

Local start-ups' biggest hurdle: Securing funds for growth ^[1]

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By : JOSÉ L. CARMONA josec@caribbeanbusinesspr.com ^[2] [Caribbean Business](#) ^[3] While a typical business start-up might not need a lot of capital to get off the ground, those relating to innovation, technology, research & development, biotech and molecular sciences often require millions of dollars in funding. Such a substantial initial investment is necessary not only to launch, but also to remain in business long enough to generate the revenue needed to sustain operations and pay back investors, a process that could take years. "Many local entrepreneurs are trying to innovate and one of the challenges they have identified in the local entrepreneurial system is the lack of funding, of venture capital," Jorge Rodríguez, founder & CEO of Process Automation—Controls. Instruments. Validations (PACIV Inc.), told CARIBBEAN BUSINESS. "If you think about it, what Puerto Rico really has is the traditional banks that lend you money, and the Economic Development Bank, which doesn't lend enough, especially for risky businesses." PACIV is an international engineering firm established by Rodríguez in 1997 with headquarters in Puerto Rico and offices in Indianapolis and England. The company is a Harvard Business School case study and has received numerous international recognitions. STAGES OF VENTURE FUNDING Rodríguez said most start-ups begin with the so-called FFFs, initials for "friends, family and fools," who provide the seed or initial funding. If the business shows potential, then the next step for funding is an angel investor—an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. After angel investors, the next step in securing funding involves venture-capital and private-equity firms such as San Juan-based Advent Morro. However, Rodríguez noted that between angel investors and venture-capital firms, there usually are no entities—whether public or private—to bridge the financing gap

commonly known as the "valley of death." A SHIFT IN THE MARKET John Brooke, managing director of Boston-based Brooke Private Equity Associates, said the hurdles faced by local business start-ups in attracting early-stage capital aren't unique to Puerto Rico. Traditionally, angel investors targeted the earlier-stage funding that small companies need, while venture-capital firms tackled fast-growing companies. Brooke said there has been a shift in the market, however. "In my observations, there has been a shift, certainly in the U.S., where professional, institutional venture capital has moved further up from the earlier-stage funding toward the later-stage funding, while angel investors and successful entrepreneurs have come in and started to provide that venture capital in the earlier stage," Brooke explained. He insisted that whether a firm is in the early, middle or late stage of funding, they all go through cyclical ups and downs in their funding quests. "Whether there is a bridge between early-stage and later-stage financing to get across that valley of death, I would say it exists for some companies, and not for others," Brooke said. "I think there is risk capital for these companies; it is just a matter of how discerning that capital is." Brooke said the valley of death, and its severity, can vary by region. In Puerto Rico, given that the local market is relatively small in scope, the difference between a successful year and an unsuccessful year could be just one successful company. One way local business startups can attract angel investors and venture-capital firms is by finding investors who have some sort of relevant background and have an interest in similar types of businesses, Brooke commented. "One of the critical forms of success for a small company is trying to find that right investor, who not only brings capital, but also will have a natural interest in the business," Brooke said. "By definition, more than likely the investor can add value to the company, either through contacts or by what the investor might have done in the past on an operating basis." Brooke noted young, small-scale entrepreneurs often lack sophistication when it comes to fundraising and, therefore, can't assume everything is going to get funded. GOVERNMENT COULD STEP IN Jeff Finkle, president & CEO of Washington, D.C.-based International Economic Development Council (IEDC), said the fact there isn't much of a venture-capital industry in Puerto Rico isn't unique to the island. There are many locations, such as Ohio, where venture-capital networks are scarce, he said. "If you look at the U.S., you are going to find venture capital in the San Francisco and San Jose areas on the West Coast, and in Boston and New York City on the East Coast," Finkle said. After that, there is a general lack of venture capital in the balance of the country. People, Finkle pointed out, have addressed that situation in a variety of ways. One such way is by setting up a local fund to bring venture capital to bear, perhaps by having the state government leverage the venture capitalists and help take away some of the risk, Finkle said. PACIV's Rodríguez added that experts have concluded Puerto Rico must develop an entrepreneurial ecosystem to develop high-impact businesses that require significant investments. Without the vital financial arm of angel investors and venture-capital firms, however, the goal of creating high-impact businesses and jobs through a knowledge-based economy is an extremely uphill struggle, he said. "That is why I strongly support the efforts of Thomas Farb with the Science & Technology Trust," he added. Rodríguez said one interesting idea is the creation of a fund or stimulus package, whereby the Puerto Rico government pays or matches the management fees charged by venture capital firms by providing tax incentives or some other benefit to them. Given that many of these venture-capital firms look into markets where angel investors are already in place, Rodríguez also suggested the formation of an angel-investor group, consisting of 20 or so local entrepreneurs, who raises perhaps \$10 million. Another idea is to have the Government Development Bank or Economic Development Bank create a structure for matching or contributing to a fund to defray some of the risks for local banks involved in venture capital.

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