ENTREPRENEURSHIP

FOOLS RUSH IN WHERE ANGELS FEAR TO TREAD

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Despite the downturn in the economy, the prospects for those looking for investors or business angels have rarely been better.

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With the financial crisis now entering its seventh year and only intermittent light at the end of the tunnel, this may not seem the best moment to embark on risky ventures. And yet this is an extremely good time to be an entrepreneur. Private investors are frustrated with the low returns they are getting on their financial assets. When the economy was going well, there was less money around for entrepreneurs because people could still get good returns on other activities, such as real estate. Now real estate is going nowhere and the return on government bonds is barely keeping pace with inflation. As a result, the perception of entrepreneurs has improved and the willingness to invest in new ventures is higher than it has been for 10 years. Increasingly, the family offices of wealthy families, for example, are looking for people to partner with or to mentor.

If you are looking for partners, mentors or investors to take your idea to the next level, there are a number of things to bear in mind and rules to follow that will increase your chances of success. However, let's first define our terms, as the label entrepreneur is often applied to people who don't fit the bill. For example, just because you run a small business, that doesn't make you an entrepreneur. Small business owners who have no ambition to grow their business and are playing defense rather than offense should not be considered entrepreneurs.

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porate job you can never be an entrepreneur. Recently, what we have seen is that people with full-time jobs with plenty of managerial responsibility in typical hierarchical organizations are launching side projects outside the office. This is partly because they feel insecure in their corporate roles and are thinking of going independent and this is the first time they've thought of being entrepreneurs. Now even people who don't like risk are setting up side projects. Indeed, people with salaried jobs are now among the most active groups exploring entrepreneurship, although many have yet to take that step into the abyss that defines the true entrepreneur. Risk is at the heart of entrepreneurship.

There is also some confusion about the role of business angels and venture capitalists. A business angel is typically someone willing to invest €100,000-€500,000 in any given project over several years. They may start small but this is essentially a person who is working for his or her own profits. A VC will be part of an investment company and has to raise funds from others to make bigger deals for a bigger return. A VC firm's main activity is identifying new companies and investing in order to return money to its own shareholders, who may be institutional investors.

However, not everyone who invests in small concerns is a business angel. A business angel tends to stay involved in the invested companies over a number of years. This is not someone who shows up, hands over some money and then comes back a few years later expecting a profit. Recently, there have been a number of "false" business angels who are not in it for mentorship or active advice but are merely frustrated with the low rates of return on financial markets. This is a passive investor profile. If you're not providing contacts or directly useful, industry-specific information to the entrepreneur, you are not a true business angel. Being a business angel implies taking someone under your wing. The defining characteristic of both entrepreneurs and business angels is the belief in an idea and the willingness to take risks to take that idea to the next level.

THE BIG IDEA

Some ideas are easier to pitch than others. Convincing someone in the bow and arrow business of the usefulness of a gun shouldn't be too difficult. Persuading investors that the bar code will revolutionize the world of retail may be a bit more of a stretch. The first question an entrepreneur should ask is "Is there anyone qualified to help me on this project?" This doesn't necessarily mean cash but someone with industry- or product-specific insights. As an entrepreneur you shouldn't team up with the first business angel that comes your way just because they have money. It's better to hold out for someone with specific expertise even if they are offering less money. The market value of this expertise is very high and entrepreneurs often don't notice this till too late because they typically prioritize the money aspect. But people who put the most money on the table sometimes turn out to be worst sources of support because they can't hold your hand to take you to the next level via their contacts. So, while money seems to be the key, what really matters is not doing the wrong thing with your project.

Anyone with a good idea runs the risk that someone will steal it. Ideas are notoriously hard to patent. With an idea you can't even enforce a nondisclosure agreement because variations of the idea could make their way into the board meeting of another company and they would be able to do something close to but not identical to your idea. You need to see what level of development you can take the idea to as a product or service design. Any of those components can be patented by the time you reach prototype stage. This is where business angels come in. They are there to support you to this point where you establish the project's technical viability and are then able to expose it to outside feedback.

When it comes to selling your idea, remember that it's not the idea they're buying – or not just the idea – it's you. Typically the investor evaluates the person before the idea. Their first question is, why are you leaving your previous job? Why do you want to do something new? Is it because you're unhappy or is it because this business opportunity is going to be very big? If you've just lost your job, are you casting around desperately for ideas? You need to anticipate these questions. You need to be able to explain that you're not just trying to survive but have a longer-term objective. Once the investor stops questioning your motives, the discussion will take a more positive turn.

Put your money where your mouth is. Many entrepreneurs make the mistake of telling investors that with your money and my labor we can make this work. From past experience investors have come to expect more from the entrepreneur. They want to know what is the minimum and maximum financial commitment you can make to the project. Why haven't you invested your own money and, if the idea is so good, why haven't you been able to raise funds from family, friends and "fools"? Even if it's a symbolic amount, it's essential to put something of your own in before you start asking strangers for money.

You also need to create a virtuous cycle of supporters. In general investors don't want to be the only one involved. No one wants to be the only one who sees value in something new. People want to feel that others want it too, and that makes them want it more. An investor wants to feel he or she is competing for the investment and if they win they will be more proactive and supportive. If you have a business partner, the investor will want to see that you and your partner have addressed the tough questions together such as roles and ownership stakes. Investors are aware that conflicts between founders is perhaps the number one reason why projects launched by multiple people go bankrupt.

Another common mistake is to end the pitch with a take it or leave it proposition. If you say, "This is the deal—are you in or out?" they will probably walk away. Don't sell an idea as if it were a product. You're not asking for a yes or no, you're asking "How can you help me with this project?" Don't assume they can only help you with money or contacts. Always end the pitch with an open question that invites the other party to contribute.

You also need to neutralize the skeptics, people who broadly agree with you but have doubts about the specific steps required. These people will ask detailed and difficult questions about the project. This is a good sign because it means they are interested, but you need to get some sense in advance of the sort of issues they are likely to raise or have raised in similar projects. You need to collect a list of potential sticking points in your presentation. And if your idea is highly technical, be aware of your audience. If it is a non-specialized audience, if you bombard them with formats and acronyms, you'll lose them.

BALANCING CHARITY WITH PROFIT

And finally, a word of advice for social entrepreneurs. Here at IESE we have been training social entrepreneurs in partnership with the Fundació la Caixa, which has so far donated €25,000 each to 40 social entrepreneurial projects. These are social business projects that are for profit but with an emphasis on social objectives. We went through the participants' venture pitches and noticed a pattern: they often created the impression that the project was just for charity when really it was about a long-term business vision. Even though you have social objectives you need to put equal emphasis on the business objectives and show that the project is sustainable and can scale up over the long term. After all, however worthy the cause, you're still asking the investors to put their hands in their pockets.

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