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Contact:

David Shore

david.shore@GalvinCorporateFinance.com
604 614-5498 [Send instant email to this phone.](#)

David Shore's [vCard](#).
(Save to your hard drive for easy importing if you use Microsoft Outlook.)

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Client Validation

Today's venture capital climate for IT companies is still reeling from investments made during the recent bubble of optimism. Investments peaked a couple of years ago both in terms of volume and value invested.

Today's VCs will still try to determine if a company has a chance at a leading market position, but not from just being first to market. (Many believe that the first mover advantage is now a disadvantage.)

When a software firm is early in business development, VCs will want to talk to their existing and prospective clients to get a feel for the potential of the firm.

This client validation can be the most important aspect of due diligence that the VC performs in deciding which companies to fund.

How Important is Client Validation to VCs?

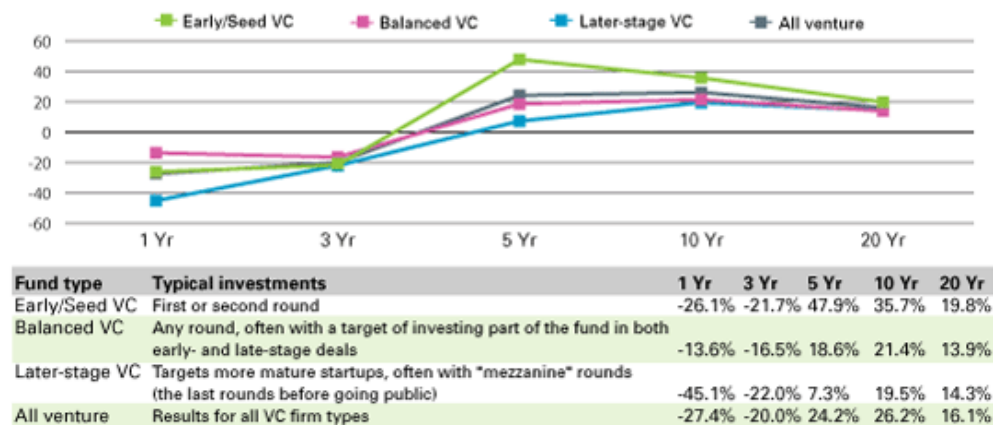
We asked a few of the more active VCs in town how important client validation is today.

[Mike Satterfield](#) of Yaletown Venture Partners considers it fundamental. "If someone has a (supposedly) finished product ready to sell but no customers I would view that as a huge negative because the risk is high that the product doesn't address a real need in a differentiated way, or the company doesn't know how (or want) to sell."

[David McIntyre](#) of Ventures West agrees. "For an IT company client validation is very important. Even if the company does not have customers per-se, we need to hear from potential users in the marketplace if the product or proposed-product does what they

VC TIMING DETERMINES REWARDS

Venture returns vary significantly depending on the length of the investment and the investment style of the firm. Later-stage VC funds, for example, take the biggest hit in their first year of investment; returns typically sink more than 45 percent. Early stage and seed funds outperform others by a significant margin over the long haul.



As of October 14, 2003. SOURCE: National Venture Capital Association and VentureEconomics



In the News...

Galvin Corporate Finance president David Shore has been recently quoted in the following articles:

In the **Globe and Mail**, Shore was interviewed for an [article](#) about the New Ventures BC competition.

In **Business in Vancouver**, Shore was quoted in an [article](#) about the emergence of new venture capital funds in Vancouver and the impact they should have on technology company fundraisings.

In the **Vancouver Sun**, the **Vancouver Province** and Victoria's **Times Colonist**, Shore's contribution to the New Ventures BC was portrayed by one of the competitors in a [promotion](#) for the competition.

Client Validation Continued

want, they way they want and at the price they want to pay. Is this the right product at the right price? If I can't talk to any prospective customer, existing customer, or someone who might one-day in an ideal world be a customer, it is nearly impossible to do [a deal] for a software company. One of the big issues is it shows the company has been working in a vacuum and they will seem out-of-touch with the market." McIntyre said.

Satterfield also cautions against development without customer involvement. "The chance that a new company will build a product that really works in the customers' hands without significant customer interaction during development is low. If there has been significant customer interaction during development but the customer isn't buying, that too is telling."

Strong client validation can also motivate an otherwise hesitant VC into action. Most VCs seem to start looking for reasons to say no in the early stages of investigating a company. And saying no is something VCs get very good at. Yet the only people that really get a vote for the value of products are clients and prospects.

