The Life Science Executive’s FUNDRAISING MANIFESTO

BEST PRACTICES FOR IDENTIFYING CAPITAL IN THE BIOTECH AND MEDTECH ARENAS

Dennis Ford
Every entrepreneur in the life science field who is seeking to raise capital must make a decision at some point about whether to do so using a fundraising partner. On the surface, the answer seems obvious—let an expert who has experience in such matters handle it so others on the team can concentrate on their areas of expertise. However, the arena of early stage fundraising partners is filled with a diverse cast of characters that constitute a “Wild West” of sorts. The purpose of this chapter is to provide you with some insight as to why a fundraising partner may or may not make sense for your company and to examine the various forms these fundraising partners take along with their respective advantages and disadvantages.

The first thing every fundraising executive needs to do is look in the mirror and determine whether he or she has what it takes to go outbound. As we go into the nitty-gritty of exactly what it means to embark on a fundraising campaign, you need to ask yourself whether you have the capacity to create the necessary materials, compile the investor list, and stay on the task of managing outbound mailings, conducting the 30 to 40 daily follow-up calls, and scheduling the meetings. Simply put, some have what it takes and others do not. Some of us are preprogrammed for this
kind of activity. If it’s beyond your ability or you just don’t have any experience with it, you have to ask yourself whether you want to learn how to do it. As is true with other challenging endeavors, you will only succeed in mastering all the facets of outbound fundraising if you have a strong inner desire to do so.

Marketing and lab science really aren’t so dissimilar when it comes to the numbers involved. Experimental science and marketing are both based on very high failure rates—failure is innate in both of these sciences! Yes, I just stated that marketing is a science. The rates of success are similar; you have to try something 100 times before getting one or two positives. The same mind-set required in the lab must be applied to outbound marketing; you must delight in irregular wins, despite the inevitably high failure rates. Both require individuals who can persevere day to day under these adverse circumstances. That is precisely what makes a great scientist and a great marketer.

To start to develop an investor relationship, someone has to take a list of investor candidates, reach out to them, and set up meetings. This simple act is a lot harder than it sounds because every start-up is trying to talk to the same investor candidates. It is a tedious job and you have to be incredibly persistent in navigating around all the barriers that are out there.

The first big question to answer is who is going to be the point person for owning the outbound efforts needed to secure investor meetings? Let’s take a quick look at the decision tree regarding this pivotal strategy (see Figure 3.1). The first and best choice is that you, the leader of your company, decides to bite the bullet and learn a new set of skills in order to go out and find the capital. If this is impossible, can someone else in your organization manage this task effectively and willingly? Your last option should be to go with a third-party entity only if there is no possibility of a member of your company devoting the time and resources to outreach.

Remember that even if you choose an outside partner, you and your team are still going to be hitting the road to attend meetings; make no mistake about that fact. Somebody in-house has to own the outbound aspect of outreach to investor candidates and be actively involved in the process of courting them. You can outsource some of the specific tasks, but you still need in-house ownership of the process.
No matter who sets up the meeting, the executive team must sell the company and innovation or product to the investors. There is no way to get around that fact. Simply put, investors invest in companies—the people and the products. Having a sound management team is as important as having a great product—that is a nonnegotiable fact of fundraising.

**Engaging with Broker-Dealers**

In the United States, anyone engaged in the business of facilitating a purchase or sale of securities between a buyer and a seller is required to be a registered “broker-dealer” (see Figure 3.2). This registration is governed by the Securities and Exchange Commission (SEC) of the U.S. government and the Financial Industry Regulatory Authority (FINRA). Most states also regulate broker-dealers under separate state securities laws. Regulatory climates are different in other parts of the world, but generally speaking, most countries have a regulatory framework surrounding these types of transactions.
Being registered essentially means that these firms have agreed to meet certain compliance standards, have vetted their staff and ensured that staff members have passed certain license examinations, and have been officially cleared to engage in raising money and selling securities. Unfortunately there are also many unregistered entities that engage in raising money without meeting these regulatory standards. Let it be said that this book is not a source of any legal advice and that you should always consult with your legal expert before engaging in business with any fundraising partner.

