "Presidential material" then this maybe your long term goal. Each of these decisions will have an impact on your level of control of the business. (For this case we will assume control exists when you own 50% or more of the equity and that you are not willing to give this up until you have raised at least $750,000 in two rounds).
3. Agree a basis for valuing a company. Although this sounds like it should be easy, there are very little hard and fast rules on this and it is very difficult to do. The simplest way to value a business is to take net present value of the expected profit, assuming that growth will stabilize within 5 years. However if you are at the pre-revenue stage, the level of uncertainty around all these numbers is so great, that this becomes meaningless. Valuation based on revenues in the future is equally flawed as is accumulated expenditure already made in the company. Sophisticated valuations can be done by an expert, but we provide an alternative approach for use in deal negotiation, which we have found to be useful. (As a general rule, most pre-revenue companies that have significant growth potential are worth more than $500,000 and less than $1 million, in our case we will use a valuation of $750,000).

¬ The value of a company is based on its proven ability to generate profit. Further profit this year is seen as having more value than profit next year. At the early stages of a company's growth, the potential profit is usually quite uncertain and at some time in the future. This translates to a low current value. As a result, investors will want a significant portion of your company, for even a relatively small investment. This makes it a very expensive time to raise money.

¬ If you raise too little money, you are likely to run out of money between milestones and be unable to raise additional investment. This will leave you and your investor with either a worthless investment, or one where the value drops enormously. However reaching such a milestone successfully, allows you to justify an increase in company valuation (partly because you are nearer to making money and partly because the risks are reduced). At this point you will have to give up less equity for the same amount of money.

CanadianInnovationCentre

Avoiding the valuation question altogether – Convertible debentures

If you understand that you will be able to raise additional funds at the next milestone, then, you need to ask for enough money to get you to the next milestone.

If you are moving through the development cycle, then you need to ask for enough to complete the development phase.

If you are moving to get the first customer, then you need to ask for enough to get the product to the first customer (and if appropriate support it there).

If you are moving to get ca channel partner signed, then you need to complete this document and get a firm order in pace with commitments on volumes and resources (letters of intent don't help much at the valuation stage).

Detailed budgets of the time, steps and costs to achieve this should be included.

Based on experiences of hundreds of innovators, we usually apply the "Rule of ∏" to all timescales and budget costs. That is everything will take 3.142 times as long as you expect and cost 3.142 times as much. Come up with realistic numbers which you can justify, ten build in some sort of contingency to make sure you do not get stranded between milestones.

Other information

See notes on "Company valuation and how much you will have to give up."