



FUNDING EARLY-STAGE INNOVATION

Using the Cornerstone Investor Model to
Attract Investors In 4 Presentations or Less

DANIEL J. O'CONNOR

B.Bus , MBA, FAICD, (Dip) MAIM, AAMI, CPM, MAIeX.

Inventors Coach

TABLE OF CONTENT

| Funding

| How I Discovered The Cornerstone Investor Model

| The Four Elements Of A Cornerstone Investor

| The 5 Reasons Investors Take Action

| The Right Amount Of Funding

| Timing And Sequencing

| Setting The Plan

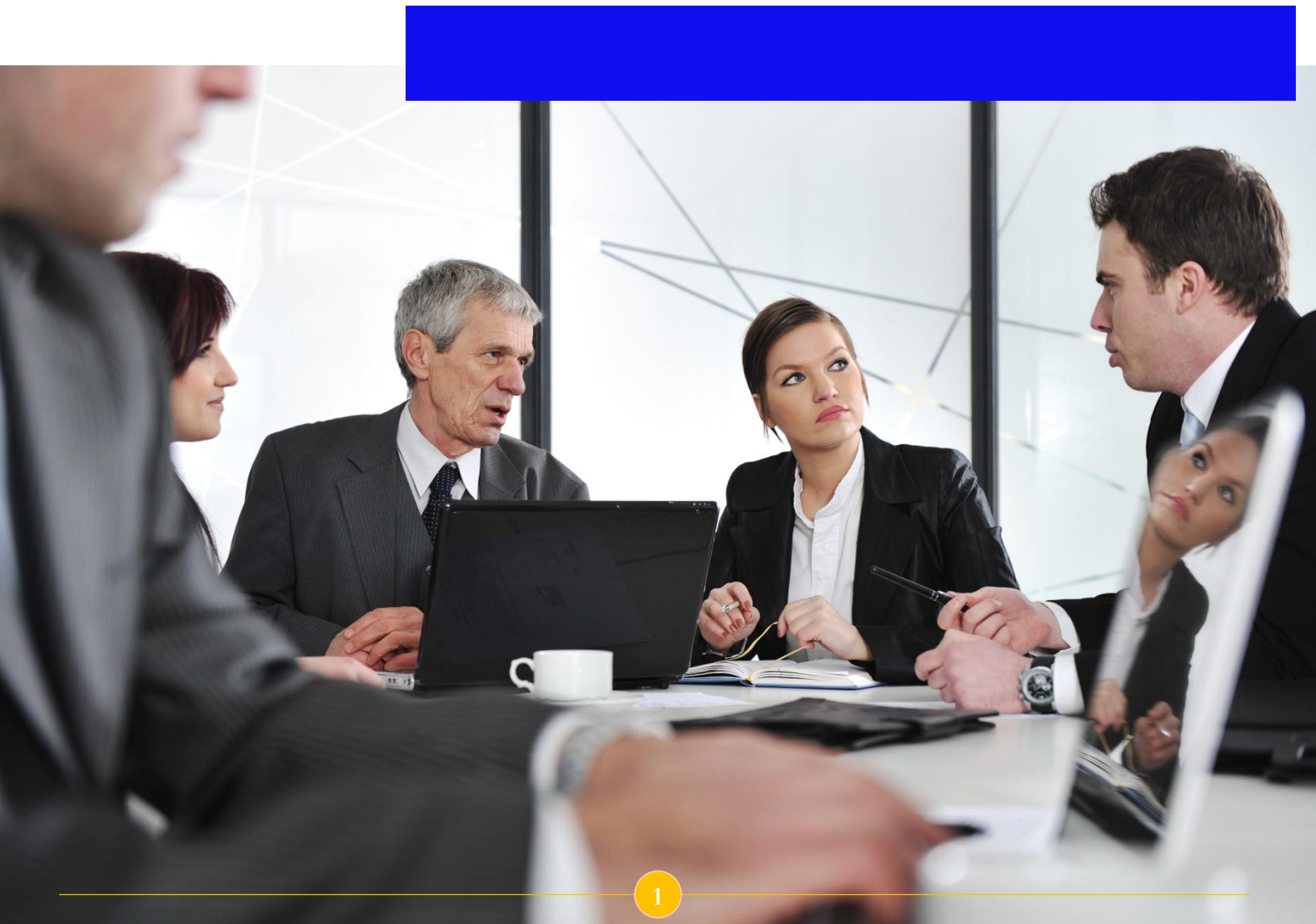


Funding

Let's talk funding

I want to teach you the key points. First, how to identify the right investor for you, so you don't have to pitch 100 or more times and hope something works differently, at least one of those times. Then I want to show you how to stack your leverages and remove the risk, so you know the investor will say yes and want to get on board with your project. Third, I'm going to show you how to avoid all those rookie mistakes that you hear about so that at the end of your 20-minute presentation, you're going to hear a yes, and you'll get to retain that yes because you want to do business straightaway. Nobody signs on the dotted line within minutes. They take days, sometimes weeks, and it's usually about two and a half to six weeks to push the process until you've got cash in the bank.

So, the first part is how to identify the right investor for your project.



How I discovered the Cornerstone Investor Model



Now I want to share an interesting story about the four critical things I learned from a Burmese investor that changed where and how I get funding. In 2016, as part of my UN Task Force, we set out to write a coffee table book called Innovation from Adversity about people who had developed innovation from absolutely nothing, who had no access to resources like government, banks, funding, consulting, any funding at all, and they had to do all of this themselves; some of them literally had dirt hut floors, but were successful.

We identified the success not necessarily being money, not a certain amount of monetary value. Rather, if that individual can become self-sufficient for themselves and their family and become benevolent into their community, that was registered as a success. We wanted to learn their stories, their trips, and tips and share them with others. That was the whole objective of that book. We looked at developing economies because we felt they are less likely to have access to any resources, and they were working from within adversity.

On one particular day, I was in Irrawaddy, Western Burma. Irrawaddy Delta is famous for Cyclone Nargis. It lost more people than the tsunami we all remember, but very few people have heard about it because of the deceit of the Burmese government. I had done an interview that morning with an interpreter, and we were sitting on the runway - me on my suitcase at the end of the runway in Irrawaddy Delta, waiting for the single-engine aircraft to come and pick us up and take us back to Yangon. While we were there, I listened to a recording on my phone from an interview done in Dhaka, in Bangladesh.

