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Financing Decisions in the Real World

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Raising equity capital for your business never happens in a vacuum. External forces inevitably affect when and how and where you hunt for investors, just as they affect your decision about how much money you'll need to support your company for a few years until you start showing a profit.

External forces include the financing market — the universe of people and institutions that constitute funding sources for your company — as well as the larger business market in which you operate. Understanding these forces will help you develop a strategy for fundraising.

Beware the bubble

Pure financial investors are in the game to make the most money they can from their investment in your company. But even they can make mistakes and act impulsively.

Investors have no more insight than you do into how a market or an individual company will evolve. They, too, can misread the economic signs and underestimate or overestimate the market appeal of a particular product or service. Their fallibility is one reason why certain market segments get "hot" and others get "cold."

The most obvious recent example of this was the Internet bubble that grew and burst at the beginning of this decade. Investors believed Internet companies would revolutionize commerce, and some certainly did. But, dazzled by the success of high-profile ventures such as eBay and Amazon, many investors poured huge amounts of money into Internet-based companies based on overstated valuations and unrealistic expectations.

Bubbles based on such speculation usually burst, and that's bad for everyone in the long run. But a savvy entrepreneur can take advantage of modest bubbles to raise money for his or her business at favorable rates.

Some like it hot

If you're fortunate enough to find yourself in a market that financers consider hot, you should capitalize on it. In a hot market, many investors chase deals, and valuations are exceptionally attractive. That makes it a good time to raise money, particularly if your industry regularly cycles through busts and booms.

A current example is the market for oil and gas. Because the market is booming and oil-exploration companies know it won't always be that way, they raise money and drill while they can — while investors are most willing to back them.

If you're in a hot market, now is the best time to raise more money. If you're in a cold market, it's best to figure out how to manage on as little capital as possible.

Apart from hot or cold markets, the overall business climate will always have an impact on financing. If you predict the economy is stuck in a period of slower growth that will last awhile, you should put money in the bank to survive these lean times.

If you're small and growing quickly, the economy's fits and starts might not shake you up too much. But if your company is mature and more vulnerable to economic turmoil, you're better off raising more money early in the downturn than doing it later, when terms might be less attractive and costs higher.

No one, of course, can accurately predict what the economy will do in the near or distant future, but paying attention to what's happening in the world of business is wise for anyone planning to raise capital.

Most businesses that choose the path of equity financing undergo up to three rounds of fundraising to reach profitability. Where you end up in that range should be a result of careful strategic planning rather than chance.

Finance New Mexico is an initiative of the New Mexico Small Business Investment Corporation (NMSBIC), New Mexico Small Business Development Center (NMSBDC), Empowering Business Spirit (EBS), the New Mexico Venture Capital Association (NMVCA) and other partners to assist individuals and businesses in obtaining skills and funding resources for their business or idea. To learn more about resources available to New Mexicans, go to www.FinanceNewMexico.org.

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