



## Considerations in Raising Outside Capital

As a business owner, you have limited options when seeking capital to start or grow your company. Essentially, there are three sources of cash: your own cash investment or that of other investors, your bank, and cash from the daily operations of the company. The cash generated from the company's operations is the least costly for the company, but in an effort to raise cash quickly, many business owners look to investor or private equity groups (PEG) without fully understanding the costs or effects of a private investment upon the company and themselves. The decision will have a long-term impact on the business; therefore, you should explore all of your options and carefully examine the effects that those options will have on you, your company, and your employees.

## The Valuation of the Business

As you enter into discussions to sell part of your company to raise cash, the value of your business will be the key issue, and your measure of value may be different than what the investor group determines it to be. The sweat equity that you have expended since starting the company and your emotional attachment to the company will have no value to the investor group. The investor will expect to receive a minimum return of 200% on their investment in 3 – 5 years at exit, and this expectation will factor into the valuation that they place on their equity in your company. When the value for the equity is established, the formula or basis used in determining the equity value should also be used as the basis for any future equity or the selling of equity. Valuation is a critical starting point in the capital raising

process; if you and the investor cannot agree on the valuation then nothing else will matter. It is immensely important that you, as a business owner, seek professional help for these negotiations.

## Information Required by the Investors

The new investor group will do Due Diligence on the company and the business owner/founder. Gathering the required information will be time consuming, in part because the requirements will include information that the company may not be preparing on a monthly basis. This information request will place additional stress on your staff, and if the company has not been keeping track of this information regularly, then it will also be important to do careful analysis to ensure the accuracy of the reports.

The information that the investor will require includes:

1. Company financial statements for the last 3 years - balance sheet, income statement, and cash flow statement
2. Company tax returns for the last 3 years
3. Sales forecast for the next 3 – 5 years that includes an analysis of the impact the additional cash investment will have on the cash flow of the company
4. Personal financial statements, tax returns, background checks, and personal references for the owner

Then you must do Due Diligence on the investor group, which will also take time and resources, but it is absolutely crucial to know everything that you can about your new equity partner.

## Operating with the New Equity Partners

The new investor group may want to purchase a controlling share of your company. You may retain controlling ownership after the first capital infusion, but that control will probably change if additional capital is required during the ownership period of the investor group. That additional capital may be required if the company is operating to forecast but needs additional capital to take advantage of new business opportunities or if the company needs additional cash to meet short term cash flow deficiencies.

The investors will also require new, timely management reports so that they can monitor the performance and activities of the company. Again, this is a time-consuming process, and you must have adequately skilled staff to handle the reporting accurately and on a timely basis.

Getting professional advice and assistance with negotiations will help to ensure that you have appropriate protections for your personal interests built into your agreement with the investor.

## What is the Exit Strategy?

The investor group will want to exit the investment in 3 – 5 years. Do you want to buy your company back from the investor group and/or pass your company to other family members? If the answer is yes then your bank may be a source of cash to buy the equity at exit if the company is able to support the debt based on the operating cash flow.

If your goal is to sell your interest in the business along when the investor group exits, are you willing to stay with the company? The new investors may want you to stay during the transition period, or they may impose an earn-out on your share of the sale proceeds. This would require you to work with a new management team that will have new demands and expectations.

Before deciding to raise capital to grow your business, you need to make sure that the value that the investment will add is worth the effort and sacrifices that you will make. You also need to be sure that your short-term goals, exit goals, and business values are aligned with those of the new Investor.

Lastly, you need to make sure that you have explored other sources of capital that could bring the same value that the investor will bring.

If you have never experienced the capital raising process before, it may seem overwhelming, and it will consume time that you would normally be spending on your daily business operations. A financial professional can help to ease that time burden, and will also ensure that you get maximum value from the investment with minimal risk.

***Founded in 2001, FocusCFO is the leading onsite fractional CFO services provider in the Midwest and Southeast. FocusCFO works closely with small to medium sized businesses helping business owners gain control over three key financial and operational areas: increasing cash flow, reducing business risk, and creating a platform for scalable growth. This allows business owners to then realize full financial control and increased value in their businesses. For more information, visit us at [focuscfo.com](https://focuscfo.com) or follow us on [LinkedIn](#).***