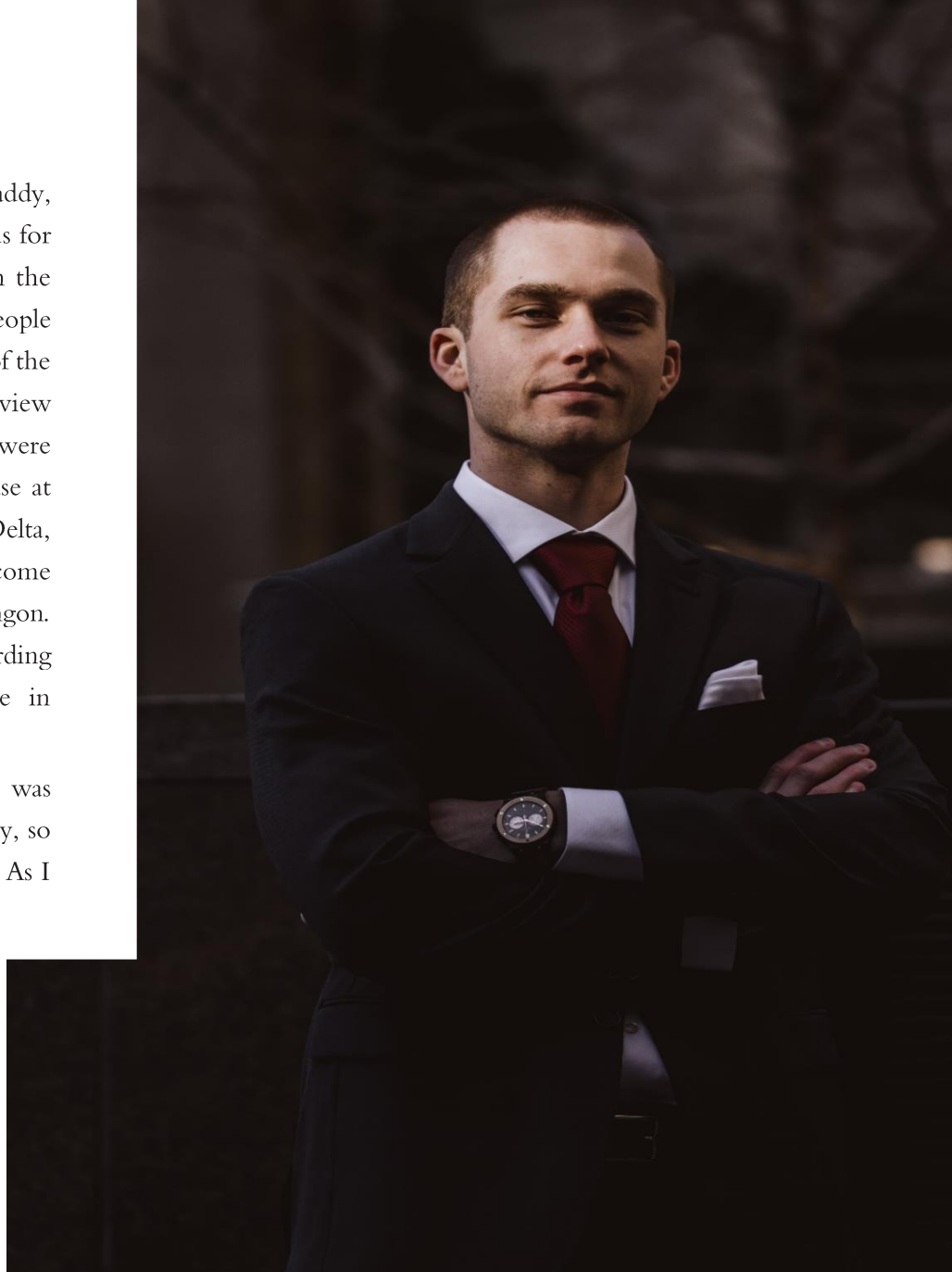
This interview I had just attended was completed with an interpreter in Irrawaddy, so I had an idea of the questions and format. As I listened to the same interview format from

Dhaka, the response to one question was quite interesting - it was tabled by the person who put the money in. I started to explore that a little because I had just got the same response from the interview that morning; it was radically different from what I expected.

When I got back to my hotel room, I started to listen to these different interviews, cutting through to the investor and listening to the responses to the questionnaire.

It began to correlate strongly that these people were indeed answering differently than I had expected. So, I shared that with my colleagues, and we decided to do some further research on this, primarily with my clients, because nobody else wanted to spend the money - and it does take money to do this. I picked several clients from Australia, Singapore, and North America. We decided to ask the inventors if we could speak to the person who put the money in. Most of them agreed and put us in touch.

We asked these investors just one question: What made you jump into this project? We didn't say, "what made you invest in it?" we said, "what made you jump into it?" There's a reason why we framed the question that way. Again, the answers correlated strongly with the responses from developing economies. That was a shock because it meant that we were looking at funding in a completely different way. That became the big key to what we now do with the cornerstone investor model.





The Four Elements of a Cornerstone Investor

There are four critical things that these investors taught me in terms of their responses to some of these questions. Firstly, the definition; how they defined themselves. None of these investors saw themselves as investors. They were partners: helpers, mentors; they were many things, but they weren't investors. So that in itself was interesting.

