KEITH J. CUNNINGHAM'S

KEYS TO RAISING CAPITAL

WORKBOOK

KEYS TO THE VAULT®

THE KEYS TO RAISING CAPITAL

The warm introduction you have heard is the voice of Robert Kiyosaki, longtime friend of Keith Cunningham. Robert is the best-selling author of a book titled Rich Dad Poor Dad, and also the creator of an innovative board game called Cashflow 101. Keith was instrumental in shaping this game, and initially helped Robert by allowing him to sell his books in Keith's carwash.

After selling over 10 million copies of his books, Robert refers to Keith as his "dear friend for years," and as a "master at raising money." You will hear his voice in conversation throughout this series.

Keith begins with some facts about money:

- Last year $175 Billion was raised in America for venture capital.
- The amount that was invested last year by venture capital firms is $100 Billion. (Not including investments made by corporations like Microsoft, Intel, Cisco)
- And $20 Billion was invested by angels.

The definition of an "angel" is a person who has already made a lot of money and who looks for people to finance and mentor. Angels are also still expecting to invest to make money for themselves, but they also have an interest in helping young entrepreneurs get started when they invest in young companies. Angels, acting on their own, are often willing to take risks that a venture capitalist won't take.

Venture capitalists differ in that they are a very organized, educated group of money people who are investing to make money, period.

> One thing is clear: there isn't a lack of money.
> There are plenty of investments to choose from.
> But it seems there is… a lack of **GOOD DEALS!**

Sometime ago, Robert asked Keith to write a book on raising money. The information in this tape series is a distillation of what Keith has written for his book.

Here begins the story of a deal, which you will encounter through this teaching:

> Three young men attempted to explain their deal for most of an hour. This hot new idea seemed pretty complex, but eventually Keith came to understand this (oversimplified) explanation: hey do for computers what electric companies do for residential houses.
>
> Here's a couple of examples of potential accounts that the three entrepreneurs could claim:

- Amazon.com has tremendous computer power laying idle most of the time, all because they will need it all during the last two weeks of the year.
- FTD Florists have a huge computer capacity, but it's just to handle Mother's and Valentine's Day. They don't really need that computing ability during the rest of the year.
- Internet companies build enormous infrastructures in case they need to cover a big surge, which doesn't usually occur.

If you kept an electrical generator at your house to cover you just for the day that you might need to turn on every light and every appliance at the same time, that would be analogous to what these companies are really doing.

At your house, the electric company keeps extra energy stored for emergency use.

The entrepreneur's new company was to be like the "electric company" for corporate computer usage.

THE IDEA:

This trio of men had come up with an idea for renting computer capacity to meet the needs of the "Amazon.coms" of the world.

In the USA alone this is could be a $300 Billion business, a truly terrific idea.

Despite the "great idea," they were really encountering trouble raising money.

That bring us to the first point (that every investor already knows):

1. It is not about the "gizmo" (and it never will be).

The investment community doesn't care if the product is:

- cheaper
- faster
- longer lasting
- stronger
- tastes better

It makes no difference. Because it is never about the gizmo in the first place:

- Consider the old Ray Crock/McDonalds concept. There are plenty of places that make better cheeseburgers than McDonalds, but no one delivers that product to the public better than they do.They make tons of money, even though other companies make (arguably) better burgers.

- Southwest Airlines is famous for its "cattle call" treatment of customers. They hand out peanuts for refreshments. But they make lots of money. They are the fastest growing airline in America.

  Conversely, consider Singapore Airlines. If you are a member of their elite club, they will call you three days before your flight to ask you what you want to eat. And people arrive hungry, because the airline food will be such a treat.
  But they don't make more money than Southwest Airlines. Not even close.

All of this underscores the difference in thinking between the entrepreneur and the investor. The investor is usually pitched a deal about a revolutionary PRODUCT… that the investor could care LESS about!

Think of money… as *fuel*. Like the heat in the oven that bakes the pie. You can have apples or peaches or cherries inside, but heat cooks the pastry!

So, if the Gizmo (vehicle) isn't important, what is?

2. The Market *(the niche)*.

- Federal Express' niche is: "absolutely positively guaranteed on time."
- Kodak's niche is: memories.
- Nike's niche is: attitude. That little flying checkmark is attitude.
- Southwest Airlines' niche is: peanuts. Cheap travel.

Some markets are narrow and deep, some are wide and shallow.
A wide shallow market is like a mud puddle, pretty worthless.
You have to define your market. You must have a proof of concept.
It might be a great idea, but you can't raise money without proof that it would work.

Think about this:

- What are the chances of these three boys talking Amazon.com into trying their system?

It was possible, but not likely.

