

# RAISING EQUITY CAPITAL - GETTING STARTED

By Rick Williams

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## EXECUTIVE SUMMARY

**Equity capital -- not debt -- is the life blood of emerging and growth companies. Raising equity for your venture is selling part of the company and giving up some control. You are also taking on new partners. As CEO, your challenge is to find investors who understand and share your vision for the company, whose investment objectives are a match for your company and who will commit to a long term relationship with you and the company. For these investors, the bottom line question will be whether you have a plan for creating a profitable business that will adequately reward them for the risks they are taking.**

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**THREE BUSINESS SCHOOL FRIENDS** recently founded TakeOff Technologies with the concept of radically disrupting the traditional grocery store model. Instead of a customer walking down aisles of supermarket shelves filled with every conceivable product, the customer will order her grocery items online. A robot fulfillment system will compile the order in about 30 minutes and package it for the customer to drive by and pick up. Huge savings in labor and real estate costs are projected. The founders raised \$10 million to start their company and have partnered with a supermarket chain to build the first “store.”

Let’s say that you are the CEO of a startup with another exciting technology and product concept. You and your co-founders have gotten friends and business partners to invest. Or your company has been a successful

regional shipping company. The company has financed modest growth from earnings. Perhaps a transition is underway from founding dad to the son. In both cases, you see opportunities to significantly grow the company-- introduce the new technology/product to the market or project the successful business model into new markets or territories.

**Equity capital – not debt – is the lifeblood of emerging and growth companies. Raising equity for your venture is selling part of the company and giving up some control. You are also taking on new partners.** Unless you are a well established and successful entrepreneur, raising equity capital requires carefully matching your business and its plans with the requirements and goals of potential investors.

*Carefully preparing your plans for the company and the rationale for investment in the company will dramatically improve your chances for a successful equity raise. Realistic expectations for your company and the opportunity it presents for investors in combination with understanding investor expectations plus persistence are key requirements for success.*

**Raising equity for your venture is selling part of the company and giving up some control.**

## GROWTH CAPITAL - OPTIONS

**My advice to early stage company founders is to pursue every possible option before taking on equity partners in a big way.** Raising equity capital is a normal part of a company’s growth process. But equity raising is a long, complex process. If you can make early progress and the company becomes more valuable without selling a large percentage of ownership then a later equity raise will take a smaller share of ownership.

### Before taking on equity in a big way, your options include:

- bank loan - probably personal debt
- friends and family equity investors
- suppliers with long payment terms
- customers who will pre-pay
- working capital loan backed by invoices
- vendors who discount services to build a long term relationship
- strategic partners who will provide services or modest investments in exchange for future options or equity rights
- key staff who will take reduced payments today in exchange for equity
- non dilutive government grants.

*Avoiding or delaying cash payments today avoids selling ownership in your company today.* Jeff Bezos started Amazon in the garage attached to his house. Bill Gates may or may not have developed the Microsoft concept in his dorm room at Harvard. But he and Paul Allen had a distributor for their first product before ever making it.

If you are persuasive that the company can be successful, then suppliers and customers are willing to talk terms with you. Large accounting and law firms working in innovation centers like Boston and Silicon Valley discount fees for promising early stage companies in expectation of full freight client relationships when the companies are successful.

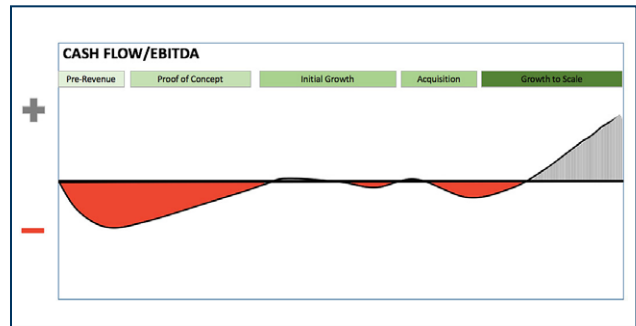
### ***Your challenge is to find the investors who understand and share your vision for the company and will commit to a long term relationship with you and the company.***

Banks lend money to businesses all the time. Fill out forms, write something about your business plan, clear a credit check and get a loan. What is missing for emerging and growth companies is a history of financial success and stability. Banks will lend when the company has demonstrated cash flow, valuable assets and the risk of default is low. That is not the profile of most early stage and high growth companies. Banks usually want assets behind a loan. You as an individual may be able to get a loan when the company cannot. The issue you face is how much of your personal assets you want to put at risk to enable the company to grow.

