IAN M. BERKOWITZ

Selling equity turns 'your' company into 'our' company

By Ian M. Berkowitz
SPECIAL TO THE NEWS

If you have been following my column for the last month you should be very familiar with all of the ways to raise capital via loans also known as debt.

This week I am changing gears and beginning to discuss what most entrepreneurs are seeking more than any good loan…equity. Equity simply means ownership in something and for our purposes, raising capital by selling ownership in your business.

Many business owners looking for business capital are always more open minded to fund their businesses by giving up some ownership in the company in return for the capital necessary to start, grow or expand their business. I wish I had a dollar for every time I overheard a conversation around town where one person was saying to the other, do you know someone who would like to invest into my company?

Pros and cons

Raising capital through the form of selling equity is very popular but just like its sibling, debt, it has its pros and cons. When most of us think of equity we think of angel investors, venture-capitalist and/or silent partners. These types of individuals are the most common equity players. They are plentiful in numbers and always looking for a new deal to put some fresh capital into. But the fact is that there are more deals around then investors, so it is always an investor's market. Moreover, not all deals are the same so the quality deals usually rise to the top and get the greatest attention.

The most attractive reason why we love equity capital is because it does not require an immediate structured pay back like debt. With debt service we have a set schedule to begin paying back the money we borrowed along with some interest. Debt is also quite often secured by some if not all of the assets of the business.

Goes to company

Equity on the other hand is most often just the opposite. The money received for the equity is contributed to the company in return for stock in the company and there is no collateral required when issuing stock. The idea of giving up some ownership in exchange for the business capital you need without the liability of paying it back sounds and is very attractive.

Equity does have its issues to think about. Equity contributions by venture capitalists or angel investors often come with strings attached.

First and paramount to these equity investors is a voice in the company's operations and some ability to be involved in the decision making of the company. Most equity deals come with such requirements such as obtaining one or more board positions and having the power to exercise voting rights especially when it pertains to material business decisions.

As to repayment, most equity deals require the equity partner to receive the money back before anyone else receives any personal loans on the business or distributions.

Main issue

The main issue I often-counsel my clients to think about is whether or not they are ready and prepared to have a business partner. Equity financing turns "your" business into "our" business. Equity partners are in fact, co-owners. Most often, they have all of the rights that you, the business owner, have when it comes to ownership and profits. They can request to see your books and records, they can question certain operational decisions and most often they can become a daily analyst and overseer of all of the business activities.

It is possible to limit the rights of your equity investor; however, today's equity investors are looking for some protection and are not just walking away from their investments.

A major positive benefit is that a large amount of equity investors are former entrepreneurs themselves and have much to contribute along with their money. Many of them have started, managed and sold very successful businesses and can give you the real moral support, encouragement and business advice you may need to strengthen and grow your business.

Equity investment can be a real benefit for both the business owner and the equity investor when a good deal is structured as a win-win for both.

Ian M. Berkowitz is a former attorney/advisor with the United States Small Business Administration in Washington D.C. During his tenure with the Federal Government he specifically worked in the areas of disaster relief for homeowners and businesses and government contracting. He is currently a practicing business and real estate attorney in Boca Raton. In addition to his law degree, Ian also holds a Masters Degree in Government from The John Hopkins University.

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