- One investor even said that the opportunity was so big, "it would be like trying to boil the ocean."
- $300 Billion in opportunity, that no one has touched, should be a good thing.
- Instead, investors would be overwhelmed.
- The entrepreneurs hadn't zeroed-in on who specifically their market was, and…
- They had no proof of concept.

KEITH'S RULES FOR MAKING A BILLION DOLLARS:

1) FIND OUT WHAT THEY WANT
2) GO AND GET IT
3) GIVE IT TO THEM.

Don't fall in love with your product… remember the models of McDonalds and Southwest Airlines. Think it through: who makes more money, Rolex or Casio? Casio.

- The rival companies aren't bad companies, they could be good companies.
- But McDonalds, Southwest and Casio are making big money because they know their market.
- *They work their niche.*

Another thing to think about:

Make sure that the deal you are offering an investor is the type of deal they would want.

Example: If you are a real estate agent, and you get a call from someone who says they are in the market for a house, should you immediately begin flooding them with information on a great deal on a multimillion dollar home you just got a listing for?
Or should you ask some questions and find out the prospect's purchasing parameters?

Entrepreneurs (who are usually in love with "their baby") like to talk about their product and don't take the time to find out what the investor wants.

Do your research ahead of time. You don't want to begin a conversation with an experienced financial investor by saying, "What is your investment criteria?" Know what she or he wants before you sit down at the table.

3. Management – "Money follows Management."

Example: You get a call from Bill Gates. He wants to talk to you about his newest money-making venture. What do you say?

- You don't need to hear what it is, just find out where to send the check.
- Why? He has a track record.
- Investors want to quantify their risk.
- Investors hate taking risks where there are too many unknowns
- They won't make a bet on "a pony that's never been to the track."
- Management is your track record.

Example: Steven Spielberg, Jeffrey Katzenberg and David Geffen got an idea to be partners and start a studio together. What is their collective track record?

- Jeffrey Katzenberg is of Disney Studio fame. He was in charge of Disney's animation department (think Lion King).
- Seven of the ten top grossing movies of all time were Steven Spielberg's.
- David Geffen, known as Hollywood's first "self-made billionaire" made over 2 Billion dollars when he sold his record company.

Each man had plenty of money to start a venture, however

- They decided to use OPM (other people's money).
- The three men determined it would take $500 Million to kick off a new studio.
- They called Paul Allen, the co-founder (with Bill Gates) of Microsoft. Paul Allen is also the owner of the Portland Trailblazers and Seattle Seahawks, among other notable holdings. In two days, and *in the absence of a business plan*, Paul Allen fully funded the studio.
- For his investment of $500 Million, Mr. Allen is a 25% owner.
- Of what? An idea on a napkin.
- Why did he do it? The proven track record of the three founders.
- Not that each of these men has turned out a perfect product every time.
- But they have enough cumulative successful experience to impress any investor.

> This is the power of management.
> Hence the statement: "Money follows Management."
> You have to have it!
> You need someone who has "done it before."
> Show an investor your "track record."

If you have an idea for a business for which you would like to find financing, jot the main ideas down here?

Who can you name as your management for this company? Where will your "proven track record be displayed? Use this space to note your thoughts.

When an entrepreneur cannot name names with solid histories, they are going to have trouble. If there is a proven management associated with the business plan, trouble is avoided.

So what about numbers, aren't they important?

4. Most people assume that investors are "numbers people."

But here is what investors know:

Good decisions equal good numbers.
Crummy decisions equal crummy numbers.
Management makes decisions.

Every deal has roadblocks, runs into problems, maybe:

Two competitors merge.
Your main supplier goes out of business.
Your CEO has a car accident the night before your stock goes public.

Who fixes these problems?

Management fixes them. This is why management is so important.

Numbers reflect whether good or bad decisions have been made.

It's a mistake to approach an investor with a string of impressive numbers unless you have the right assumptions. These are the underlying thoughts that resulted in these numbers.
If you are missing assumptions, then you don't have any evidence driving the numbers in the first place.
It is easy to create a terrific financial projection for a company on paper.
Assumptions are crucial.

If you haven't "been to the track" how do you get there for the first race?

Think about it:

No first-time pony enters the Kentucky Derby;
they progress through smaller races and gain experience.
No boxer climbs in the ring for the first time and wins a World Title;
they box increasingly difficult opponents, with increasing notoriety.
No football team heads straight for the Superbowl;
they have the opportunity when their scheduled opponents are beaten.

Gather the right people around you. You don't want a lot of first timers on your team.

Let's get back to the track record of the three boys with the brilliant idea:

- Two of the three had wealthy parents and had never held a job. The third had worked as a stockbroker.
- One defined his role as the "technical brains" of the group.
- One was the "finance guy."
- The third guy's job was to be the "glue."
- They were all getting $80K/yr as equal partners with equal salaries and equal equity ownership.
- But just because you are a shareholder doesn't mean that you have the skills and talents to be employed by a company.

