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Investors Bring Benefits Beyond Capital

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Business owners who obtain outside equity – whether from family, friends or institutional investors – quickly learn money has strings attached.

Most outside equity providers want to get repaid over a reasonable period of time and at a very good rate of return. In exchange for providing capital, they obtain a piece of the company, thereby becoming business partners.

For a growing business, the advantages of this kind of capital are numerous. Equity significantly improves a company's balance sheet and provides resources for hiring marketing and sales staff, developing new products, purchasing equipment, and other needs that can help the business grow.

But there are other important benefits too. A strong cash position will make the company look better to suppliers, customers, and lenders, which can result in better credit terms and improved borrowing power. Equity also reduces the risk of failure because unlike a loan, funds do not need to be paid back on a fixed schedule, and there are no interest payments. Other factors being equal, 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.

Family and friends are usually the first place business owners go when looking for equity investment. Family members and friends can act quickly and don't necessarily require burdensome terms or time-consuming due diligence. But family investment can put stress on personal relationships. And other than the money they provide, family members and friends don't usually bring any additional value to the business.

Professional investors, such as organized angel investors and venture capitalists, look at capital investment primarily from a business perspective. They want a significant return and will do a considerable amount of due diligence before investing to make sure they know and can mitigate the risks faced by the business.

The advantage of accepting money from these sophisticated investors is that they bring structure and experience to the business. They often have business or technical expertise, and they may have networks of contacts with banks, potential new customers and other resources. As owners, they want to direct the company as members of the board of directors.

Sophisticated investors also assess their exit opportunities – the ways to get their money back with a good return on investment. Since exit typically requires the sale of the company, institutional investors will research sales of similar companies in the market and be well informed about exit potential and sales prices. As a result, the business owner is likely to receive more money at exit for his share than if he had not taken equity investment.

Business owners who intend to grow their business rapidly; need capital, relationships, and other resources to do so; and are willing to sell the business down the road should seriously consider seeking sophisticated equity investors.

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