"If I don't like the company, but then see a list of 100 customers, that is impossible to ignore. If people are buying the product I am compelled to

look and find out why." McIntyre added.

Benefits to Entrepreneurs

Client validation is an important step in the process of venture funding. This is a key step in either moving on to a close or going back and building a case for funding. In either situation, the sooner entrepreneurs can engage investors in this milestone the better.

Aside from advancing the process with VCs, there are other benefits to be gained from this stage in the process.

Some prospective clients are reluctant to commit to a

fledgling start-up unless they are confident the company will be around long enough to deliver the ROI they seek. When business development stalls for this reason, working with the VC to phrase questions to help close a sale can have double the positive impact.

The client validation process can also help investors get a better picture of the value the solution has for the target market.

"In the event that the value proposition doesn't appear strong, it can help to talk with a variety of people in an attempt to clarify - some companies are surprisingly inarticulate about their value proposition, in which case discussion with prospective customers and partners can help." Satterfield

"The only people that really get a vote for the value of products are clients and prospects."

Preparing for Client Validation Questions

Any time entrepreneurs engage the time of VCs there is plenty of reason to make their life simple by having as much detail prepared in advance and client validation calls are no different. Here are some things to consider:

Contact List

Include name, company, position, phone, email, relation to company and the reason they are on the list. Provide as much as possible on where the person fits in the organization and the purchasing decision.

Time Coordination

Have both parties agree on a window for when the calls will

occur so both can be prepared.

Prepare Your References

Ensure your references are prepared for the call. Ask your VC to provide a list of the questions they expect to ask and spend some time to help your reference get acquainted with them.

Keep in mind that your references are likely to be more enthusiastic when talking to you than they would be with your VC. If they feel they are sticking their neck out for you they may hold back. Remind your references that the VCs are simply trying to understand why you value the product.



Investors' Top Client Validation Questions

What are the top client validation questions entrepreneurs should prepare for?

- What is the pain and where does it fit in the company's pain hierarchy? How do they quantify the value of a fix? Is the company committed to solving this problem?
- How does the customer describe what the product does? What are the key features they selected it for and what is it missing?
- What else did they look at when were shopping for this product? How familiar are they with the company's nearest competitors? Why did they select this vendor to fix the pain?
- Would they consider building their own solution and if so, how far are they with an estimate of cost?
- Do they think they have similar needs as other companies in their space or do they think they are fairly unique?
- What were the business and technical selection criteria? How long did this take?

C30 Wins

Galvin client [Condition 30](#) was a top ten finalist in the recent [Telus New Ventures BC Competition](#).

Investors' Top Client Validation Questions Continued



- How important was price in the selection? What was the cost justification and ROI (dig for parameters)?
- Did they recognize other tangential returns? What did they pay for the fix? Did they get what they expected? How do they feel about value promised and delivered?
- Was the fact that the company was a small Canadian startup an issue? Why?
- Was there a pre-existing relationship with the vendor, and how did that impact the decision?
- Where do they expect the relationship with the vendor to go from here?
- When do they expect to buy? Is the budget in place? Who is in the loop on the budget decision? Who will be making the final decision?
- Who else should the vendor approach as a potential customer?

About Galvin Corporate Finance

Much has changed with the way investors screen opportunities; some rules have changed and the focus on third-party validation and due diligence on execution has intensified dramatically.

What has remained constant is the need for entrepreneurs to juggle the time-intensive money raising process with the required focus on the business development activities that will make an investment attractive.

Galvin Corporate Finance assists emerging IT companies with the

process of raising private equity, debt and government assistance for growth while enabling entrepreneurs to keep focused on their business.

Services include:

- Financing Plans
- Business Plans
- Presentations
- Presentation Practice
- Due Diligence Prep
- Marketing to Investors
- Deal Structure
- Negotiations
- Closing

Recent clients include Scientia, Celeres, Universco, Payroll

Guardian, TAP Ventures, Crystal Quartz Canada, Aggredata and CIBC Investment Banking.

The principal of Galvin Corporate Finance is David Shore who has 12 years of experience in mid-market mergers and acquisitions and raising debt and equity investments. David has a broad network of lenders and equity investors in Vancouver, Seattle and Toronto, and has recently closed financings in this rather cool investment market.

For more information call 604 614-5498 or write info@galvincorporatefinance.com.

“What has remained constant is the need for entrepreneurs to... focus on the business development activities that will make an investment attractive.”