



Is My Business Ready for Equity Investment?

What is equity and how does it differ from debt?

Two types of financing are available for your business – debt and equity. Debt financing and equity financing are significantly different forms of capital investment and may have considerable advantages or disadvantages for your business.

Debt financing is money that is borrowed and expected to be repaid over a specified period of time starting almost immediately. The loan typically comes from a commercial lending institution such as a bank. Since the lending institution wants to be repaid, information indicating previous profitability of the business and/or industry and market information that 'proves' future profitability is required. The lending institution also requests a second source of repayment, most often personal or business assets. Your personal financial history is an integral part of your ability to obtain a loan. Your personal credit history is a strong indicator of how likely you will repay new debt and obligations. Unlike equity financing, debt financing does not affect the ownership structure of the business and there is a standardized process in obtaining the financing needed. You can find more information on debt financing by calling the Women's Business Development Center (WBDC) at (312) 853-3477 or the U.S. Small Business Administration (SBA) at (800) U-ASK-SBA.

Equity financing is available in two forms – public and private. Public equity is obtained by offering shares of your company in the open market in exchange for capital. This is referred to as an initial public offering (IPO). Once you take your company public, investors are able to purchase shares of your company and become shareholders or owners of your company. They are repaid through profit sharing such as dividends or when the stock is sold.

Private equity comes in many forms such as friends and family, angel investors and venture capital. **Angel investors** are individuals who provide capital to start-up companies in exchange for partial ownership and control of the business. Most new businesses obtain their first round of financing from angels who may invest from \$2,500 to a million. The angel market is approximately 5-10 times greater than the institutional venture capital pool. **Venture capital** firms (VCs) have a large amount of capital and seek out companies in which they can invest in exchange for a share of the ownership in the company and some control of the business. Venture capitalists typically invest in amounts greater than \$1 million. The average VC will invest in approximately seven firms per year out of the approximate 1,000 firms that contact them.



Is My Business Attractive to Investors?

A major difference between equity and debt capital is that equity investors expect a far higher return because of the greater risk involved. Unlike lenders, equity investors have no claims against the assets of the business and are not guaranteed repayment. Thus, equity investors are willing to invest in your business based on the expectation that they will make 20% to 50% returns (although specific target returns may vary for each investor) on their original investment at the time they are bought out. Most equity investors will expect a significant return on their money within a reasonable time frame, typically five years. Equity providers look for the following characteristics, among others, in the companies in which they invest:

- A solid management team.
- Your and your team's experience either in the industry or as an entrepreneur.
- Potential growth in revenue, size, and market share.
- Proprietary technology, patents or other barriers to entry
- An exit strategy (e.g., going public or acquisition by another corporation) within a reasonable time frame.

Equity investors will expect you to give up a portion of your business for their capital investment. Their share of the ownership will depend on many criteria including their level of participation or investment, the type of control they desire (e.g., the number of seats on the board of directors), their exit strategy (i.e., how do they get their investment back when they are ready to exit and invest in another company), and other pricing and legal issues.

Do I need equity?

If you are in need of capital to either begin or grow your business, you should evaluate whether debt financing or equity financing is the right choice for you. You might also consider a combination of both debt and equity capital.

Many entrepreneurs who choose to use equity as a source of capital have made this decision for a variety of reasons. One reason may be that they are unable to obtain a loan due to insufficient collateral, owner equity, or inability to 'prove' that the business will be profitable within a short period of time.

How can I obtain equity financing for my business?

1. Develop a business plan: The business plan includes your business strategy, the strength of your management team, marketing plan, market research about the industry, the economy, the competition and financial pro-formas (projections). A good business plan will also include a short (three to four page) executive summary. Given the number of business plans an investor sees, it is important to be able to sell your business in a few minutes or in a few pages.

2. Network, network, network: The private equity market is unstructured. There are no listings of all the angel investors nor a description of the types of investments in which they are



interested. It is therefore necessary to become involved in groups or events where investors, attorneys and other professionals participate. It is also important to keep on top of the current trends in investment. Attend seminars where investors describe what they envision for the future and what types of business models are attractive to them.

