Finding and Attracting Investors

1.1 Introduction

Welcome to SBA's online training course: Finding and Attracting Investors.

SBA's Office of Entrepreneurship Education provides this self-paced training exercise as an introduction to finding the right investors and an introduction to how investors affect your business. You will find this course easy to follow and the subject matter indexed for quick reference and easy access. It will take about 30 minutes to complete the course. Additional time will be needed to review included resource materials and to complete the suggested next steps at the end of the course.

As audio is used throughout the training; please adjust your speakers accordingly. A transcript and keyboard shortcuts are available to assist further with user accessibility.

The highlighted Next Steps at the conclusion of the course will help you apply what you have learned and engage you in the process of writing a business plan. When you complete the course, you will have the option of receiving a completion confirmation from the SBA.

1.2 Course Objectives

The course has four key objectives:

- Explain why a small business may need outside financing
- Identify three types of investors and their investment requirements
- List three benefits of securing capital from an investor
- List the typical steps in the process of finding investors

1.3 Course Topics

This course will cover five topics. These topics will illustrate how locating and attracting investors can improve your business' success:

- When is outside financing necessary?
- What is an investor?
- Where can you find investors?
- What is the investment process?
- What are investor expectations?

Numerous additional resources are identified to assist you. Visit the resource icon in the course player or locate additional tools, templates, and mentors on SBA.gov once you finish the course.

Let's get started!

1.4 The Challenge

Finding and securing investors can be challenging. Let's explore the issues facing a small business when deciding to expand the use of investors.

The focus of this course is to help the small business owner decide if bringing in partners or outside investors is the best option for their business; to give the small business owner methods to incorporate partners or outside investors; and to list some of the potential complications that can occur when taking on partners or outside investors.

1.5 Outside Financing

When is outside financing necessary? If you want to expand your business, you will have to decide if you can do so with your operations cash flow or if you will need outside financing of some kind. When starting a business, you will have to decide if you need outside financing as start-up capital.

Reflect for a moment and consider whether you need outside financing. (Pause)

There are traditional sources of financing, including banks and commercial loan companies that are debt-oriented.

There are other financing options involving investors -- these include factoring, venture capital firms, individuals, and business acquaintances.

In addition, there are non-traditional sources like crowd-funding.

1.6 Equity or Debt

If you choose to pursue outside financing, you will need to decide whether you want to acquire it through equity or debt. You can take out a traditional loan from a bank to fund your expansion or start-up costs. This allows you to maintain full ownership of your company, but the additional capital is listed as a liability on your balance sheet.

You can also sell equity in your company. Selling equity can be difficult, but there are significant advantages to equity financing. You will not have a repayment burden on your cash flow from operations. On your balance sheet, capital is listed under stockholders' equity rather than liabilities. Also, professional investors, such as venture capital firms, can bring substantial expertise to help your business succeed.

Of course, there are some significant disadvantages, depending upon your point of view. Advice from investors can be seen as interference. Once you or your company accepts money from investors, you must run the business for the good of all stockholders. Professional investors will require audited financial statements and independent accountants. Finally, professional investors will require a voice on the board of directors.

Reflect for a moment. Would you prefer to take on debt to expand or start your business or would you prefer to sell equity in your company? Carefully consider the pros and cons of each before deciding.

1.7 Equity and Debt Equity Hybrids

Equity comes in several forms. You can sell common stock which gives an ownership interest and right to vote to your investor. You can also sell preferred stock, which gives the investor an interest in assets and revenues.

However, there are hybrid options as well. You can sell convertible preferred stock or get convertible debt, which can convert to common stock in the future. These terms are defined below:

- Convertible Preferred Stock: Convertible preferred stock allows the holder to convert the preferred shares into common shares. This would be especially valuable to investors should you anticipate rapid growth and increase in value of your common stock.
- Convertible Debt: A convertible debt is essentially a loan that may require repayment at some level of interest. However, should your company experience incredible growth and you decide to raise a round of venture capital, the convertible debt can become equity, giving the investor an ownership stake in your company.

1.8 What is an Investor?

Now that you have decided you need equity, let's discuss who investors are and what they expect from you. An investor is someone who places money into a business, usually receiving an ownership or partner stake in the business. Since the investors undertake a great risk, they may require a substantial share of ownership in the business in return. It's important to remember that investors do not place debt capital in your business; investment is not a loan. Investors can also contribute to the credibility of a start-up or growing business through their scrutiny, certification, and investment.