**Categories of Fundraising Partners**

So what exactly is a fundraising partner? It’s a broad, catch-all term for anyone who claims to have the ability to raise capital for you through his or her investor network. Within this general definition are dozens of models, ranging from the highly sophisticated investment banks to the “friend-of-a-friend” sourcers and finders (whom I will describe in detail later in this chapter). Wherever there is a thriving market rich with start-ups, you will find the third-party service providers that will match up those companies with capital. Where there is tremendous upside and opportunity, everyone and his brother wants to cash in on the next big thing, so many entities
jockey for position as the go-to guys who can find the capital and bring companies to the right investor. Navigating this third-party fundraising market can be difficult even for an expert, let alone a novice.

The main challenge when raising funds is understanding what is legal and what isn’t. Unfortunately, determining this is going to cost you money, as you need a lawyer to advise you on these matters, since the rules and regulations are ever changing. Other considerations are how much these third parties charge you, what the company promises to deliver, and what they expect you to give in return. Key details to remember are that it is the executive team and the strength of their product that will ultimately convince the investor on the decision to allocate and that all the heavy lifting will be done by your team during the vetting and product due diligence processes. You must be careful not to give away too much for introductions and potential relationships, since the brunt of the effort will still fall on you and your team to get a deal done.

Payment methods requested can vary widely. Many third-party entities want a stipend or retainer that can range from a few thousand dollars a month to tens of thousands of dollars. They sometimes want a percentage of the amount they help you raise, which can range from 2% to over 20%. Many of these entities want warrants (a warrant is an option to buy stock at a particular price) as part of the fee deal; still others demand equity (a piece of your company).

Third-party entities tend to gravitate to what is hot and represents the quickest path to a cash payout. Many times these entities have a stable of start-ups they are representing, some of whom naturally capture investor attention more easily than others. These start-ups will always be prioritized, and if you’re not one of the top priorities, you may be left in the wings paying a monthly stipend and not getting any investor meetings.

So you can see that when I refer to the third-party fundraising sector as the Wild West, I am not joking! You must have a sophisticated team around you so you can be sure that you are being charged fair industry standard rates and that there is someone to raise the red flag if any terms sound unfavorable. It is very easy to become the victim of a predatory strategy of a convincing third-party entity. Buyer beware!

That being said, there are plenty of upstanding third-party fundraising entities you can work with, and later in the chapter, I will provide you with
a guide to help you vet these partners. I have broken these entities into six general categories (see Figure 3.3).

<table>
<thead>
<tr>
<th>Entity</th>
<th>General Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>The finder or sourcer</td>
<td>Typically an individual with a “strong” network; make sure they have the appropriate licenses to represent you in the buying and selling of equities.</td>
</tr>
<tr>
<td>The third-party marketer</td>
<td>Can be an individual or a regional or global firm; sophistication varies. Make sure they have the appropriate licenses to represent you in the buying and selling of equities.</td>
</tr>
<tr>
<td>The investor-audience provider</td>
<td>Can be a “connected” individual or firm. Uses a pay-to-present model; be sure to check references for recent success stories.</td>
</tr>
<tr>
<td>The consultant or advisor</td>
<td>Typically an individual or small firm; tends to be sophisticated and often offers value-added services.</td>
</tr>
<tr>
<td>The investment bank</td>
<td>Can be a firm of any size; tends to be sophisticated and typically offers value-added services.</td>
</tr>
<tr>
<td>The crowdfunding portal</td>
<td>A potential solution for very early stage companies; most appear to be a relatively costly option, and their legal status is pending.</td>
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Figure 3.3: Types of fundraising partners

The Finder or Sourcer

This category covers a broad spectrum of entities that claim to have the ability to source capital via special, high-end personal networks. They come in two flavors: sourcers have some technical expertise that allows them to vet deals, so that when they present an opportunity to someone with capital, they can claim to have gone through a first due diligence process of sorts; finders claim to have connections in the “right places” and that they can get you into introductory meetings with people who have money. The “right” places could take the form of a venture capital (VC) firm, family office, or other such established investors. The finders may claim that they are the only access point and that only they possess the inside knowledge required to reach these investors.

Finders and sourcers will often surface at events and conferences that focus on guiding entrepreneurs in fundraising. There are very successful,
well-connected sourcers and finders with the right licenses and strong networks that can be excellent and productive resources for entrepreneurs raising money. However, this category also has its share of unlicensed entities that operate in a legal gray zone. As such, it is imperative that an entrepreneur does his or her own due diligence and carefully vets a company or individual before engaging in any sort of agreement. Either of these constituents can charge you for general services or meetings, or get a piece of a deal—or a combination of both.

