

Raising capital for IT companies

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If you're an early-stage company trying to raise money from private investors, you're going to need a thick skin. Stunned venture capitalists are still recovering from the widespread failure of once-promising startups that drained investors' money before succumbing to the realities of an unforgiving marketplace. Today's sadder-but-wiser investors are more likely to nudge entrepreneurs out the door than to open their pocketbooks to them.

But there's a ray of sunshine for companies in the information technology, or IT, sector. IT firms offer software, hardware, telecommunications, networking equipment and related services. Even with the investment downturn, at least 60 percent of last year's venture capital funding went to IT businesses, according to PricewaterhouseCoopers. From January through April of this year, venture capitalists doled out more than \$3 billion to IT companies nationwide.

The message from the investment community to IT firms is this: There's money out there. If you have a truly competitive technology, can position yourself strategically and knock on a lot of doors, you may get some of it.

Investors want to see novel products with clear advantages over existing alternatives. "We're not very interested in ventures that use off off-the-shelf software, like a business that sells phone cards," said Mike Templeman. A co-founder of Aldus Corporation, Templeman now is with Seattle-based Guide Ventures, which funds IT firms. "I want something that is innovative, compelling and competitive enough to make someone a lot of money," he said.

You must convince investors that you have real customers to buy your products. A survey in March by Forrester Research, Inc. showed that twenty-three percent fewer firms than in 2001 will consider purchasing server, network or storage hardware this year. Fewer than half plan to purchase new enterprise-wide application software.

One way to overcome this buying caution is to demonstrate that the product will pay for itself quickly--in a year or less. "To justify IT spending, companies want to show a return on investment in their current fiscal year report," said David Clarke, a partner at Perkins Coie, a law firm headquartered in Seattle with a large clientele of tech-based startups.

Today's IT departments also are wary about adopting new products. "IT operations are often reluctant to standardize any one piece of technology, and they're not going to throw out anything that already works," Templeman said. Instead, show them how your product can fit into what they already have and make it better. "You're not requiring them to change their behavior or their

contracts,” he said. “And no one at the company has to admit they made a previous purchasing mistake.”

Your product’s installation, deployment and integration must be simple, because there are fewer skilled computer people to solve problems. “One of our IT companies can deploy its software system in 15 minutes,” Templeman said.

Many investors will consider only businesses that have made sales. Susan Mikels, vice president of WinWhatWhere, hopes that the 7,000 software licenses sold since 1993 will give her company an edge as she begins seeking outside investment funds.

The Kennewick firm, which Mikels owns with husband Richard Eaton, developed the popular WinWhatWhere Investigator computer program that stealthily tracks computer usage by recording keystrokes. The software has been installed on about 200,000 computers so far. “Our customer demands and markets are growing, so we decided it was time to raise more capital for expansion,” Mikels said. She is revising the firm’s business plan to reflect what investors want to see.

Even with an established product or service, persistence is the key, Bill Murphy said. He is chief executive officer of Global Medical Connection, with offices in Pasco and Bainbridge Island. The four-year-old company sells an online service called e-Nurse that lets healthcare providers and patients share medical data on the Web while maintaining data security and patient confidentiality. After successfully raising equity capital for the company in its early years, Murphy is on the road again in search of a followup round of financing. His advice: “Instead of making your pitch to 20 investors, be prepared to make it to 50 or more.”

A modest spending revival may be around the corner. Corporate spending is expected to increase somewhat during the first half of next year, and investment funding is creeping up in anticipation, Clarke said. “Even in the last couple of months, I’ve started to see venture capitalists being more aggressive in funding new companies,” he said.