Understanding the Mind of an Investor

It can be the difference between getting your business funded and floating in the ocean of "want-to-be's"

by Mike Elia

The single most important key to raising capital for your business is to understand the decision making process from an investor's perspective. The better you can learn to think like an investor, the easier it will be to do and say the correct things to get your business funded.

Fortunately, this is not difficult. Most of us have ourselves made an investment decision or two sometime in our life—perhaps it was buying a car, a home, or even a computer. By reflecting on your own decision making process and your emotions at each stage, you can deepen your understanding of what's going on in an investor's mind by drawing on your own investment experiences.

Business owners traditionally divide their financing tasks into two stages, marketing (generating investor leads) and selling (converting a lead into an investor). Investors, on the other hand, experience these two stages as qualification and selection.

First, I, the investor, try to reduce the large number of possible investment opportunities I'm considering down to the subset of those which I judge to be qualified. In this qualification stage I consider such facts as "How well do I understand your products or services; the industry and the markets you serve?", "How much can I make and lose?", "What makes your business unique?", "How does your business make money?", and "What evidence shows this is a good investment?"

Except in the most unusual situations—where a business is so unique or so well positioned that it is the only legitimate available business—even the most thorough due diligence (examination of available facts, references, books, records, etc.) usually ends with more than one investment alternative that meets my investment criteria. Typically, after exhausting my abilities and those of my professionals to make technical distinctions among the businesses, I must still make a choice between reputable businesses with good ideas, good stories, and the prospects for high returns.

This leads to an important conclusion: Unless a business venture is truly unique and unmatched by any competitor, ideas and projections alone are not enough to get you funding. Excellent ideas and solid financial projections are essential to get on an investor's shortlist of investment considerations, but it is for other reasons that you'll eventually get funding.

Once I have decided which businesses I will consider in the final subset, my focus of inquiry shifts significantly. I am no longer asking "Can you do it?", but rather "Do I want to work with you?" I am no longer interested in the known characteristics of your business, but am now trying to form a judgment about you. By the mere fact that you are sitting here meeting with me, you can assume that you have successfully marketed your business: now the time has come to sell yourself.

What It Feels Like To Be an Investor

Making an investment decision is rarely a comfortable experience. Among the unpleasant emotions frequently felt are the following:

First, I feel that I'm taking a personal risk. By investing in a business venture, I am putting my money into the hands of someone else and have to give up some degree of control over it. This is my money, and even though intellectually I may know you have the expertise to put this money to good use, emotionally it is not comfortable to put my money into the hands of others. Even if the investment is relatively routine, I will need convincing (beyond protestations of good intentions) that you will use it wisely and protect it as if it were your own hard earned money.

Second, I'm feeling insecure. Since I find it hard to detect which of you are going to deliver the expected return on my investment, I'm going to have to commit myself without feeling totally confident about my decision. What's more, I don't know all the risks related to your venture; that's why I need you, the business owner or entrepreneur, to tell me. But, I'm not sure I can trust you to be honest about this; it isn't in your best interest to convince me that the risks are minimal. You business owners and entrepreneurs are always over-optimistic. Everything is never a problem.

Third, I'm skeptical. I've been burned before by overly optimistic business people. I get a lot of promises. How do I know whose promise I should invest in?

Fourth, I'm concerned that you either can't or won't execute your plan. Will you be one of those typical business people who know it all but never execute, who leave me out of the loop, who will befuddle me with jargon, who don't explain what they're doing or why, who, what, when? In short, will you deal with me in the way I really want to be dealt with?

To a degree I am also exposed. Whoever I invest in, I'm going to have to support and empower. Once we start heading down this road together, how do I know you'll be truthful and tell me when and if the venture is not going to be successful so that I don't throw good money after bad?

What all this reveals is that, among the subset of qualified investment opportunities, I am looking for the one I can trust. The act of investing is, by very definition, an act of faith. I must, inevitably, believe your promise more than another one. In selecting an investment opportunity, I am not just investing in an idea; I am entering into a relationship. Your selling task is to earn my trust and confidence – with an emphasis on the word "earn."

