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# Equity Financing

## 6 Strategies to Consider

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When starting a business, it can be an all-consuming affair, something that becomes so ingrained in your life that it can feel like a part of you. When seeking equity financing, you will likely be required to give up a small portion of yourself and your business in order to achieve the end result of additional funding. In addition, you might think you and your business are an easy sell, but it can be quite difficult to find an investor willing to take the risk and invest.

The first step in equity financing would be to determine which small business option for financing best suits your



needs. There are a variety of plans, but some of the most common are as follows:

### **Grants**

The use of grants is an option for equity financing, and it can be a very attractive alternative. Various government entities give grants to support small businesses. Many times these grants are targeted to an industry or type of ownership, like technology or minority owned businesses. The competition is high for these grants, but if you are awarded one,

feel lucky, as it is basically "free money" that does not have to be paid back, although there are usually stipulations on how the money can be used.

### **ESOP**

ESOP stands for Employee Stock Ownership Plan. In an ESOP, employees can purchase shares of stock in the company by paying cash or by agreeing to reductions from salary or benefits. The employees become part owners of the business and you have additional funds for other business purposes. This option can provide greater loyalty, harder working employees, and additional financing to aid in the growth of your company.

### **Franchising**

Franchising is a means of growth financing in which the franchisor "sells off" expansion rights to another party. Typically the franchisor will receive an initial franchise fee, service fees, equipment sale or lease fees, and royalties from the business.

### **Venture Capital**

Venture capital involves an investor who regularly takes risks with business in the hope of seeing fast and lucrative returns on the investment. There are three tips you can use to protect yourself and your company when dealing with venture capitalism:

- Be on your guard. They are a business first and foremost and will look for weakness that can benefit the deal they make with you.

- Pay attention to detail or “read the fine print”. You need to know what you are signing and it is best to involve a lawyer in such transactions.
- Need to know, as in they are on a need to know basis. Keep up on communication, but do not divulge too many trade secrets. The use of confidentiality agreements and patents are very helpful in this area. Nothing is free in this world- that should include your great ideas!

Venture capital will infuse your company with funds that originate from private sources, but remember that they are looking for companies with great potential and a rapid growth rate. This potential is also usually paired with the need for a larger financing sum and thus makes venture capitalism a more risky venture. The company that is being invested in will need to produce almost immediate and substantial results. The amount of time that venture capitalists typically invest in these types of businesses can vary, but is often a period of three to seven years, as long as there is at least a 20-40% annual return in profits. When big money is invested, big money is then expected in return. Don't be surprised by the fast paced and pressured atmosphere that can come when dealing with venture capitalists, that is just part of the game. Are you prepared to play?

Now, let's say that you have weighed your options and decided that VC is the correct path for your business. The reality is that VC deals can be difficult to attain, as the percentage of companies that achieve such financing is miniscule. Emily Mendell, a spokeswoman for the National Venture Capital Association

estimates that of every 100 business plans VC's are sent, about 10 of these get a cursory glance, and one achieves funding. One way to know if you are VC material is finding out the specifics they are looking for. Aside from the previously stated matter of rapid financial return, venture capitalists seek out companies with great potential and who are in a booming field. For example, being involved in technology or a medical field will give you a leg up on the competition, as will being in a desired location such as the increasingly profitable Silicon Valley.

### **Angel Investing**

Another financing option can be found through private investors or “angels”. They are people who are actively seeking out new investments for various reasons. Angel investors are typically a less demanding group than venture capitalists, and often times you will find less pressure and demands in their financing agreements. You should be aware that they are still business people who will want results and financial success, but they are also people who are likely to help you out. Know that many times angels are looking to invest more than just money, as they can bring your venture knowledge, contacts and mentoring. Angel investors are often people who have or have had their own businesses and can aid in putting you in contact with a valuable network.

Angels have slightly different terms than your average venture capitalist, but be sure these terms are clearly outlined and understood by both parties. Some angels are willing to offer extremely low interest rates on loans in an effort to give an added push to the company when starting out. Other terms might include

giving equity interest to the angel in conjunction with an “exit” clause that can include a mandatory buyout or a public offering of stock. The expected returns that angels expect from a company are usually about three to five times their initial investment, an expectation that stands in contrast to venture capitalists, who desire a return of five to ten times greater than their original investment.

### **IPO**

Another option available is the IPO, or initial public offering, which can be attractive to many budding businesses due to the success stories associated with such a strategic move. A company that was previously held by a group of private investors would open itself up for sale of ownership shares to the general public. It is an option with a number of benefits ranging from notoriety, or getting your business in the public spotlight, to achieving rapid funding to be used at your disposal. Previous debts can be paid off, new improvements made, inventory acquired, etc. Investors can greatly benefit from IPO’s as well.

The publicly held stock is more “liquid” or able to be sold quickly if the business starts to have a downward trend. This lessens the risk factor for the investor.

Choosing to “go public” however involves letting a larger group of people into the inner circle of your business. Beyond that, you must consider the addition of the federal and state official’s oversight. Federal and state laws govern the sale of business securities and sifting through all the complexities of these laws can be tedious. Be informed on what your state laws consider a “security” as they can differ from federal law. Being aware of the finer points involved with IPO’s is not just beneficial to your company, it is crucial to your business and financing future.

Look over your options and give serious thought about what would best accommodate your needs. You need to know the risks involved with all methods of financing and ascertain whether it is worth the risk to take that particular route.

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### **About the Author:**

Aaron Dyer is President of Dyer Consulting Group, a small business consulting firm that advises business owners on ways to grow their revenues and increase profitability through better strategic planning and financial management. For more information, and also to sign up for Aaron’s future articles, visit [www.DyerConsultingGroup.com](http://www.DyerConsultingGroup.com)