**The Third-Party Marketer**

Third-party marketers are firms or individuals that market securities on behalf of your company. They have lists of investors of various types and promote your firm to them in order to source your capital. Simply put, a third-party marketer is an outsourced sales force that helps to sell your equity.

Although there are many registered third-party marketers, some of them are unregistered; you must proceed with extreme caution when negotiating with these entities. The third-party marketers typically are compensated through a monthly retainer plus a success fee in the form of a percentage of the money they raise.

**The Investor-Audience Provider**

These entities are essentially “pay-to-play” matchmakers that typically charge you a fee to go to a preset meeting with a potential investor or group of investors. When it comes to these types of scenarios, if it sounds too good to be true, then it probably is. There have been stories of these types of arrangements leading to allocations, but simple logic would indicate that a truly serious investor or group of investors who would be interested in the long-term viability of the companies in which they are investing wouldn’t want to potentially hamper their development by charging up-front fees just for a first meeting. If investors trust in their investments, they would undoubtedly rather see that money put toward the growth of the company or product.
Anecdotally speaking, many investors with whom my company Life Science Nation (LSN) works have at some point been approached by an investor-audience provider, and the experience has usually proven to be a disappointment.

**The Consultant or Advisor**

Consultants are an interesting breed in the fundraising space, largely because the term is used so broadly. There are many different kinds of fundraising consultants that utilize a variety of compensation models. However, a consultant could be simply defined as a third-party marketer that offers some insight and expertise on how to approach your capital raise. They are typically individuals or small firms, and though they may not have the arsenal of resources that a full-service investment bank can offer, they can help to some degree with advice on positioning and developing a market strategy.

Consultants can vary in terms of quality and legal legitimacy, so be careful in navigating the territory. Consultants, like third-party marketers, typically are compensated through a monthly retainer or a success fee in the form of a percentage of the money they raise, and sometimes both.

**The Investment Bank**

Investment banks (or I-banks) are typically certified broker-dealers that have access to life science entrepreneurs and a myriad of investors; some specialize in high-net-worth individuals, family offices, and institutional connections. Though there is considerable crossover between I-banks and third-party marketers, one of the primary differentiators is that I-banks often offer strategic advisory services. Additionally, they often compose the offering memorandum and other components of the legal paperwork required in the fundraising round.

To establish a productive relationship with the right I-bank, it is important to undertake a thorough vetting process. You need to find a life science-specialized firm that understands the industry’s technology, knows the marketplace, and has access to current life science investor data. At the very least, find an I-bank that is specialized and has access to the right kind
of clients. Investment banks, like third-party marketers, are usually compensated through a monthly retainer, plus a success fee (typically about 6%) as a percentage of the money they raise; as with other entities, they can decide to throw in warrants and equity as part of the package as well.

**The Crowdfunding Portal**

As already discussed in the legal section of this book, crowdfunding potentially represents a new fundraising partner category. The Jumpstart Our Business Startups (JOBS) Act, pending SEC acceptance of the new rules, can allow a fundraising executive to use an online portal to raise money via an online campaign. You may refer to the Crowdfunding section of Chapter 2 for an overview of the current rules and regulations in place for this type of investing, though as of the writing of this book, they are far from established. Again, please ensure that you are up to date on the legal requirements for all fundraising transactions, as they are constantly evolving and changing.

Because there is a ceiling on the amount that can be raised through crowdfunding, it is likely best suited for early stage financing to get a company off the ground. Moreover, the fees associated with these portals are likely to be disproportionately high, as justified by promises of quick and easy money. Additionally, the regulatory compliance work required over the long term, coupled with the large number of investors to whom you will be beholden, could make this a less attractive option. Because it is an untested model, when it comes to equity crowdfunding for life science companies, the proof will be in the pudding.

