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Considerations in Raising Venture Capital for a Biomedical Company

The World's Awash in Liquidity

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We often hear the phrase "the world's awash with liquidity." Thomson Financial reports that for the first six months of 2007, approximately 2,300 U.S. firms invested $86 billion in private equity. But getting a piece of that capital for your biomedical enterprise can be tricky, so we would like to offer a few hints on the best way to approach the VC market.

Let's say you're a successful biomedical entrepreneur (you probably are) and you need to raise $20 million to finance your firm to its next major milestone. How do you get your $20 million? First of all, you have to target the right set of firms. For our purposes, we can focus on the 1,600 VC firms shown in Figure 1, which constitute about 70% of all private equity firms. And of the 1,600 firms, only about 600-700 are actively investing.

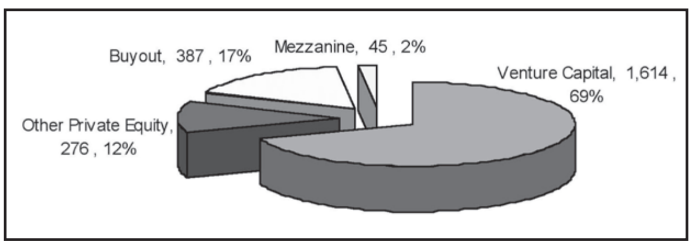

Figure 1. Private Equity Firm Investing Capital
Analysis: FairView Advisors Data Source: Thomson Financial

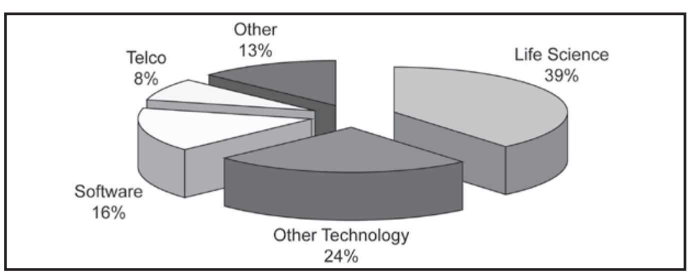

Figure 2. VC Investment
Analysis: FairView Advisors Data Source: Thomson Financial

VCs Invest Over $20 Billion per Year

VCs are still investing a lot of money. Other than during the bubble years, venture firms have been investing about $20 billion per year since 1998 and appear headed for about $30 billion in 2007.

As can be seen by Figure 2, life sciences accounted for 39% of funds invested during 2007 year-to-date, involving approximately 250 firms and an estimate of $12 billion total for 2007. These are the firms you should be targeting.

Fund Raising Basics

Fund raising takes a great deal of time because venture investors employ a very fine sieve. In order to maximize one's chances of success, careful planning and execution are mandatory.

Plan on at least six months to raise funds. Try not to raise money during the summer months, or add two months to the time line if you do. Make sure you're raising enough money to accomplish key milestones and reach another value inflexion point. Otherwise, you may have to seek more funds at a lower valuation, further diluting your current investors.

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Compelling Marketing Materials

An important part of raising money is having effective marketing materials. Many entrepreneurs make the mistake of thinking their business plan is a satisfactory marketing document. It's not.

There are three key elements to compelling marketing materials: 1) a company "Teaser," 2) an Information Memorandum, and 3) Management Presentations. Assembling and completing these marketing materials can take 1-2 months.

Company Teaser

The Company Teaser is a 2-4 page summary description of investment highlights, technology overview pre-clinical or clinical results (if any), market potential, management team, and financing history. The Company Teaser is critical because VCs receive so many investment solicitations they only have minutes to scan each proposal. Unless you capture their imagination quickly, it's a lost cause. The Teaser should be designed with graphics, charts and bullet points so VCs can quickly determine if your company meets their investment criteria.

Executive Summary
Investment Highlights
Financing Summary
Business Description
Overview
Technology
Products
Sales and Marketing
Manufacturing
Facilities
Management and Advisors
Market Analysis
Competition
Intellectual Property
Business Strategy
Historical Financial Information
Projected Financial Information

Table 1. Information Memorandum Key Elements

Information Memorandum

The Information Memorandum (IM) is different than a business plan although it contains some common elements. Its purpose is to provide a detailed pitch on the company to the VCs. A typical IM consists of 30-70 pages and usually contains the key elements found in Table 1 (see below).

Management Presentation

Once the IM and Teaser are finished, one or more management presentations should be prepared for "short" (15-20 slides) and "long" (30-40 slides) presentations. The presentations should summarize the key business and investment points in the IM as well as the technology and pre-clinical and clinical results.

Targeting the Right Venture Capitalist

You must match your company characteristics with the investment criteria of the 250 actively investing VCs, information that is usually available only in private subscription databases. Select VCs according to the following characteristics:

- Location: VCs invest nationally or regionally. Often, they prefer to invest within their own region to reduce travel.
- Lead investor or follower: Smaller VCs (those with less than $200 million under management) often want to follow larger, better known firms.
- Focus: Firms may favor medical devices, therapeutics, or health services.
- Stage: VCs may focus on seed, early stage, expansion or growth capital opportunities. Some won't invest beyond Series A, and others won't invest unless the company is near commercializing their product.
- Valuation: Some early stage VCs won't invest if the valuation is more than $10 million. Other firms invest only at the Phase II stage when valuations are in excess of $50 million.

It's very important to sort through all of the above variables and pick the right audience. Trying to convince a late stage VC to provide seed capital is a waste of time.

Process

You will likely have over 100 prospects after winnowing down the list of potential VC investors. Each one needs to be called and sent a personalized email with the Company Teaser. If you don't hear back within a week, call and email again. If there is interest, it's appropriate to ask for a Confidentiality Agreement or CDA. Allow the VC two weeks or so to digest your IM. If there's continued interest, the firm may ask you to make a management presentation either in person or telephonically, depending on geography and schedules.

Once you have interest from several prospects, solicit non-binding term sheets, which specify the major investment terms and a valuation range. Assuming the valuation is reasonable, firms will want to conduct a thorough due diligence, which typically takes between one and two weeks. The final and most critical steps are negotiating the legal documents and insuring that a satisfactory valuation isn't undermined by other agreement terms such as an onerous liquidation preference.

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Consider Using a Professional Advisor

Raising funds is a very time consuming and distracting process. Perhaps the most costly part of the process is the time senior management must devote to the process and the negative impact this has on the business. Exactly at the time your business must perform at its best, senior management must spend 50% or more of their time on the fund raising process. After being stretched thin for months and feeling the pressure to return to managing the business, management will often accept a sub-optimal valuation or investment terms. An advisory success fee may total 3% to 5% of the amount raised, but should produce an attractive return for the following reasons:

- Much higher chance of success
- Much improved valuation and investment terms
- Management can concentrate on running the business and hitting their all-important milestones
- The advisor can handle tough negotiations, allowing management to preserve a positive relationship with a new investment partner
- The advisor is more practiced and skillful at managing the process and obtaining attractive results, since that is their business. ■

For more information on this article, please contact
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