What an Investor Looks For

How am I to determine with which venture I want to partner with? Certainly the answer is not contained in the promises you make. Talk is cheap. Someone who tells me "Trust me, your investment is safe, we can execute" is not likely to win my confidence simply by that assertion.

Your business plan document is often the first exposure I'll have to your company, even before I'll talk to you on the phone or having a meeting with you. If your document includes careless mistakes or you leave out supporting details that I expect, you can do more damage than good and risk losing your credibility before you even get started.

As for your business plan, I'm expecting it to lead quickly with a description and explanation of your business. It should paint a picture of your business, followed by convincing arguments and supporting evidence. I'm looking for specific statements and concrete facts to support your plan. But whether I read your plan or not, or whether those statements and facts are forceful and effective, is dependent on the manner in which you present them to me.

A strong business plan is a rite of passage. It is the deciding point for whether or not I will take steps to invest time and energy in trying to analyze your opportunity and to work out a deal.

I'm constantly under attack from a long list of entrepreneurs seeking money to back their ideas and businesses. I'll see as many as twenty proposals a day, a hundred business plans a week. Of these I'll read only about ten. So help me narrow my list. Provide me with a summary that sparks my interest. Keep the summary no longer than three pages. It's okay to attach your complete business plan, but realize I won't plow through it unless I understand your business summary.

After I read a summary, I usually know whether or not I want to invest. If I decide I don't want to invest, we just saved both of us a lot time and expense. Please, if I notify you that I do not have an interest in investing, don't think that if you could only meet me face to face, you could "sell" me on your idea.

But, if I invite you to meet with me, then you know that I'm interested and that you're half way to obtaining funds. To help prepare me for our meeting, I'll expect your business plan to discuss your business in detail.

Even if I view myself as a sophisticated investor, at this point in my evaluation I am inevitably forced to rely on clues obtained through interviews and due diligence to guess at what kind of person you are. My impressions and perceptions are created by small actions that are meaningful for their symbolism, for what they reveal. I'll watch how you behave during the interview (or my due diligence) and use it as a proxy for how you will handle my investment and deal with me after I invest in you. Unlike the process of qualification, which is predominantly rational, logical and based on facts, the selection stage is mostly intuitive, personal and based on impressions.

The first thing that will catch my attention is your preparation. There is no bigger turnoff than someone who begins a meeting with me without being able to explain their business concept or idea in sixty seconds or less. It not only reveals a lack of clarity, but makes me feel like I'm about to waste time with another "idea" person. Lack of clarity is the first indication that you don't have a clue about what you need, where you're going or how you'll get there. You're just trying to find someone with deep pockets and foolish enough to fund you.

On the other hand, someone who can describe what it is their business does; articulate the typical prospect they sell their product or service to, the main industry they serve, and how large the market is; tell me how they'll make money; identify the key reasons they can be successful; state their competition: who they are and what they have accomplished; and tell me how they separate themselves from their competition—will catch my attention. It shows me you've done your homework. It tells me something about you.

Your most productive tactic here is to educate me. Pretend you and I are just entering an elevator on the ground floor heading to the 42^{nd} floor. You've got 42 floors to tell me why I should invest in your company. Help me picture in my mind what you do and how I can profit by investing in you. If you get me excited about the possible opportunity, I will then want to know more about how I can help you. If I don't acknowledge the opportunity, nothing else you say will be of any interest to me.

The point can be taken further, for preparation is your opportunity to demonstrate initiative. You see, this meeting is not your meeting. I'm interviewing you to see if you and your business fit my investment criteria and risk level. You get to interview me only if I decide I want to go forward with you.

I'm having this meeting because I want to hear you articulate and explain your business and how it will make money. By having a face-to-face meeting, it helps me evaluate you and your team, how you interact with people, how you answer questions, and your body language when you answer them – in short, are you the type of person I want to partner with.

I do not want you to avoid answering my questions or to give me vague answers. My time is important to me. Don't force me to repeat my questions. When I ask you if you've had any significant problems, don't hide them. I'll eventually find about them and when I do you'll lose all credibility with me. I want to learn what I can do for you, so leave your lawyer at home. Lawyers are by nature combative. Their pay is directly proportional to the time they can drag out what they're doing. It will be cheaper for the both of us to agree on a deal that the lawyers can draft in legalese later.