Next, very few of them were in the projects for a return on investment. They came in for other significant reasons.

Thirdly, there were many non-cash top ups; that is, people were saying, "Well, you're going to need, \$100 and \$50 of that's going to be spent on acquiring the machine. I've got the machine, so I'm going to lend you that machine to do this, and that's going to save you \$50, and then you can give me \$40 for the equity out of that. So, now you only need \$60." Therefore, it was an excellent way to mitigate their risk by non-cash top-ups.

The fourth was that there were very few high-net-worth individuals, or specifically, millionaires. We always think, "Find me a millionaire! I'll get someone to throw money into my project!" Very few of these investors had that profile, and they nearly all got in for other reasons, which I will share.

Now, there were a lot of decision criteria for investor partners to be jumping into projects. I discuss the Top 6 because number six is the one you'd expect to take first place, and the five other key reasons were basically more important. I could have discussed a Top 10 or Top 20, but number six is the one that I need to include for your reference: return on investment.



The 5 Reasons Investors Take Action

There are five further important reasons why people jump into projects with money and other assets to make these projects work.

To start, fairly expected: novelty and protection. Nobody wants to invest in a me-too project that doesn't have that excitement; they don't want to do it.

Next, it had to have an exit plan. Again, we cover this repeatedly in this book—because it is so important – investors need options, and you have to demonstrate that you know that and offer a logical and achievable exit plan from the beginning.

Thirdly, risks managed. You need to show people that you understand what their risks are and how you're going to manage or mitigate those risks. If you don't do this well, people will recognize that you don't understand their business as well as they do. Most investors come from within the industry or the market, and they understand those risks far better than you, the inventor! Therefore, it's crucial that you show your prospective investor that you actually have a sizeable understanding of the risks and how you're going to mitigate those.

The number two spot goes to the commercial model. I can tell you this much, the money is not in the product, it's always in the commercial model you wrap around it. Now I'm going to ruin for you the business reality tv shows where people pitch their products to a panel of investors and (very often) walk away with investment just like that.

Do you think those investors are looking at the product? No, they immediately switch this and say, "What commercial model can I use? How will I interface this product to a known market?" If you watch one of these shows and you say, "So, that's what the product is - now, what's the market? How do I devise it for the market? How is it best done?"

What sort of rollout is it going to be: is it going to be a franchise, is it going to be a trade sale, is it going to be a license? How am I going to do this?" – you start working through those models. That's what those investors are doing. They're not looking at it, saying, "Well, that's nice, that works well, it's a great idea." No, it's not about that all, it's about the commercial model.

Finally, the number one reason why people jump into these projects—no matter what demographic they came from – was: leverages.

Now, leverage is fairly hard for most people to understand. So instead of trying to explain, I'm just going to give you a fictitious example.

Let's assume that I have a machine that does wheel alignments. It does them so well that I can do a wheel alignment for \$50, where it would typically cost you about \$100 to do a wheel alignment, and you'd charge about \$250 for that. Now let's say you have ten tire outlets, each with, let's say, 3,000 customers on your books. Those customers are not coming in every week, but you've got them on the books, nonetheless.

So, you have this all on a database. I come to you with this machine, and I say, "Let's install one in every one of your ten branches. Give me a million dollars, and I'll build them. We'll trial them in your branches, and then off we go." At that point, you'll buy them at the end of it if I can prove to you that they work. Of course, you would, because you've got a hungry herd of people who need wheel alignments, and every time you sell them wheel alignments, you're going to sell them tires because a wheel alignment pretty much says your tires are being worn down unevenly if you haven't got your wheels aligned. So that's where we are with the first of leverages, which we call reciprocal trade.