ONE BIG REASON THAT NEW COMPANIES FALL APART:

- The person with the good idea becomes the brains of the company and thinks he should run things.

An investor takes one look at this and goes the other way.

"The skills that it takes to dream up an idea, are exactly the opposite of the skills that it takes to run a company." Keith Cunningham

There are precious few Michael Dells and Bill Gates.

- Neither one graduated from college.
- Both of them are smart.
- Both founded companies.
- Both ran those companies.
- They started with ideas.
- And turned those ideas into *multibillion dollar businesses*.

They did it all, but that almost never happens!

If you have a great idea… *hire someone with a proven track record* to run that company for you. If you don't do this, you either:

- won't ever get funded,
- or you'll get funded, and go broke.

The Notes and Assumption page is a mandatory appendix to a set of projections.

Example:
The statements should sound like:

- We expect 300 customers the first month, and the reason we think this is...
- Each customer is going to pay us $6.95, and why we assume that is...
- In this same way discuss: rent, specific salaries and all other expenses...

An investor can then agree or disagree with the projections, and play with the numbers.

5. If you build it, they will not come.

- The reason that most businesses don't get funded is because there has been zero focus on the marketing.
- Entrepreneurs are like mothers: they love their baby (idea) and think it's beautiful.
- Investors think in terms of business.
- Remember: until an investor opens his checkbook... your "business" is vapor.

The entrepreneur must impress the investor by answering his questions:

- Who is your market?
- How will you tell them about it?
- How will you get them to pay?

6. What's the value add (the value proposition)?

- What problem does it solve (what itch are you scratching)?
- What distinguishes your product?
- If you can't identify this for the investor, you have no business in being in business.

The value proposition should sound like:

> "Here's the problem that is out in the market place, and why my product will solve that problem. Here's how many people have that problem (market) and how we're going to tell them about it. This is the management team that we have that is going to produce all of these great numbers."

VALUE CREATION?

This was a huge problem in the whole Dot Com era, where there was frequently high Value Adds but no Value Creation.

Example: Napster (solved a lot of problems, but zero value creation).
This was a great value add, the customer could download songs to make his or her own CD's. *There were 38 million users.* That's unheard of! But how much money did they make? They *lost* hundreds of millions of dollars for their investors simply because they were unable to convert the Value Add into Value Creation.

In Hollywood there are two businesses.
Getting the movie into the can
Getting the can into the theatres.
They have nothing to do with each other.

It's the same in your business: Your great idea solves big problems (value add).
But nobody wants to pay you for it.
What investors are looking for is making money, which is value creation.

VALUE ADD vs. VALUE CREATION

Value proposition is "the itch you are scratching."
It is the problem you are solving.
It is the reason that someone would give you their money.

- If you are a Value Add at your job, it means that you do more than they expect of you.
- If you are a Value Add in business, you have to provide the consumer with a better deal for their money.

It's what you are doing with your product that makes it superior to capture the buyer's money.

Value Creation is how you turn your Value Add into cash.

- Value Creation is where the cash changes hands.
- It is how you create your profit.

Without Value Creation it is possible to "… make less and less, on more and more, until you go broke on getting rich."

Example: Dr. Koop raised $40-50 million for a web-based health care business.
According to the stock market the company was worth $850 million.
A year later the company was broke.
Their idea (that solved problems) was to provide the public access to health information.
Their failure was never finding a way to get the consumer to pay for this service (no revenue model, no value creation!).
Value creation is the cash you put in your pocket.

Make your personal notes on Value Add, Value Proposition, and Value Creation:

7. We really don't have any competition.

- Nobody is doing exactly what we are doing.
- Of course not. *This is already understood.*
- Why spend your time (and someone else's money) duplicating something that is already being done?

But in reality, *everyone has competition*.

There are two kinds of competition, direct and indirect.

Direct competition:
Pepsi and Coke.
They have similar products and compete for the same shelf space.
Chevrolet and Ford.
The same kind of buyers purchasing similar vehicles.

Indirect competition: is the way cable television used to be.
In the 1950s, Cable Television was primarily in rural areas. But by the 1970s, Keith made convincing propositions to city councils as to why they should give the cable company a rate increase. There wasn't any direct competition in small towns.
But the *indirect* competition? Cable television was competing for entertainment dollars, for information dollars, and education dollars.

Knowing everything there is to know about your competition is vital to launching your business and convincing an investor to back you.

Part one: Know and acknowledge that you have competition and who it is.
Part two: Differentiate yourself from your competition.