There are several different types of investors and methods of investment, such as equity financing. Equity financing is based on the company selling part of its ownership to other investors, either private investors or to the public. In its simplest form, the owner of a company decides to raise some additional capital by selling shares of stock to family members, business acquaintances, or key employees.

Another option is a formal private placement of securities to angel investors. Angel investors are generally wealthy individuals who invest in early-stage companies or mature companies wishing to expand, with the hope of earning a substantial return on their investment.

- Equity Financing: Equity financing is accomplished through selling common or preferred stock to individuals or institutional investors. After purchasing the stock, the investors own some portion of your company.
- Formal Private Placement of Securities: Formal private placement of securities is the private sale of stock in your company. This method of raising capital allows a business owner to avoid a public offering.

A third option is venture capital firms. A venture capital firm is one that provides funds to early-stage, high-risk/high-potential startup companies. Venture capital firms recoup their investments by owning equity in the company in which they invest. Venture capitalists have more requirements and usually involve funding at a much higher level than most angel investors. Almost all venture capitalists will require a seat on your board in return for their investment.

A final option is casual or non-professional investors, such as friends and family who are interested in helping your business succeed.

Now reflect for a moment: which kind of financing appeals to you? Which kind of investor within that kind of financing appeals to you?

1.9 Where Do I Find Potential Investors?

There are many places where you can find potential investors. Your local community is one of the best places to start your search. You can also look at business and trade organizations, which are optimal places for networking. Your local of Chamber of Commerce can provide resources. You can call the Small Business Development Center in your area for information about local investors. Visit www.sba.gov/local-assistance to find your local SBDC. A final option is regional and state economic development agencies, which help new and established businesses start, grow, and succeed. Visit http://www.sba.gov/content/economic-development-agencies to learn more.

Where will you begin your search for investors?

1.10 Sell, Sell, Sell

You found a potential investor! Now how do you convince them to invest in your business? The main strategy is to sell, sell, and sell.

- You have to give the potential investor a reason to invest in your business. You can fine-tune your pitch based on what the potential investor's needs are.
- Sell Your Business Plan. After you convince your potential investors to hear you out, you must prove that your business plan is strong and convincing. Make sure you have a detailed and well-written business plan to show you have done your homework. Include financials and market research.
- Show Them the Money. Detail how your business will generate profit and how that profit ends up in their pockets. Ultimately, all investors want a solid return on their investment.

Reflect for a moment. Are you really prepared to approach an investor?

1.11 Investment Process

Due diligence and preparation are equally important for all investors. You should go through the same preparation process for a venture capitalist or a family member. To evaluate an investment in your company, investors want:

- A business plan
- Five-year financial projections
- Current audited financials (if available)
- A reason to invest in you – What is the return on investment?

Once an investor is satisfied that the investment works from a financial point of view, the investor takes a very close look at the management team.

A company must expect that any deal with angel investors or venture capitalists will be heavily negotiated. The company's leverage depends on its need for the investment and the tolerance of the owner for oversight by the investors. Investment from family and friends typically does not require the same level of negotiation.

1.12 Crowd-Funding for Equity

A recently emerging source of investment is crowd-funding or crowd-sourcing.

You can sell up to $1 million of securities a year without doing a public offering

How does it work? A crowd of people, each of whom takes a small stake in a business idea, contributes toward an online funding target.

Advantages

- Raising your own capital
- Creating a strong network of support for your business
- Providing a newsworthy backstory

Disadvantages

- Full rules and regulations regarding crowd-funding are not complete
- You must use a pre-existing crowd-funding portal or gain approval from the Securities & Exchange Commission, or SEC, to set up your own
- You may need legal counsel to assist with the legal forms

Would crowd-sourcing be a good approach for you?

1.13 Timeline

Securing investments from friends and family can take up to 30 days. Figure at least 6 months to find and secure capital from angel investors. The process of securing investment capital from a venture capitalist can take up to 8 months.

What is your expansion timeline?

1.14 Investor Expectations and Exit Strategies

What is expected after investment capital has been secured? Professional investors, those who are not family or friends, usually have specific expectations as to investment returns. Angel investors have differing expectations, but will require substantial profits. Most venture capital firms expect a 50 percent per year return on their investment, and the financial projections you provide must support that kind of return. All professional investors need an exit strategy; the investor must know when and how the company proposes to make his or her investment liquid.

