Article 20 February 17, 2008

Venture Capital: Is it right for you?

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Not every company is a candidate for venture capital. Outside equity, whether from family, friends, so called "angels," or institutional investors like venture capitalists, always has strings attached. If your company is a lifestyle business or one in which the main goal is to generate personal income, or if it is a company that you would like to pass along to family members, then outside equity probably isn't your best choice.

On the other hand, if your business is one that you want to quickly grow and at some point sell, then looking into the pros and cons of outside equity might make real sense.

Providers of most any kind of outside equity want to get repaid over a reasonable period of time and at a very good rate of return. In exchange for receiving equity capital, you are selling a piece of your company to the provider of that equity, so you now have a new business partner. Make sure you know who that partner is, and what their goals are for your company.

For a growing business, the advantages of this kind of capital are numerous. The most important is that equity significantly improves a company's balance sheet. This means that the company will have more growth resources for things like hiring marketing or sales staff, developing new products or purchasing capital equipment.

But there are other important benefits too. The company will look better to suppliers, customers, and lenders, sometimes resulting in better credit terms from suppliers, improved borrowing power and the ability to attract larger customers. Equity also reduces the risk of failure because funds do not need to be paid back on a fixed schedule and there are no interest payments. Other factors being the same, a company that is financed with a lot of equity has a lower risk of failure than one that is financed with a lot of debt.

Fortunately, there are several sources of equity capital in New Mexico. Family and friends are usually the first place to go. They often can act quickly and don't necessarily require burdensome terms or time-consuming due diligence. On the other hand, they may not bring any value to the business other than the money they provide – which, in itself, can be significant. Another problem is that family investment can put stress on personal relationships – just at a time when you don't need it.

Sophisticated investors – like organized angel investors and venture capitalists – look at their investment primarily from a business perspective. As a result, they will want a significant return,

typically in a three to seven year timeframe. They will do a considerable amount of due diligence before investing to make sure that they know, and can mitigate, the risks faced by the business.

The advantages of these sophisticated investors are that they bring structure and additional benefits to your business. They will want to participate on your board of directors, they often have business or technical expertise and they may have networks of contacts with banks, new customers or other resources.

Sophisticated investors will assess their exit opportunities – the potential ways to get their investment back with a good return. This generally requires the sale of the company. Therefore, institutional investors will learn the typical sales prices for similar companies in the market. As a result, you will be very well informed as to whom the right buyer of your company might be, and what you could expect to sell for.

The bottom line is this: if your company intends to grow fast, needs capital, relationships, and other resources to do so, and you are willing to sell it at a profit down the road, then you should seriously consider attracting sophisticated equity investors.

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