Once you get revenues and a track record, some forms of debt become available. The problem with debt is that you are committed to paying it back. If you have a bad quarter or sales do not develop as hoped, you are still obligated to repay the debt, and the bank will have the power to seize your assets. Be conservative in your assumptions about how much debt you can carry. Think about working capital differently than permanent capital. You may be able to borrow against customer orders to pay the cost of making the product or delivering the service. You will pay off the debt when customer payments are received.

## RAISING EQUITY CAPITAL - A LONG TERM RELATIONSHIP

If your company is to grow significantly, selling ownership in the company – raising equity capital – will be part of the process. After exploiting all of your minimally dilutive



options for financing the company, you will eventually need cash to pay for building production capacity, rolling out sales and marketing, and advancing technology and product development.

The primary source of this cash is at-risk equity. And those dollars only come from individuals, funds and institutions with their own goals, preferences and expectations. These investors are willing to take a significant risk with their funds but want a high return on the investment. *Your challenge is to find the investors who understand and share your vision for the company and will commit to a long term relationship with you and the company.*

Many founders are convinced that the huge potential of their new business will be obvious to anyone with half a brain. Company founders prepare 100 page treatises on their technology. Many present the worldwide market for

their product and say that capturing only 1% will make the company fabulously successful. In their minds, the opportunity is so clear that when the time comes for raising capital, just getting the word out to a few people will surely bring in the cash.

*To successfully raise equity, you need to get in the mindset of looking for a life partner and getting married.*

Equity raising is completely different than applying for a bank loan. Raising equity capital requires finding one or more investors who will buy some of your company. In the end, you are making a proposal to an investor hoping the investor will agree to join you in a walk down the venture aisle. And there is no Match.com to introduce you to prospective investors looking for what you have to offer. ***Before going on a dating site, going to a cocktail party, or going to a bar hoping to find your next date or life partner, you need to get clear about what you are looking for and what you have to offer. Finding an investment partner is no different.***

In our big and complicated world, there are many smart and energetic entrepreneurs and lots of folks with cash or access to cash. Both have numerous partnering options. Active investors, whether they are angels, venture capital funds, private equity funds, family offices or strategic investors are constantly “asked to dance.” ***If you are lucky enough to get them to listen to your pitch even for one minute, that investor is looking for is a simple, quick reason to say “NO.” They only want to spend their time on good marriage/business prospects.***

Most investors will not partner with you regardless of the merits of your story. Convincing investors to buy some of your company is a difficult process. Your challenge is to find that special investor who wants to partner with the unique combination of your business opportunity, your plans for the company, the position of new equity in your ownership profile and your team.

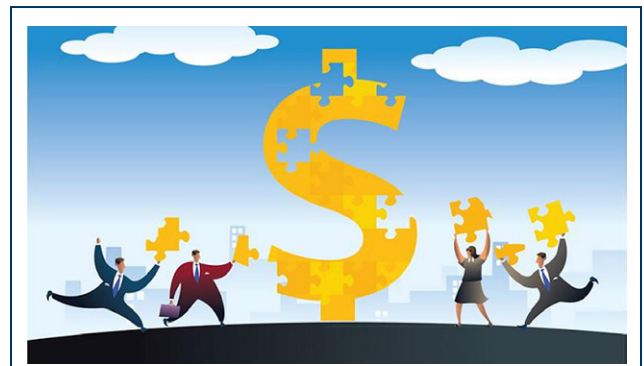
## **FIRST KNOW YOURSELF AND YOUR COMPANY**

An important starting point for the equity raising process is get clear about what partnering with equity investors means for you, your team, and your company. ***Does the equity raising path – selling ownership – line up with your goals for yourself and the expectations of your key staff and current investors?*** Similar to marriage, the new investors become part of your life for a long time.

***To successfully raise equity, you need to get in the mindset of looking for a life partner and getting married.***

**Raising equity capital means you are:**

- Selling some or all of the company
- Giving up some or complete control of the company
- Taking on a board of directors or new board members with some say about how the company is run
- Teaming with the investors. Their value to you includes their ability to advance more funds, access to their network, and their reputation
- Subjecting yourself to regulatory/legal review of your relations with your investors and the public.



A second essential step in the process is developing a realistic understanding of your company and its opportunity. Why will this company succeed as a business in a highly competitive environment? And what resources are required for the business to grow and succeed? Outline a five to seven year plan for the company – subject to change – and estimate its financial requirements. Different forms of equity may be appropriate including convertible debt, preferred shares, options, etc. The value of the company should grow and later stage equity sales will buy less of the company. Debt and mezzanine debt will be part of the financing as you develop a track record.

