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WHAT ENTREPRENEURS NEED TO KNOW July 25, 2007, 11:52AM EST

Raising Money? Beware the Broker

Engaging intermediaries to help raise investment capital, the biggest sticking point in angel-entrepreneur negotiations, and more

by [David E. Gumpert](#)

YOU'RE THINKING OF ENGAGING A BROKER TO HELP YOU RAISE FINANCING. THINK AGAIN

It seems so tantalizing. You're looking for investment capital, so you engage an intermediary who supposedly has investor contacts in your industry, and agree to pay him or her a percentage of whatever money is raised. It sounds great, but there are significant obstacles, and even if those are overcome, the approach rarely works. That has been my experience hearing from entrepreneurs who have tried it, and advisers discussing the topic on Harvard Startups, a [listserv](#) for startups, come to a similar conclusion.

One issue is that any intermediary offering shares in a private company should probably be registered with the Securities and Exchange Commission as a broker-dealer, qualified to sell such shares, and then only to others who qualify to invest in private offerings under SEC income-and-net-worth requirements. In addition, individual states may have their own regulations.

Then there are the practical implications of using an intermediary. "If you can't raise your own money, then you won't be able to sell your product," cautions an entrepreneur. "Any investor worth having will not want any of their money going to pay a commission for finding them. I have known hundreds of folks who have raised money, and not one did it this way."

The main exception? If you're looking to sell or merge your company with another.

THE BIGGEST STICKING POINT IN ANGEL-ENTREPRENEUR NEGOTIATIONS?

Disagreements about the impact of dilution on an investment's long-term value—something venture capitalist Luis Villalobos refers to as "divergence of valuations." He offers this example in a recent [article](#): "An investor funds at a \$4 million post-money valuation and receives shares valued at \$2 each. The company is sold in five years for \$60 million, which is a 15-times increase in company valuation.

"Due to dilution, however, the value of the investor's shares will almost certainly not have increased 15 times, to \$30 per share. They might instead have increased only 3 times, to \$6 per share. In this example, the increased valuation of 15 times divided by the increase in the investor's share value of 3 times demonstrates a 5-times divergence." His suggestion: "Investors should understand and be able to explain divergence to entrepreneurs. Once entrepreneurs realize that their assumptions about investors' returns based on the company valuation at exit may be off by a factor of 3 times to 5 times, negotiations become easier."

THE FUTURE OF NANOTECHNOLOGY? HOW ABOUT MICRO-ROBOTS?

Bruce Donald, a computer science and biochemistry professor at Duke University, likens his "machine," which is as wide as a strand of human hair, to a robot. "They can haul things around and push them," he says in a [video](#) from a recent lecture he gave

at the Massachusetts Institute of Technology. The likeliest applications—still probably some years off—are in medicine: the "self-assembly" of proteins and enzymes.

CONFRONTING PERSONAL CONSTRAINTS WITH ACTIVE COUNTER-MEASURES

*I'm not usually a huge fan of self-help books, but there is a new one that could be of use to owners of small businesses. *The Flip Side: Break Free of the Behaviors That Hold You Back* (Springboard Press; May, 2007) identifies 10 "killer constraints" that hurt owners and employees alike. While it starts out overly self-congratulatory, its consultant-author, Flip Flippen, eventually provides useful insights into such problem behaviors as being aloof, angry, and domineering.*

Equally useful, it encourages serious self-assessment and specific steps to counter problem behaviors. He suggests, for example, practicing certain techniques with family. For domineering bosses, he encourages closer listening to others and verbally confirming with subordinates that ideas and messages have been correctly understood.

[David E. Gumpert](#) covers business/health issues and also writes the biweekly *What Entrepreneurs Need to Know* column.

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