If I like what I see and hear, then it's time to discuss a "deal" or lay out a preliminary outline of the investment – size, percentages, general terms, and so on. However, getting me to an immediate decision on a transaction won't necessarily be easy. After all, I've just read your proposal and met you. But, you should expect me to give you an indication of my interest level and my ideas for the type of deal that might best fit your situation.

Even though I may acknowledge that there is an opportunity, I'll be looking to see if you have some basic personal qualities. For example, I want to work and partner with honest business people. A dishonest business person is like a sprained ankle that you never know when it will give out on you. You must convince me that you have a strong desire to win and to make money; that you have the physical and mental energy to execute your plan and weather the years it will take to deliver the financial results. You'll need to make me comfortable that you're intelligent. Not just in terms of degrees from recognized universities, but by demonstrating logical thinking and the problem solving skills to handle complex situations. I want to determine what specialized knowledge you have that makes you able to make money from the proposed venture. You must show me you have the leadership qualities to get the job done either by doing it yourself or through others. Finally, I want to see that you are a creative, resourceful problem solver who will not hit a wall when solutions are not obvious.

You must make me feel comfortable that you know your stuff. My partners and I are going to fire hundreds of questions at you from every direction about your business. There'll be marketing questions, production questions, and financial questions. We'll want to get behind your projections and the evidence supporting them. We'll expect you to know your business inside and out.

I'm going to discount all your assertions and claims until you give me some evidence to back them up. For example, don't tell me you're an expert in your industry (or on a particular topic). Rather, illustrate it with your knowledge of key industry terminology, facts and figures or latest events. That way, I'll draw my own conclusions (which I'm going to do anyway) about how well you understand the proposed business venture and potential issues.

While I expect you to know your industry, don't assume I know nothing about it. Instead of saying "Here are the three most important things happening in our industry," say "Our experience suggests that these are the three most important things. Do you agree?" If I agree with you, fine. If I disagree, we can have a conversation.

To avoid coming across as arrogant, patronizing and pompous (a common experience with entrepreneurs) turn your assertions into questions. By doing so, you convert possible signs of assertiveness into evidence that you'll respect my opinions, involve me in the thinking process and are sensitive to the need for a congenial relationship. Your manner of speech, how you choose to phrase your sentences, tells me something about how you'll deal with me. Make our meeting a conversation. Don't talk all the time.

Show a sympathetic understanding of my role as an investor in your company. Understand that I expect you to keep me abreast of what's happening, to be able to measure your progress, to see what your budgets are. By asking me about these things, I'll believe you are treating me as a person, not just a funding source.

This doesn't mean I want to become your best friend. It does mean that I want you to be sensitive to the fact that your prospective investor (me) is a person, not a corporate entity.

Don't start telling me how you can make me a lot of money until I have acknowledged that there's an opportunity here. Simply asserting to me that I have an opportunity to make a high return isn't enough. If you say it, I can and will doubt you. If I say it, it's true.

The key talent in raising capital is being good at getting me – the investor – to reveal my investment criteria, needs, wants and concerns. If I'm talking, telling you about my investment strategy and my needs, you're ahead. If you're talking too much, you're losing. Business owners and entrepreneurs talk too much. Ask good questions; then listen.

As you try to get me talking about my investment strategy, demonstrate your sensitivity. I do not respond well to someone who asks me right up front "Are you willing to invest in my business?" That's too assertive and you haven't yet earned the right to an answer. Similarly, don't ask "How much would you invest?" I'm not going to answer that. But I might answer this, "What types of investment opportunities are of interest to you?" I can answer that without feeling uncomfortable.

While I am unlikely, initially, to tell you my investment criteria, I may be willing to acknowledge certain industries and markets that interest me. For example, ask me what industries I find attractive and why. Instead of asking, "What recent investments have you made?" say, "We believe our industry is positioned for growth because of... What prospects do you see for our industry?" That question gives you an opportunity to show you are familiar with your industry, and that you're interested in my prospective.