**Regulation D**

Changes to Regulation D Rule 506 have done more than opened up the possibility of using crowdfunding as a tool; restrictions have also been loosened on soliciting capital for private offerings. Essentially, Rule 506 implies that it is now legal (though you must review this with an attorney) to solicit private investment capital directly from accredited individual investors (with certain income stipulations—see the Regulation D section of Chapter 2 for more detailed information on this).
This opens an enormous wealth of opportunity to companies seeking to raise money, as these entities could previously only be propositioned with an investment opportunity after certain requirements implying an established and ongoing prior relationship had been met (for example, a history of meetings over a specified period of time). Changes to Rule 506 will lead to a massive reduction in red tape and the compliance work required to raise money. Additionally, fundraising via this avenue doesn’t carry with it the same limits on capital that crowdfunding does. In fact, you can raise as much as you’d like, without any formal caps or limits (see Figure 3.4).

This regulatory change is groundbreaking for fundraising executives and offers huge potential if effectively leveraged. It will greatly enhance the ability of my company LSN to assist entrepreneurs in raising capital using an outbound fundraising strategy, as the timeline to cash has been greatly shortened.

**Vetting Fundraising Partners**

As mentioned in the introduction to this chapter, the landscape of fundraising partners is a veritable Wild West. There are some excellent firms that are trustworthy and have proven track records, but there are many unscrupulous entities with dubious legal or moral standards. I have heard both great reports and terrifying tales regarding every category of fundraising partner, so I know that there is no uniformly standard right choice. However, here are a few questions to help guide your evaluation:

- How many clients is the entity currently working with? Too few, and there may be a reason they are having trouble selling their services. Too many, and they may be taking a shotgun approach, hoping to hit on whatever is hot and potentially leaving you by the wayside.
- Ask about their track record—how much did they charge and help raise? Where, when, for whom, and from whom? If the firm or individual isn’t able to elaborate on their last few deals, that’s a red flag.
## Regulation D, Rule 506 & Crowdfunding Regulatory Overview*

<table>
<thead>
<tr>
<th>New Rule 506c Offerings</th>
<th>Crowdfunding (Pending)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Solicitation</strong></td>
<td>Marketed over Internet, TV, social media, etc., via advertisements or direct marketing</td>
</tr>
<tr>
<td><strong>Eligible Issuers</strong></td>
<td>Both SEC-registered and private companies</td>
</tr>
<tr>
<td><strong>Eligible Investors</strong></td>
<td>Accredited investors only</td>
</tr>
<tr>
<td><strong>Determining Investor Eligibility</strong></td>
<td>Various “verification” methods permitted</td>
</tr>
<tr>
<td><strong>Offering Size Limit</strong></td>
<td>No dollar limit</td>
</tr>
<tr>
<td><strong>Intermediaries</strong></td>
<td>Not required; any intermediaries used must be registered broker-dealers or exempt</td>
</tr>
<tr>
<td><strong>Disclosure</strong></td>
<td>Driven by market demands and liability concerns</td>
</tr>
<tr>
<td><strong>Filing Requirements</strong></td>
<td>Prior filing of Form D, amendment post-closing, informal submission of solicitation materials to SEC</td>
</tr>
</tbody>
</table>

*Derived from a table created by Sarah Hanks and originally published at www.crowdcheck.com, 2013.

**Figure 3.4:** Regulatory overview of Rule 506 and likely legal framework for crowdfunding
• Do references check out? Good fundraising partners live off their investor relationships and their reputation as a good and fair company. References should be relevant, in context, and current.

• What is the culture of the entity? Hopefully the prospective partner can speak positively of his or her own firm’s culture and give you a sense of the firm’s values and commitment to clients.

• What is their method of conducting deals? How do they interact with your prospective investors? There is no clear right answer, but this question is especially important to ask.

• Do you trust them? Basic trust is essential—if you do not have trust, you have nothing. Listen to your gut.

• Many investors want direct contact—particularly for early stage investments—and do not want (or appreciate) a middleman. What will your fundraising partner do if an investor voices that preference? The best answer is that they won’t get in the way of a deal, and will continue to make themselves valuable.

• If you are interviewing a third-party marketer, ask them if they use a mass-canvassing approach. Good third-party marketers are focused on targeting investors specifically. If their approach involves spamming, they are not worth your time.

Ideal fundraising partners understand investors’ needs and desires. They employ a rational, systematic approach to canvassing for an investor fit. This means doing lots of tedious research. Your partner should understand the value of fit, and be able to prove how they plan to match investors with you.

If you have decided that the best way for you to raise money is via a fundraising partner, be sure to get sound advice and do your research. Discussions with other successful entrepreneurs in the life science space, legal experts, and respected industry players will help lead you in the right direction.