Now there are other leverages that will hang off of that. For instance, I can say to you, let's do this under an R&D program, and therefore, you can have exclusivity for 12 months. Then after that, you buy these machines for this much, and I use that capital to scale up the project. Another option for another leverage is for me to suggest that I bring you in, and instead of you paying for these ten machines, you simply pay all the cost associated with buying the parts and building machines? Therefore, you become what's known as a collaborative research partner.



Now, suppose your tax jurisdiction allows you to have collaborative research partnerships. In that case, you may get a tax deduction, a tax credit, or an incentive for investing in R&D because that's what you're doing now. So, if you're investing in R&D now, in Australia, you can get up to 46 cents back in the dollar immediately. That pretty much says that your million dollars are now only \$540,000.

You're going to buy these machines, and then you've still got a million dollars of equity in the company as it goes forward. So, it can show you how rapidly this can become huge in terms of how it works for everybody.

Next, I want to show you how to stack your leverages and remove the risk, so you know that investors will say yes and want to get on board. Remember: these investors are either from the industry or the market, and they understand everything about it, so you need to show them where the value is.

No investor wakes up and decides to invest in any unproven project; it just doesn't happen. And most inventors pitch what they think the investor wants to hear - all about the money and the returns and the great product.

A perfect commercial model works out an attractive offer; it proves the leverages that the partner will get, shows them how you managed their risks, and finally shows them how you planned their exit. If you cover these five things: model, offer, leverage, risks, and exit, people will say, "This guy understands my business."

So, with approaching your investors in mind, let's go over how to avoid the rookie mistakes so you get a yes at the end of your 20-minute pitch. Yes, a 20-minute pitch! No three or four-hour pitches! The psychology behind it is at three minutes, people start to drift; at

12 minutes, they switch off; and at 20 minutes, you've lost them completely. So, you can keep pitches between 12 and 20 minutes by giving them information that is of interest to them.

What you're looking to achieve is to get through that 20-minute pitch, get a yes, and then have that yes sustain itself over the next two to six weeks. Those two to six weeks will be taken up by all that deliberation, getting all the facts together; getting your due diligence file, getting evaluated, getting their people to understand what it is that they're putting money into, etc.

Let's go through some of those factors.

If you rushed out and got a patent or a prototype, that's money you've wasted, because you haven't got a value yet. Until you get a commitment for investment, remember you don't need a patent. As we looked at in Step Two, there are options to mitigating the need for immediate patents, such as non-disclosure agreements, waiver of rights, confidentiality deeds, and everything else to restrict the trade from anyone who looks at your project or is invited to look at it.

I would advise pitching a product without a patent, under a solid non-disclosure agreement - you will still have to write up the patent application and show that to them, but you don't lodge it until the day before they put the money in. Doing so gives you a full 12 months of provisional patent time; and, therefore, an opportunity to get your project from start to cashflow positive in 12 months.

That's what that Transition is all about: getting there in 12 months. So, at 11 months and 29 days, I can go into the patent office and lodge that patent or the extension of the patent, which can cost \$60,000 or more. But at that point there, the company's paying for it; If not, the project should have generated sufficient capital to pay for that.

That's what we've provided for you in your cash flow.



Next, if you've been hunting and begging for wealthy investors, you're probably not getting anywhere. I hope I've explained it to a point that most investors aren't your market. We can tell you that if you're getting a yes from a high-net-worth investor, within two to six weeks, you're going to get a phone call saying, "I love the project, but I don't want to get involved, sorry, I have changed my mind. Good luck with it."

The reason for that is not that they've lost their shine or anything else; it's due to other people around them. Any high-net-worth individual has people around them to manage their money: accountants, financial controllers, planners, all these types, and they all put up the barricades to potential loss of money!

If you're trying to take a million dollars out and put it into your project, that's money that's off the table for them. So, they're going to fight tooth and nail against you. If you don't want that phone call, don't go to high-net-worth individuals; they will just burn you.