Outline how ownership and control will change over time. Some equity raising paths could eventually bring new leadership to the company or could end with selling the company as a whole. If maintaining control and keeping current leadership in place is your long term goal, consider whether that expectation is consistent with the likely expectations of your investors?

***In the end, the financing plan (including debt and equity) and the likely transitions of ownership and control must be your plan. And the plan must be fully supported by your team and your current investors. The financing strategy and exit plan will be an essential starting point of communications with potential investors.***

## WHAT DO INVESTORS WANT?

All equity investors want to see a strong leadership team, a realistic business plan, an unfair competitive advantage, and a plan for growth to scale so the value of their investment will multiply. Beyond criteria common to all investors, each investor or fund is looking for

Exhibit A What Do They Want ? – Other Than \$		
INVESTOR TYPE	COMPANY WANTS	INVESTORS WANT
Friends & Family	A Chance	To Help
Crowd Funding	A Chance	To Help
Angel Investors	A Chance	Access to deals
VC	Build Staff & Resources	Demonstrate the company can grow
Private Equity	Liquidity for founders	Growth to scale
IPO	Liquidity for investors	Growth in market & share price
Strategic Acquirer	Liquidity for investors	Synergies with acquirer

companies in an industry/business sector they know and believe has big potential. They are looking for a schedule for their investment to be monetized matching their fund requirements or investment horizon. Financial investors want a leadership team with which they would be comfortable working for years.

Beyond these basic investor requirements, each type of investor is looking for companies in different phases of their growth trajectory. Exhibit A is a simplified display of what the company and the investors each want from the transaction. Companies talking to angel investors usually want to prove their business concept can work. Angels cannot compete with Venture Capital (VC) and Private Equity (PE) funds so they are looking for access to deals where their smaller funding capabilities can have a big impact. They are looking for early access to companies with big potential.

Private Equity funds usually are looking for companies that have already proven they can be successful in a regional market or a product sector and have the potential to grow significantly larger. The companies they are buying, or in which they are taking a major ownership position have often had VC funding and the PE investment will be a major liquidity event for the founders and early investors.

***The financing strategy and exit plan will be an essential starting point of communications with potential investors.***

### Investor strategies:

- Angels want to support companies in the proof of concept phase
- Venture capital funds generally support companies while their products gain initial market acceptance and they work out a successful business model
- Private equity funds grow companies with initial success to significant scale
- Strategic investors buy companies with products or technology that complement and supplement their existing business. These investors have the technology, marketing and sales infrastructure to fully exploit the value in an acquired company's products.

Investors often look for companies where their capabilities add value beyond just their cash. The investor's network, technology, customers, sales organization and international presence are examples. In some cases, the investor will want to bring in their own leadership for the company.

## INVESTOR PAYDAY - LIQUIDITY AND EXIT OPTIONS

If you buy a share of General Motors today, the share value may go up or down. But you know you can sell the share tomorrow. Part of the early and growth stage investment deal is that the shares or options you buy today cannot be sold tomorrow. They are illiquid. Some investors are willing to put their funds into illiquid investments when they understand and accept the risks and the return is high enough to compensate for the risks.

***Before an investor will commit to funding your company, she will want to know how she gets her money back out and when that is likely to happen.***

Liquidity options include:

- A new private investor buys the shares/rights of earlier investors
- VC or PE firm buys all or a significant share of earlier shareholder interests to establish control of the company
- VC or PE firm buys new equity in the firm and agrees to buy some amount of earlier shareholder interests at the same price
- Strategic or financial investor buys all or most earlier shareholder interests
- Your company does an Initial Public Offering (IPO) and a public market is established for your shares.

Liquidity events are not completely predictable, but your plan and schedule for enabling new shareholders to sell their shares needs to be part of your business plan. Before knowledgeable PE and VC funds invest in a new company, they usually identify companies that could acquire that company in the future. The funds have an estimate of the resale value of the company and when the liquidity event will happen before they make the investment.

Knowledgeable investors expect the company to have thought about liquidity for the funds invested today. What is the exit plan, who are potential major new investors/acquirers, what are likely valuations, and when will this happen? The company's schedule for liquidity must come close to the investor's requirements. Some investors like to get in and out of deals quickly. Pension funds and insurance companies want to put their funds to work for 8 to 10 or even 15 years.