1.15 Course Summary

That was a lot of information about some relatively complex concepts. Let's review.

A small business may need outside financing when it is not possible to expand based on operations cash flow alone. Start-up businesses may need outside financing to fund their start-up costs. Outside financing can come in the form of a traditional debt or through investors.

We discussed three types of investors: angel investors, venture capital investors, and non-professional investors. Each investor will likely require some kind of return on investment in the form of an ownership stake or monetary compensation.

There are a lot of benefits that come with securing outside investors, including an infusion of capital for growth, managerial and technical expertise, and potential business connections and collaborations.

Securing an investor usually requires the development of a business plan, five-year financial projections, audited financials if they are available, and a solid reason to invest in your business.

1.16 Next Steps

Now what should you do? Follow these steps to begin expanding your business.

- Step 1: Discuss with a mentor, coach, or SCORE or SBA representative to determine whether your business is ready for outside investors.
- Step 2: Create a business plan that includes a sound financial statement using SBA resources available to you.
  - Build Your Business Plan tool link: http://1.usa.gov/1eOeygT
- Step 3: Identify and solicit investors using the techniques you learned from this course and your mentor.
  - Read an SBA article about Venture Capital link: http://1.usa.gov/Q7db1x
- Step 4: Consult with your mentor or coach as you negotiate the terms of your investment.
- Step 5: Execute the exit strategy agreed upon during negotiation and enjoy the success of a profitable investment that leads to the growth of your business.

1.17 Resources

SBA has a broad network of skilled counselors and business development specialists. Below is a short description of our resource partners:

- Small Business Development Centers (SBDCs) are associated with institutions of higher education – universities, colleges, and community colleges. More than 900 SBDCs offer no-cost, extensive, one-on-one, long-term professional business advising, low-cost training, and other specialized services such as procurement, manufacturing, and technology assistance, which are critical to small business growth.
- SCORE offers free, confidential small business advice from successful entrepreneurs. SCORE is a nationwide program and boasts more than 12,000 volunteers to give you guidance to grow your business.
- Women's Business Centers (WBCs) provide free management and technical assistance to help women and men start and grow small businesses. There are over 100 WBCs located throughout the U.S. and Puerto Rico.
- SBA's 84 District and Branch offices connect entrepreneurs to resources, products, and services that can help them start, manage, and grow their business. These offices are located in all 50 states, Puerto Rico, the U.S. Virgin Islands, and Guam.
- The SBA Learning Center is an online portal that hosts a variety of self-paced online training courses, quick videos, web chats, and more to help small business owners explore and learn about the many aspects of business ownership. Content is filtered by topic, so no matter what the stage of your business, or the kind of insight you need, you can quickly get answers.

Find your local resource using our handy ZIP-code tool by visiting www dot SBA dot gov slash local assistance.

1.18 Have a Question?

- Call SBA at 1-800 U ASK SBA (1-800 827-5722)
- E-mail SBA at answerdesk@sba.gov
- Locate a SCORE counselor, SBA District Office near you, or an SBDC office near you at www.sba.gov/local-assistance
- To provide feedback, comments, or suggestions for other SBA online content, please email: learning@sba.gov

1.19 Certificate

Congratulations on completing this course. We hope it was helpful and provided a good working knowledge on how to find and attract investors. Click the certificate to receive a course completion confirmation from the U.S. Small Business Administration.

2.0 A.C.T. NOW!

The Article, Course and the Tools below are related to the course you just completed. They are provided to help you take action on your path to entrepreneurial success. You can also get in-person assistance for all of your business needs through a local resource center. And if you liked the course, please help spread the word by sharing it with your friends!

Click here to share on Twitter
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Click here to share on Facebook

Read an SBA Article.

The *About Venture Capital* article might help if your business cannot seek capital from more traditional sources.
LINK: http://1.usa.gov/Q7db1x

Take Another Course.

The *How To Write A Business Plan* Online course explains the importance of business planning, defines and describes the components of a business plan, and provides access to sample plans and resources to help you develop your own business plan.
LINK: http://1.usa.gov/1hYCURr

Try a Tool.

SBA's partner, BusinessUSA created the *Access Financing Tool* that, in a few quick steps, will guide you to government financing resources for your business!
LINK: http://1.usa.gov/1gwGiF9

Find local assistance!

SBA has a broad network of skilled counselors and business development specialists.

LINK: http://1.usa.gov/1kihdhJ