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Entrepreneurs Beware the Valley of Death

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Business owners know it takes money to make money; production expenses must be paid before products are sold and revenue is received. Entrepreneurs with a business idea have an even greater need for up-front cash. They must have enough capital to cover negative cash flow in the early months or years of new business creation and growth. Without adequate initial investment, they risk falling into the so-called valley of death – the deep and wide gulf that separates a company's need for capital and investors' willingness to supply it.

Also known as the grand canyon of capital need vs. availability, the valley can be shallow or deep depending on the amount of money needed to develop the idea or product. Width of the valley is the difference between initial investment and the amount that is available from professional investors.

For example, technology startups often need a minimum of $1 million of initial investment to generate evidence or proof of concept that will provide professional investors with confidence to invest. Initial investment is typically raised from friends and family, and entrepreneurs are lucky if they can raise the full amount needed from these initial sources. More often they find themselves short of funds, peering from the precipice into the valley depth. Some are able to secure angel investments, which keep them from falling into the valley by slightly narrowing its width; but angels are only helpful if they have alignments with venture capitalists who will make the follow-on investments required to bridge the remaining capital gap.

Compounding the problem – and adding to the width of the valley – is the increasing minimum investment amount venture capitalists prefer. As venture capital firms matured over the years, their pools of money grew and so did their expenses. With larger amounts under management, they can no longer expend the time and expense to manage small investments. Where at one time investments ranged from $250,000 to $500,000, most venture capitalists now look for opportunities of $2 million to $10 million. These larger opportunities tend to be in growth or maturing companies rather than startups in need of research, development, and market entry.

Some states, including New Mexico, have established seed and early-stage investment funds to bridge the valley of death, but many can not decide whether their investment goal is pure job creation or cash return on investment. As a result, state legislatures keep changing the management and/or strategy of their investment program, or they terminate their program altogether.

The valley of death remains wide and deep, trapping many young companies. The result is that many innovations never enter the marketplace and many new jobs aren't created.

SCORE counselors provide free and confidential advice to New Mexico entrepreneurs and business owners from offices in Albuquerque, Las Cruces and Santa Fe. To learn more, visit www.abqscore.org, www.scorelascruces.org, or www.santafescore.org.

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