

Alternative Sources of Funding: Strategic Investors & the Government

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Strategic Investors & the Government

- **Case studies span different venture stages**
 - **Seed stage in large public company:** **Corning Inc.**
 - **Seed to A round of private venture:** **Boston MicroSystems**
 - **C+ rounds of private venture:** **E Ink Corp.**

- **Pros & Cons**

- **Key Success Factors**

A decision with far-reaching implications!

- **Be stage-appropriate**
 - **Government can underpin seed stage**
 - **'Strategics' can hurt if too early; big help if later**

- **Alignment is crucial**
 - **Purpose, priorities, pace**

- **Avoid impediments to others**
 - **Potential partners, customers, investors**

Seed stage funding & beyond in large public company

- Major internal 'new venture'
- Launched with coalition of sponsors
 - Division
 - Corporate
 - Government (DARPA)
- Leverage from government was key to other funding
 - Millions total
 - Dominate share of budget at onset (seed stage)
 - Minor share in development stage

Boston MicroSystems, Inc.

Seed to A round funding of private venture

■ **Government funding**

- **1997 - 2004: Seed Stage**

- >\$4M from SBIRs, NSF et al
- Primary funds (no equity)
- Enabled inventions & 7 issued patents

- **2005 - present: Development Stage**

- \$1.3M & \$1.9M from TSA
- Strategic design-in relationship
 - TSA specifies standards, certifies products, & buys as end-user

■ **Strategic Investor**

- **2005 - present : Development Stage**

- Industry leading OEM for safety & security equipment
- Design-in partner/customer
- Sole series A investor
- \$7.5M gated by milestones
- Board seat

C round funding & beyond of private venture

■ **Government**

- Multiple sources including DARPA
- \$1~2 million per year
- Underpins research

■ **Strategic investors across value chain**

- **Publishers**
 - End product users (of electronic readers)
- **Motorola Ventures**
 - Design-in partner/customer
- **Philips Electronics (\$7.5M)**
 - Design-in partner/customer (Observer)
- **Toppan Printing (\$30M)**
 - Manufacturing partner (Board)
- **Air Products & Chemicals**
 - supplier
- **All funding was up front (no milestones)**

Government Funding: Pros & Cons

Area	Pros	Cons
Funding	<ul style="list-style-type: none">▪Non-dilutive▪May attract other investors▪De-Risks research spending	<ul style="list-style-type: none">▪Uncertain<ul style="list-style-type: none">•Selection•Priorities change•Government budget politics
Strategic Position	<ul style="list-style-type: none">▪Design-in Vehicle<ul style="list-style-type: none">•Certifying agency, buyer	<ul style="list-style-type: none">▪Complications may impede new partners<ul style="list-style-type: none">•Foreign suppliers•March-in rights
Execution	<ul style="list-style-type: none">▪Enables expansion of R&D staff & capabilities	<ul style="list-style-type: none">▪Distraction<ul style="list-style-type: none">•Proposal writing, accounting•To team if poor alignment of purpose•Defocus from multiple projects

Government Funding – Key success factors

Can anchor seed stage, but only supplement development

- **Maximize alignment!**
 - With technical interests & purpose
- **Target strategic agencies**
 - Certifies, buys products...
- **Play the odds**
 - Submit multiple submissions
- **Get to know key players in advance**
 - At funding agencies
- **Tailor accounting system & operations**
 - Use accountants with government expertise

Strategic Funding – Pros & Cons

Area	Pros	Cons
Funding	<ul style="list-style-type: none"> ▪Tolerates higher valuations ▪Validation for new investors 	<ul style="list-style-type: none"> ▪May impede new investors <ul style="list-style-type: none"> •With special rights & protections •Inflated valuation ▪May hold hostage <ul style="list-style-type: none"> •Slow, unreasonable •Demands are unclear or change
Strategic Position	<ul style="list-style-type: none"> ▪Committed partner/customer ▪Validation for market ▪Leverage partner's capabilities & channels ▪Potential acquirer 	<ul style="list-style-type: none"> ▪Over-reliance on one party <ul style="list-style-type: none"> •Risk change in its priorities or mgt ▪May impede new customers & partners <ul style="list-style-type: none"> •Fear partner control, exclusivities •Confidentiality & IP complications
Execution	<ul style="list-style-type: none"> ▪Reduce time-to-market ▪Potential role model 	<ul style="list-style-type: none"> ▪Over-reliance on one party <ul style="list-style-type: none"> •Risk passive or poor execution

Strategic Funding – Key Success Factors

A great asset can be undermined if too early.

- **Focus on later rounds (C+)**
- **Work with sophisticated investor**
 - ... or at least an exceptional champion
- **Maximize alignment for ‘win-win’**
 - Strategic, operational, venture interests
- **Avoid milestones & uncertain funding**
- **Avoid terms that impede other parties**
 - Potential investors, customers or partners
 - Decouple equity & commercial elements
 - Avoid barriers to sales & exit
 - Only narrow exclusivities subject to strong performance

A decision with far-reaching implications!

- **Be stage-appropriate**
 - Government can underpin seed
 - ‘Strategics’ can hurt if too early; big help later

 - **Alignment is crucial**
 - Purpose, priorities, pace

 - **Avoid impediments to others**
 - Potential partners, customers, investors
- ... and it's a relationship, so trust your gut if it feels right or not.***

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