Conversely, people often think, "If I get \$2,000, each from 100 people, I'm going to have the money I need; that's all I need." I can tell you from experience, if you do that, those 100 people give you another role or another hat to wear in your ongoing project, and that hat is Investor

Relations; you become somebody who has to manage these people. If you have one investor, and that person isn't actively involved in the industrial market, and they're giving you feedback constantly, you're going to want to talk to them. But these individual people, you're not going to want to talk to. Try to keep it down to one.

When I've had projects where two or three friends have got together and said, we'll pitch in for this, I generally encourage them to go and get a proprietary company format. Put their money into that as equity, and then pitch in or roll that money into the project so that the company owns it. That way, you can update all of them as one person. If you talk to one, you don't have to worry about breaking equity rules about pitching to others, telling one person information, and not telling others because you're then talking to them as one entity. Little things like that really do help you in the long run.

Next, did you pitch the invention? A lot of people start to pitch, "Oh, this is my great idea. It's terrific!" But they forget that it's all about the commercial model and don't pitch the invention. If you've done this right, you've already talked about the commercial model. You got the appointment in the first place because they know about the product, and now all they want and need to know about how this will make money, in what timeframe, etc.

So, let's go over which key points are necessary.



Some inventors go in there and talk about their previous successes and their current other projects. That tells people that you're going to be spending money on other projects too. Because if you've got more than one project going, how do I know you're going to be using the money I give you on my project, and the time you're spending on the other projects should be the time that I'm paying for?

There's always going to be that sort of conflict. There are ways to diarize your time, but you don't pitch any of the other projects you've got when you're going to present to a prospective investor.

Did you put yourself in charge of everything? In the Transition step, we talk about taking all the hats off and putting other people into your project with different skill sets; that's more important than ever because you've limited funds. Let's say you've got \$1 million, and \$600,000 of that is going to be for investment in people. If you spend that with the right people, your project is going to take six months and not six years, and that, people will understand.

Next, have you chased venture capital? We always remember the Americans talking about startups; this startup got \$80 million, that startup got \$100 million. They're not startups; they're scale-ups. Understand the difference: a startup is somebody who has little or no cash flow, and a scale-up is somebody who's doing, say, \$5 million a year and wants to get to \$5 million a month. That's for a moderately small project. So, if that were the case, then you can do that, that's scaling up; that's the time to talk venture capital. They don't invest in projects; they invest in cash flow; everything is about cash flow. If your startup hasn't got cash flow, or it's got very little cash flow, these people will nod, smile and send you away. They'll say, come back when you make these four criteria. So, save yourself time, don't burn them.

Did you promise millions? We find that one of the big mistakes that inventors make is they go in and start pitching millions of dollars just because they feel they have to be bigger than the last guy or the next guy. That's not the case. It's how realistic your returns are going to be, and it doesn't have to be millions of dollars. Investors are more interested from the ground up, not from the sky down, so promising millions doesn't work! Being realistic about how you're going to grow it, keep doubling it – that's what people will understand and represents far less risk for them.

How does the investor get out? As we've previously discussed, this is crucial – you need this planned out from the get-go. It's imperative that you show investors the exit pathway at the beginning, because they will not get in if they can't get out.

With all of that taken into consideration, remember, at 20 minutes you should be summing up! There are only five things you need to get across: model, offer, risk, leverage, and exit.



The Right Amount of Funding

If you have not prepared your budgets and researched your spend rates, or you haven't timed your patenting expenses and so on, most professional investors will walk away from the project. Worse still, some may fund you with the intention of running you out of money, so they can offer the additional finance at a much steeper rate, thereby taking your project.

The key here is to not ask for too much, but never ask for too little. There are some costs that can be pushed out to beyond the commercialization process. These costs should be paid for out of future cash-flow. Because the value of money at an early stage of the project is far higher than later, the project team should only seek funding for essential items that are critical to bringing the project to a positive cash flow.

