



Article 18

February 3, 2008

Picking Your Investor is like Choosing Your Doctor

By Tom Stephenson, Managing General Partner, Verge Fund

Entrepreneurs just starting out will often view all sources of capital as identical – money is money, right? However, as we have learned previously in this series, there is great variety in the sources of capital available to entrepreneurs. The primary distinction that has been highlighted so far is the difference between debt – borrowing money – and equity – selling a piece of your company. However, the specialization continues even within the equity world, generally denoted by stage of development and area of focus.

This specialization is not unlike what occurs in the medical field. The cardiologist you might see for heart disease has very different skills and training from the oncologist you might consult to treat cancer. Venture capital has similar specialization, and just as a pediatrician would not be appropriate to treat an adult, a “seed” stage investor is very different from an investor that provides expansion capital. As an entrepreneur, you need to pick the financial partner that fits your stage of development and your particular industry.

For example, the Verge Fund focuses on “seed” stage investing. Some believe this means we invest in agribusiness, but it actually has to do with the stage of development of an opportunity when we make our first investment. “Seed” stage refers to the time when the idea is just germinating and has not yet grown into a full company. Often this means companies that are at the earliest stage of development – sometimes before they are even generating revenue.

How do you know which stage is right for you? While there are many different terms used to describe the various levels of equity financing, all fall close to the following:

- Seed stage venture capital - investments less than \$2 million in firms with no revenue or just receiving their first revenue
- Early stage venture capital – investments of \$3 million to \$5 million in firms with revenue but that are not yet profitable
- Later stage/expansion capital – investments of \$5 million to \$20 million in firms that may be profitable with substantial revenue
- Buy-out – Investments over \$10 million in mature and profitable firms with revenue greater than \$10 million

Instead of – or sometimes in addition to – specializing in stage of company development, many venture capital firms focus on industry or geography. Psilos Ventures, a firm that has recently come to New Mexico, only invests in later stage healthcare companies. You would not want to approach Psilos if you had written a new software program to track farm and ranch inventory, any more than you would go to see a heart surgeon for cancer treatment.

While it is not possible to list all the areas of specialization among venture firms, it is usually easy to figure out what a firm’s specialties are by doing some basic research. Almost all venture capital firms have web sites that describe their areas of investments. Individual investors can be harder to research, but a few direct questions early in your first meeting will make sure that you are not wasting time.

Just as all doctors have basic medical knowledge applicable to all areas, all investors have capital to invest and similar basic abilities to evaluate opportunities. In each case, however, they concentrate primarily on what they know and understand. Your job as an entrepreneur is to find the right capital “specialist” – the firm or individual who invests at your particular stage of development and in your industry. While it might seem that a shotgun approach to financing would yield better results, you will actually improve your chances of success by researching potential sources of capital carefully, and making sure that the firms or individuals you are targeting do, in fact, invest in companies like yours.

Finance New Mexico is an initiative of the New Mexico Small Business Investment Corporation (NMSBIC), New Mexico Small Business Development Center (NMSBDC), Empowering Business Spirit (EBS), the New Mexico Venture Capital Association (NMVCA) and other partners to assist individuals and businesses in obtaining skills and funding resources for their business or idea. To learn more about resources available to New Mexicans, go to www.FinanceNewMexico.org.

