

Finding Funds for Your Business 101

No argument. It takes money to make money.

The issue really is: Whose money are you most likely to source and use to make money, and at what stage in the growth and maturation of your business?

Yours? From your savings or your credit cards?

Money from friends and relatives with your promises to pay it back someday, hopefully with interest?

From the sale of shares? In this case, the timing of the investment is everything. Earlier stage investors will expect the management to keep some skin in the game and not cash out. In middle to late stage investing, it is more common to see shareholders sell shares as part of a compensation package.

How about an IPO in the early going? Is it worth the risk and can it be done as a practical matter? Are IPOs even possible? What about mergers and acquisitions? Generally, there are two markets, private or public equity, to raise capital and/or cash for a successful idea or early-stage venture.

Or, can you borrow it from a bank or the government (through the Small Business Administration) using collateral?

Raise it from the sale of shares? From “angel investors,” typically accredited investors (e.g., doctors, lawyers, successful business people) who are interested in investments?

From a venture capitalist in return for a chunk of the business later?

From strategic investors who might find value or potential in your product or business idea?

In the 1980s there was a wave of mergers and acquisitions (M&A) and industry consolidation; in the 1990s, we saw more initial public offerings. But more recently, the Sarbanes-Oxley business reporting legislation and the increase in private equity have forced the migration from IPO to M&A. Both approaches remain possible, but are dependent on market conditions, and in these instances, professional advice is worth everything you spend on it.

The M&A climate in travel and hospitality technology remains active and robust, and consolidation should continue. Private equity activity is on the rise given interest in up and coming players like ITA Software and G2 Switchworks. IPO success favors B2C over B2B firms, given the latter's more limited and defined market opportunities.

If it's a small store, pre-revenue business start-up or something of the sort, the first approaches are probably preferable. Those who'll put up seed money often are called “angels,” affluent individuals who provide capital for business start-ups, usually in exchange for an equity stake. Unlike venture capitalists, angels typically don't pool money in a professionally managed fund. However, angel investors often organize themselves in angel networks or angel groups to share research and pool investment capital. Unlike a partner, the angel investor is rarely involved in management. Angel investors can usually add value through their contacts and expertise.

Generally angels want less control of the company and a slower return on investment, however the criteria for investment are likely to be similar. Angel investor groups are great sources of private capital and frequently invest in new companies.

But if we're talking serious money for a continuing, revenue-generating venture, fund-raising gets a lot more serious, and might require professional assistance from an investment banker. It's far more likely you'll need to be talking to a commercial bank, the Small Business Administration (SBA), a venture capitalist, an entrepreneurial foundation or a strategic investor. When you do, here's what to expect, and what will drive the price you're likely to have to pay.

A bank or the SBA may want collateral such as your house (which makes it a secured loan). Banks, the SBA and similar institutions will expect interest. These tend to be very conservative sources of capital.

A venture capital company typically will want its money back, a return on its money and a share of the business to sell later on. Venture capital companies will take greater



risks in return for greater rewards.

Early stage venture capital companies provide capital to startup ventures or small companies that want to expand but lack access to public funding. They'll invest before there is a real product or company organized, or might provide capital to start up a company in its first or second stages of development.

Growth venture capital firms typically provide capital to companies that have reached the emerging growth and expansion stage, enabling them to grow beyond a critical mass to become more successful. Generally, these companies have a management team in place, proof of product or concept, and an organized sales force.

Traditional venture capital companies are typically partnerships capitalized by large institutions, such as private or public pension funds, major corporations or insurance companies. Traditional venture capital firms historically fund less than 1 percent of all companies seeking assistance. Many traditional venture firms focus on existing companies with considerable growth potential, or on the leveraged buy-outs of strong companies.

On a travel and hospitality technology industry-specific basis, it appears VCs have an even higher level of interest than they did earlier. Continuous technological advancements in the way travel companies utilize the Internet, meta search engines, distribution channels, tour/travel packaging and reservation systems, have led to innovative products for both travel suppliers and consumers. Recent investments by the VC community indicate that growth in the travel technology market is vast.

Strategic investors provide companies with know-how, technology, management skills, marketing techniques, intellectual property, clientele, distribution channels and a vision, a focused sense of direction. Very often, they'll have the greatest interest in acquiring your business, and its technologies if the product is successful and complements the investors' interests. Strategic investors will typically expect certain rights, such as right of first refusal on the future sale of your business. This can be problematic for the future valuation of your company and has to be dealt with very carefully.

Roughly, the more speculative your idea or proposal, the more costly and difficult the money-raising will be; the scarcer the sources

and the tighter the terms. Venture capitalists typically take the largest risks. Next-stage private equity groups typically want significant ownership and control over your business.

If you have a unique idea, patent, market niche or client base and have momentum, perhaps the odds are in your favor. That's when you need a professional advisor to help chart a reliable course through murky and complicated options. A registered broker/dealer investment bank can be a good option to consider under these circumstances. This approach usually means the institution will require an upfront retainer and take a success-based fee keyed to the transaction, and warrants in your company in return for obtaining the money you need at the best possible valuation and terms. The capital raised, equity interest sold, valuation and other terms and conditions will be negotiated by the investment banker on behalf of the client as part of the deal.

Credit Suisse recently said, "Capital will be available for companies targeted at reducing inefficiencies, driving down costs (technology enablers) or targeting an attractive niche."

Capital availability, and how much at what kind of a price, is dependent on the stage of the company, but generally, conditions are more favorable to those who have management with deep operational expertise, industry experience and key business relationships; a firm business plan and reasonable financial model (no hockey stick estimates); a unique or distinct product and/or service offering; a rapidly growing industry; a potential exit strategy and a positive financial condition.

Those who will be less attractive candidates will be those who fall short in developing and operating to a business plan; lack a sales force; and who do not offer a unique or distinct product and/or service.

The money is there for investment in travel and hospitality technology, and all of the traditional sources and transaction mod-

Who's Getting the Money

PriceWaterhouseCoopers, in its annual report on venture capital spending, said VCs invested \$21.7 billion in 2,939 deals. Funding for later stage companies rose to \$9.7 billion. The number of companies getting venture capital for the first time increased to 901 (a four-year high). Hot sectors include the wireless sub-sector of telecom (four-year high of \$1.3 billion) and first-time investing in Internet-specific companies across all industry categories (nearly doubled to \$840 million), with 2005 fourth quarter investments totaling \$5.1 billion in 709 deals, down from \$5.4 billion in the third quarter of 2005, but in line with investments levels over past 14 quarters.

The report further stated that "entrepreneurs in any area can look forward to a more receptive, though no less demanding, market for their ideas. This positive environment is reinforced by the fact that VCs are doing more new deals again. While continuing to manage risk by investing heavily in late-stage companies, the venture community is filling the pipeline again by doing a growing number of first-time transactions. This is obviously good news for entrepreneurs."

The funding climate in general, as it relates to travel technology is active in U.S., India, China, the United Kingdom and Canada. Valuations continue to be higher for B2C versus B2B firms, given the more significant potential of the former versus the somewhat more limited and defined markets of the latter.

els can be used, depending on the company's stage of development and maturity. The price of the money—or the conditions an investor might impose—will vary with the state of the market, the potential of your idea or the strength of what's already set in place. The market is active, the interest is there and the continuing influx of new ideas, new approaches and advancing technologies should keep it that way for some time to come.

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