In most cases, it's better to present your projections in a statement of source and allocation of funds. This allows you to put your cash flow projections alongside your equity placement or debt placement as agreed. Investors can assess at one glance, how the cash flow will track over the life of the commercialization process.

It is most imperative that money received (for either debt or equity) should carry the project into a positive cash flow situation. If, after the expenditure of these funds, your project is still incomplete, you will need to be extremely nice or ruthlessly tactical to dig your project out from under the chaos that will ensue.

One of the biggest issues in commercialization is always budgeting. If a project is under-budgeted, the money will generally run out before the project is commercial and everybody's investment is at risk. If a project is over-budgeted, the foundation shareholders are diluting themselves beyond what they need to, thereby giving away more of the project than they should have.

About a year ago, I looked at a very promising project, by a group of software developers, which I believe was truly a global game-changer. I did some rough costings with these guys, so I could get an idea of how much they actually needed to drive the project to a commercial reality.

They did not engage me at that time, as one of the prospective investors objected to spending the money on an independent consultant. The project principals made an agreement with this Cornerstone Investor, for a commitment that was substantially less than what was required, under the investment calculations we have made. The project subsequently ran out of money, and everybody was stuck.

The foundation shareholders had more than they could afford to lose, tied up in the project, and the Cornerstone Investor had a considerable amount of funds buried in there too. It wasn't until the parties were able to agree on a fixed valuation of the innovation and IP assets, could we prepare an offer document that would raise the appropriate amount of capital to reach a cash flow positive position. In VC (Venture Capital) jargon, everybody had to take a haircut, which essentially meant revaluing each of the shares issued, to accommodate the equity to be issued to new investors.

Timing and Sequencing

One of the most important tenets of investment and accounting is the time value of money. If for instance, \$1 million is required to commercialize a particular intellectual property, there would be a very small chance that all that expenditure would be required in the first month. If the development program is over twelve months for instance, there would be a monthly budget required which matched to milestones in the development phase.

Given that these milestones were achieved, the funding for the next part of the commercialization or development can then be drawn down. This will reduce the risk significantly for the Cornerstone Investor and make the investment far more attractive to a wider range of Cornerstone Investors.

Asking for \$70,000 a month for 15 months, may be more affordable than asking for \$1 million upfront, to some Cornerstone Investors, particularly those who manage their cash prudently from within an associated company that could later use the technology. Be mindful of only asking what you need, when you need it. The more attractive your project would be, because of the reduction in capital required at certain times, the quicker the decision from a wider range of Cornerstone Investors could be available to you.



I Setting the Plan

Once you have your funding commitment in place, there is an expectation that you will make periodic drawdowns against the agreed budget. To justify these, you will need a very specific action plan to commit all of your resources to meeting the agreed milestones on the timetable you have promised.

In most cases, people set about building a business plan consisting of hundreds of pages. I would consider this only necessary if you were attempting to borrow money from the bank, which will require the evidence of your project's capacity to repay. Instead, I have always preferred an action list of tasks, sequenced to each milestone and each allocated to one person, who becomes the person accountable for that task.



In most cases any particular task may require the efforts of several personnel, but it is more prudent to have one person in charge of the accountability of each task. This allows macro management of a project through weekly or monthly project status review meetings, where you only look at milestones, tasks completed and any upcoming issues. If everyone knows what they're doing there is less likelihood that people are going to slack off. If the project leader on a particular task is held to account for that task, he will drive the other people within that task to complete their parts in a timely fashion or become accountable to the PSR committee, at a later time.

Once you have an action plan, you need a budget. In some cases, you will not receive the amount of money you pitched for. As a result, you may have to compromise some aspects of the development or commercialization programs. Some commercialization tasks may be left to a later time, so they can be paid for out of cash flow. In most cases, investors encourage early income to be re-invested into commercialization, as a way of reducing the allocation of equity thereby diluting their equity and of course, yours.....