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Don't Count Those Chickens: What the Entrepreneur Must Consider Before Raising Money, by Michael S. Friman, Partner

Raising capital for a new or expanding business venture can be a daunting task. With the downfall of so many real estate and small business ventures over the past few years, asking an outsider to trust you and invest in your company is intimidating and oftentimes met with skepticism. However, traditional sources of financing, such as banks or credit unions, are still too difficult for small and start-up companies with little operating experience or credit. Accordingly, entrepreneurs looking for capital often find themselves seeking financing by way of private capital raises. Sources for such funds can be friends and family, venture capital groups, so called "angel" investors or other equity funds. Each has their own positive and negative attributes (beyond the scope of this article), but before seeking funding from any source, the entrepreneur must be prepared. Investors are savvy, and they will closely scrutinize your business, including its operations, structure, personnel and projections before opening up their wallets. The purpose of this paper is to briefly summarize what a company seeking capital must, at a minimum, consider before asking for any money.

- **Before seeking capital:**

- Get your house in order – Making sure the company itself is ready to accept outside capital is an extremely broad proposition and should be the subject of an entire article. This paper assumes this step is in place and, instead, focuses on issues to consider once the company is established and is ready to accept such outside funding. Briefly, however, the global considerations involved in this step are: Make sure that you have selected and properly formed the appropriate legal entity, be it a C Corporation, S Corporation or Limited Liability Company, taking into consideration tax and liability protection issues. (A discussion of the various entities is beyond the scope of this article, but visit our website at www.mbflegal.com for further information). Determine whether your capital structure is set, clearly stated and appropriately structured to bring in outside capital. If the company has any key assets, make sure that they are appropriately titled. Are key employees incentivized sufficiently, and are there any problems with personnel that need to be addressed? Have you protected confidential information?
- Bootstrap – Use your own financial resources and those of your family and friends before asking an outsider to invest in your company. This will demonstrate your commitment to the success of the venture and increase its valuation.
- Know your business – Raising capital is just selling your business idea – like anything else, you need to know what you have before you can convince someone else to buy into it. Investors will ask tough questions about the concept and will want thorough answers. Most investors will expect to see a business plan. The in-depth analysis involved in preparing a business plan will give you the tools to competently answer investors' questions. At a minimum, you should prepare a brief executive summary of the business and perhaps a power point presentation to share with potential investors. Be sure to develop a clear and rational strategy with key milestones and goals succinctly



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articulated, financial projections, realistic current valuation and capital needs and an exit strategy.

- Pitch – Run your idea by experts in the field. Practice selling your idea and answering tough questions. What key feature of your business sets you apart from the competition?
- Secure your first customer - Show investors that there is a demand for the company's products and a viable means of securing income.

- **When should you begin the process:**
 - Timing – Your company will have a higher valuation if it has been operating long enough to raise revenue and prove its viability. But keep in mind that the fundraising process takes time, so don't wait until your company is running on fumes to start looking for outside capital.
 - Do you have everything Investors look for? - Investors will want to see a strong management team, a clear business concept, an exciting, growing market, an estimated time before you see positive cash flow, and a reasonable valuation of your company and capital needs. Have these elements in place before looking for funding. One critical issue is the use of funds: investors do not want to see their money being used to pay off debt or personal loans to the founders.

- **Where to look for funding:**
 - Family and friends – You should utilize this source, as well as your own funds, before looking for outside capital. If your family and friends don't trust you, who will?
 - Banks – Banks may offer small business loans to entrepreneurs, but the days of easy small business loans are over.
 - Angel Investors – Angel Investors are often current or former entrepreneurs who provide early stage funding to budding ventures. Expect to get less money but keep control.
 - Venture Capitalists – Venture Capitalists manage the money of several investors in a fund from which they can draw to invest in other companies. Venture funding is typically used at a later stage of the business lifecycle than Angel funding. You may be able to raise more funds from a Venture Capitalist, but expect to share control of your company in return.

Michael Friman focuses his practice on commercial real estate transactions, finance and business transactions. He regularly advises entrepreneurs and closely held businesses on legal matters incidental to their day to day business operations as well as capital raising and start-up activities, including choice of entity, private equity raises, and operational agreements. Michael also represents developers, lenders and businesses, locally and throughout the country, in such matters as: mixed use condominium projects, industrial and retail developments, medical office facilities, multi-family apartment buildings, hotels, construction and acquisition financing, commercial leasing, sophisticated workout transactions and tax-deferred exchanges.. For more information, please contact Michael Friman at 312-327-3374 or mfriman@mbflegal.com.

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