Making a strong case to be investor-friendly

There are direct and subtle ways a business can get those funds coming

By Hardeep Plahe

Why are investors important?

Well, they can, for example (a) help grow your business; (b) provide knowledge and expertise; (c) open doors to other funding sources and markets; and (d) help your business realise its full potential.

Businesses large or small can struggle to attract investors. Attracting investors is an art, not a science. Here are some tips:

1. Work out what you want from investors

You may want their money only. You may want their money and expertise. You may want their money and contacts.

Whatever it is, it is essential to work out what you want from an investor (including how much money) and whether the investor is able to deliver. For example, some investors may have invested in similar businesses and will be able to apply their knowledge and connections to help grow yours.

Others may have great relationships with the finance community and their involvement in your business may give it greater credibility.

Knowing what you want from your investor and the strengths and weaknesses of different investors will help you determine who to approach.

2. Work out what you are willing to give up

The saying goes that there is no such thing as a free lunch. Although it is overused, it is nevertheless true. Investors will not give you their money for nothing; they will want to ensure that the return on their cash is appropriate to the risk they take.

They will also want to ensure that their investment is protected though governance rights.

On the investment return side, investors may require, for example, (a) a shareholding in the company (for potential dividends and capital appreciation); (b) preferential interest on subordinated debt financing; (c) a combination such as preference shares or convertible debt; and (d) a clear exit route (i.e. a straightforward way to realise their investment).

On the investment protection side, investors may require, for example, (a) board seats; (b) veto rights over major business decisions (e.g. material investments or capital expenditure); (c) an agreed budget and business plan; and (d) other protections to allow them to look after their investment.

Early stage investors — such as angel investors and venture capitalists — are usually not after control of the business. Late stage investors such as private equity firms may require control, but they may also be willing to take a minority stake. Therefore, it is important to work out what type of investment you wish to attract and what it is that you are willing to give up for the investment being made.

3. What are investors looking for?

Ultimately, investors are looking for a good return on their investment.

The key things investors will look for to ensure that their money will be put to good use and earn the anticipated returns include:

Confidence in the management. Do you know your industry? Do you know your business plan? What is your track record of success?

Confidence in the business plan. You must be able to demonstrate why the business needs investment, how it will be used, how it will make money for the investor and the timescale required to make the return. The business plan must be realistic and able to withstand scrutiny.

Confidence in your valuation. You should prepare a true and fair valuation of the business. It is, after all, the basis upon which you are asking the investor to invest. Inflating the valuation and not backing it up by comparable valuations will be discovered and will diminish the investor's confidence in the management of the business.

Confidence in your record keeping and organisation. An investor will wish to understand your assets and liabilities and the risks to your business. It will do this by requesting information and documentation to allow it and its advisers to carry out legal, financial and commercial due diligence. You should ensure that your accounts, contracts, correspondence, licences, books and records and other business documentation are up-to-date, complete and well organised to allow you to provide information and documentation quickly.

Failure to do this may reduce the investor's confidence in the business, lead to delays and result in the investor pulling out of the deal.

4. What else helps?

In addition to knowing what you want from your investor and knowing what your investor will expect from you, an investor will want to ensure that you are well-advised and able to handle the investment process (and legal agreements required) quickly and efficiently.

For example, you will need to negotiate and agree a subscription/investment agreement, a budget and business plan, a shareholders' agreement and other related documentation. The investor will usually have a team of financial advisers, accountants and lawyers to look after its interests.

Make sure you have a good team of advisers to look after your interests!

Hardeep Plahe is a Partner at Gibson, Dunn & Crutcher LLP.