If I do begin to show interest in your industry, your next task is to convince me (or get me to convince myself) that your particular opportunity is big enough to bother with. Remember, I don't like investing time in deals that don't fit my criteria. I'll only proceed if I'm convinced the benefit is big enough <u>and</u> certain enough (two separate issues) to justify the expense, time, and effort of investing in you.

If I'm still with you, interested in (maybe) proceeding, I may ask you for more information. This is the start of my due diligence. This means I'm going to conduct background checks on the management team, complete an independent industry study, and verify the representations in your business proposal. This review is a more detailed study of your business plan. I'll try to find misrepresentations in your plan, verify the potential of your business to make money. You must understand that it's my nature to be suspicious. By working with me through my due diligence, you leave me with the sense that you're the type of professional who will respect my judgment and involve me.

Recognize that I'm not going to say "yes" or "no" until I complete my due diligence. I'm going to consult my advisors before I make a decision. So don't pressure me. Don't try any "closing techniques" on me. Give me reasons and reasoning which I can use when I consult with my advisors and colleagues.

Instead of reaching to close a deal at every meeting, make your objective one of making progress in our relationship. If you try to rush me, I'll take it as a sign that you're more interested in getting funding than in making a return on my investment.

I may ask you for a formal presentation merely to confirm (or destroy) a decision already made. If you can't afford to spend time, up-front and in personal contact, don't bother writing the proposal.

Here's what I want if I ask you to make a presentation. Sit down, distribute your materials in advance and let's go through them together. Don't lower the lights, put up your slides, stand up and walk me through your canned speech. It makes me feel I am being lectured to. If I want to ask about something, don't say "we'll get to that." It makes me feel like you're inflexible.
If I interrupt you, deal with my question. I want to see how you handle yourself when I ask a question, not judge how practiced you are at your standard spiel. Most of you rehearse your presentations, but rehearse the wrong things. I'm not looking for how smoothly you can get through your practiced presentation. That's not what influences my decision. Rather, I give great weight to how flustered you get when I ask hard questions. Flunk that test, and I'm not sure you're the one I want to trust. What you should be rehearsing are your responses to my questions.

I want you to prove that you can listen, by picking up on my comments and – adapting in real time – what you say to what I've just said. Involve me. Ask me what I think. I know someone's listening to me when they show the ability to depart from their prepared scripts and base their subsequent comments on what I've just said. If you don't have the talent to depart from your script when I throw a curve ball (and I'm going to), then why should I believe in your abilities?

When I challenge you with an objection, hear it out, don't interrupt. Don't tell me I shouldn't be concerned about that: I've just told you I am concerned. Acknowledge what I said as a valid concern. I'll let you rephrase and soften it, but make sure you check for my acceptance of your rephrasing. Then give me an answer; and ask me whether I accept your answer. Don't try to "survive the moment" by waffling and moving on. You may get out of an uncomfortable moment, but I'm going to be left with the feeling that you didn't answer my question. And that means I don't trust you.

I'll be impressed if you've clearly anticipated me and thought of that objection or concern before – it shows me that you've taken the time to see things from my perspective. So predict my objections and practice your responses as part of your preparation. On such things are sales won or lost.

Summary

No matter whether you're seeking funding from your local banker, a venture capitalist, an investment banker, or your friends and family, your single biggest challenge is to help investors resolve whether the investment they are reviewing is any better or worse than the others.

As an investor, I simply want to understand what you're asking me to invest in, my risks and potential payback, so I can choose the investment that makes me the most money within my risk tolerance. Without enough of the right information, I won't feel in control or comfortable enough to choose which investment is right for me.

Mike Elia is the president of Elia and Partners, LLC, the author of Business Plan Secrets Revealed, and the Chief Financial Officer for FastenTech Inc., a $240 million company owned by Citibank Venture Capital Group. He's helped business owners complete $967 million worth of merger and acquisition transactions and arrange for $760 million in financing from 1997 to 2003. Business Plan Secrets Revealed provides in-depth guidance on preparing a business plan that earns credibility for your business and wins the confidence of investors. [http://www.business-plan-secrets-revealed.com.](http://www.business-plan-secrets-revealed.com)