Ideally, we want to invest in Microsoft early and ride its value growth all of the way to an IPO and further growth as a public company. The reality is that many companies with investor funding fail and these funds are lost. Other companies have some success but not enough to earn material returns for the investors. In some cases, the investor will want to keep their funds in the game, but new investors want to remove earlier investors. The sum of all these investor experiences creates a frame of reference for investors that shape their views and expectations when they are listening to your pitch.

## THINK LIKE AN INVESTOR

You will need a Business Plan, an Investor Proposal, a slide deck and financial projections. And yes, you will need some back up details on why your technology or service offering is unique, cannot be easily duplicated and will solve a pressing customer need. Put these investor facing documents together while thinking like an investor.



### Investor considerations:

- *What is in it for me?*
- *Most of the companies in which I invest will fail. Why is yours different?*
- *I am investing in the team more than your idea/plan*
- *I am looking for a quick reason to say NO*
- *Your plan will not work out. What will you do when it fails?*
- *I don't want to be devalued by later investors - crammed down.*
- *How do I get my money out?*
- *With demonstrated progress and success, I will be more forthcoming.*

## YOUR PROPOSAL – BUSINESS SUCCESS AND INVESTOR SUCCESS

All investors other than perhaps your family and friends are asking themselves whether your understanding of the marketplace and where your company would fit in is close to reality. They will evaluate the risks in your plan - what could go wrong. Each will have their own rules of thumb and analysis approach for deciding whether to invest. But their core evaluation will focus on:

- Are you solving a compelling customer problem – a Must Have Proposition and not just a neat technology development?
- Is there a clear business opportunity that can gain substantial customer acceptance and resist competition?
- Can you and your team execute on the plan?
- Is the business you are entering one I understand and want to participate in?
- Does your plan demonstrate clear progress phases with valuation step-ups?
- Are my requirements (if any) for a board seat, management participation or other forms of influence or control of management decisions included in the plan?
- Does your business plan include an exit or IPO that matches my investor goals?

***The bottom line question is whether you have a plan for creating a profitable business that will reward your investors.***

You must have a strong underlying competitive advantage – cheaper, faster, better – through cost advantages, technology advancement, and superior performance or unique market access. ***But the bottom line question is whether you have a plan for creating a profitable business that will reward your investors. Attracting investors to buy part of your company and become long term partners requires that you convince them your company will be successful as a business. And they will be financially rewarded for the risks they are taking.***

## About the Author

Author | Corporate Leader | Board Member



Rick Williams is an inspiring writer and speaker sharing his experience as a company founder, CEO, scientist, management consultant, and board member. His new book *Create the Future* is a guidebook for making more creative and better decisions for your company and yourself.

Williams engages with an international audience through his newsletter, published thought leadership articles, and speaking engagements for leadership audiences.

He also brings his insights and experience to his service on boards of directors. He has served as board chair of a medical device company and a bank/VC firm. Williams started his career as a physicist followed by Harvard Business School, management consulting with Arthur D. Little, Inc., and then founding and leading a real estate investment and development company.

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## IMPROVE YOUR CHANCES FOR SUCCESS

Before pitching to the first investor, take these steps to improve your chances for success.

1. Delay raising significant equity as long as possible.
2. Develop a funding schedule, including rounds of equity raising, that coincides with major step-ups in valuation.
3. Be clear about your expectations for changes in ownership and control of the company through the cycles of equity raising.
4. Ensure that your leadership team and current investors are on board with the plan.
5. Identify the type of investors most likely to seriously consider your company and your proposition.
6. Develop your business plan and your investor proposal around what that type of investor will require.
7. Get real about the value of your company. Investors will determine the value not you.
8. Seriously consider whether you want to be in a long term relationship with that investor. You are creating a partnership with your investors. You are not just taking their cash.
9. Finally, keep it simple. Get it done.

Following these guidelines will not make it easy to raise capital - it is hard work. But you will start with the right frame of mind and will focus your precious time on the essential tasks for success.

**Rick Williams** brilliantly delivers a leadership compass for high-performing companies. With his wealth of experience, Williams provides a clear playbook that's indispensable for leaders seeking a practical approach to shaping their organization's destiny. Packed with structured team exercises, this book empowers leaders to make choices that resonate with their goals and values. Like an in-house management consultant, *Create the Future* is your invaluable resource for decision-making in turbulent times.

**Hubert Joly**, Former Best Buy CEO,  
 senior lecturer Harvard Business School,  
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