3. Build your Resource Team: Find a lawyer, an accountant and build an advisory team. These people will help you develop your business plan, guide you through the equity process and provide introductions to important contacts. Begin networking with people who understand your industry. It is best to find people who will introduce you to potential investors. Avoid cold calls.

4. Determine your business' valuation: An equity investor will assign a book value to your business (the *valuation*). Many different methods exist for determining your company's value. Investors look at industry-specific accounting methods to determine the book value of your company. The book value enables the investor to determine how much capital they will provide you with. Valuation methods can be complicated and have significant impact on the funding you receive, so invest a reasonable amount of time in determining an appropriate valuation. Moreover, you should enlist the help of an attorney, business broker, or a variety of resources to help you value your business prior to meeting with an investor.

5. Selecting an Equity Partner: Because of your significant investment of time, energy, and motivation, you will want to select the right equity partner. This partner will be an integral part of your business and may sit on your board of directors. Since you will likely have a close relationship with this investor, you should be as discerning with selecting the right person or company as they are with selecting you. Moreover, you should explore multiple revenue sources for the best deal. It is not unusual to pass up some opportunities to find your best fit. You should be able to find a good personal fit as well as business fit. Some important questions you should consider in your search for the right equity partner include:

- What are they willing to offer in terms of time and capital?
- What kind of control issues do they have? Do they require a majority of the board seats?
- Do they have the requisite experience to complement you and your company and to give advice?
- Can they provide additional capital if necessary?
- What is their reputation in the industry? Will other potential investors see this as a sign of strength if you partner with this company or individual?
- Can they weather the downs of the business as well as the ups?

Do not get discouraged in your pursuit if you encounter disappointments, but use these experiences as a learning tool. You may need to re-write parts of your business plan or develop certain aspects of your business. Nonetheless, keep focused on your goal and keep in mind the ultimate payoff - obtaining the necessary capital to successfully start and grow your business.



Resources

Many programs are designed to offer special assistance to women and minorities. If you are interested in obtaining equity to grow your business, we suggest that you review the classes, networking and counseling opportunities the WBDC offers. In addition, the WBDC can refer you to other local resources that fit your needs.

1. *How to Write a Business Plan*

Women's Business Development Center: Call for information on classes and counseling (312) 853-3477 x 0 or go to www.wbdc.org

www.onlinewbc.gov
www.vcapital.com

Online Women's Business Center
V-Capital

2. *Network, network, network*

Organizations for Women in Technology

www.witi.com/chicago
www.worldwit.org

Women in Technology International (WITI)
Chicago Women in Technology

On-line publications that list all technology and investor events:

www.i-street.com
www.themayreport.com
www.ePrairie.com
www.techvenue.com/usmidwest
www.chicagotechtoday.com

i-street
The May Report
E*Prairie
TechVenue
City of Chicago

3. *Investor Forums*

- Springboard Enterprises – Investor forums for women-led companies.
www.springboardenterprises.org
- Midwest Entrepreneur Forum offers a monthly newsletter, monthly seminar or investor's forum, and will arrange a panel of experts to review a business plan and provide expert input. For more information contact Jerry Mitchell at mef@gss.net.
- Chicago Software Association sponsors the Early Stage Conference every September, quarterly angel investor forums and monthly roundtables and seminars.
www.csa.org
- Midwest TiE - <http://www.tie-midwest.org/>



4. Venture Capital/Angel Investors

- Technology Development Bridge Fund - <http://www.ilcoalition.org/tdbinfo.htm>
First-round investments made by IDFA under the Technology Development Bridge range from \$100,000 to \$300,000.
- Small Business Investment Companies - www.sba.gov/INV/
Small Business Investment Companies (SBICs), which are licensed and regulated by the SBA, are privately owned and managed investment firms that provide venture capital and start-up financing to small businesses.
- Prairie Angels: www.prairieangels.org
- Illinois Coalition: www.ilcoalition.org
- Illinois Technology Challenge Grants:
http://www.commerce.state.il.us/technology/Tech_Dev.html
<http://www.chicagotechtoday.com/investmentresources.shtml>
- Crains' Chicago Business has a list of Venture Capital Firms in Chicago.
http://www.chicagobusiness.com/cgi-bin/article.pl?feature_id=7&page_id=869