"Keep your friends close, and your enemies closer."
Vito Corleone, The Godfather

8. Create an elevator statement.

- This is a maximum of 20 sentences/2-minute duration.
- It is memorized.
- It is an overview that could literally be delivered during an elevator ride.

You must be:

- Passionate.
- Articulate.
- Concise.

You must talk about:

- The product.
- The problem.
- The size of the market.
- The niche/Value Add.
- Your competition.
- The management.
- The milestones (where are you now, in your testing, or in your market).

Rehearse in front of a mirror. Be excited. Get ready to convince.

- In 2 minutes, you must be able to tell a prospect how much money you are going to make for him/her.
- Investors want to make money.
- It answers this question: "If I put money in your deal, tell me how I'm going to make a bushel-basket of money."
- You have to *sell* it.

If you do this correctly, you will capture someone's imagination.

> Note: Your aim should be to pitch your deal to the kind of investor that is interested in your kind of deal (a high tech investor isn't interested in a car wash). Your best chance is approaching someone who will see your business as fitting his/her investment parameters.

Develop and rehearse your personal style. Your pitch needs to be dynamic and enthusiastic in your own unique way. Your mode of dress and speech should reflect you, but also the extreme conviction that you have for your deal. *This is crucial to raising capital.*

If you have the chance to observe a great pitchman, do it! The more you watch a great delivery, the more tips and hints you will pick up, and the more you will find ways to adapt those successful habits to your personal style. You don't want to try to copy someone else's style. That probably won't work. You want to adapt the best elements you observe, to make yourself and your delivery style dynamic, confident, knowledgeable and relaxed.

9. Entrepreneurs tend not to listen.

Negotiation begins during the communication process, but that is more than the entrepreneur telling his story.

NEGOTIATION IS A PARADOX:
TO GET WHAT I WANT, I HAVE TO BE WILLING TO GIVE YOU WHAT YOU WANT. OTHERWISE THERE IS NO AGREEMENT.

Here is the essence of a successful listener:
If making you ecstatic will give me what I want,
I'm going to listen to you very, very closely …
so I can give you what you want.

When you are raising money remember that investors have hot buttons, concerns and questions. (Whenever you hear a question, write it down so it can become one of your pre-answered questions next time).

Do a lot of listening during your presentations. If an investor says, "I don't think you have a management team." You probably don't. Investors are very, very smart people. Chances are you will hear the same thing from the next investor who hears the pitch. So don't be arrogant; fix the problem.

Here's the end of the "great idea" story that we started with. These three boy entrepreneurs were terminally arrogant. Keith was hired as the pitchman to get funding for the company, (he was evidence of management) and in return he got 25% of the company. He developed his pitch and made the rounds until he found a man who would fund the company with a $600,000 cash infusion, presuming the company was deemed to be worth $2.5 million before the investment came in. The three boys rejected the offer, even though they were already $350,000 in debt and about to be evicted. They said the idea was worth a lot more than the offer, and they would rather do no deal than a bad deal.

Keith could not appeal to them to be reasonable and save their company. They would rather have 100% of zero, than have 25% of $300 billion. But they insisted on losing their company. Keith resigned his position, and returned his stock.

These boys might have been right about their company being worth more than the valuation, but they were dead right. Their arrogance killed their company, and they were evicted. End of a great (worthless) idea, that couldn't get funded.

Here lies the body of Justin Graves,
He died defending his right of way,
He was right, his case was strong,
But he's as dead as if he were wrong.

If you are going to be a successful entrepreneur, you must surround yourself with a trusted team that you can listen to.

Get a good board of directors, and good advisors, because you don't have all the answers.

Remember, investors are very, very, very smart people.

But if you behave like the typical entrepreneur who has all the answers, you'll be dead in the water.

10. Vapor.

This problem is rampant among entrepreneurs and is a hot button for all investors.

Vapor happens when the pitchman gets evasive.

- The idea is their "baby" and they don't want to admit it only has nine toes!
- If they feel trapped or they don't have a good answer, they "do a little dance."
- This is the kiss of death.
- You should know every facet by the time you present to an investor.
- If you really don't know, say you don't know.
- As soon as the shuck and jive starts, credibility exits.

To avoid vapor, you must deal from the point of integrity.

- Never make things up, or quote off-the-wall statistics to try to get funded.
- The investor will find out during the due diligence.
- (Due diligence means they will examine every nook and cranny of your deal.)
- Due diligence is a lot like a thorough physical examination – nothing escapes notice.
- So never "deal from the bottom of the deck."

The investor is your future partner.

"The Keys to Raising Capital" outlines common errors and pitfalls entrepreneurs make in trying to get their ideas/companies funded. We hope you will not only be able to avoid these mistakes, but become financially successful in all your business ventures.

Keith J. Cunningham

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