



THUNDERBIRD
SCHOOL OF GLOBAL MANAGEMENT

Financing the Venture and Going Public

By

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Alternative Sources of Financing

Source of Financing	Length of Time		Cost				Control	
	Short-term	Long-term	Fixed Rate Debt	Floating Rate Debt	Percent of Profits	Equity	Covenants	Voting Rights
Self		X				X	X	X
Family and friends	X	X	X	X		X	X	X
Suppliers and trade credit	X				X			
Commercial Banks	X		X	X			X	
Private equity funds		X				X	X	X
Angels (private investors)		X		X		X	X	X
Venture capital		X	X			X	X	
Private equity placements						X	X	X
Public equity offerings					X	X		X
Government Programs		X						

Bank Loans

Bank Lending Decisions

- | | |
|--|---|
| <ul style="list-style-type: none">• Character• Capacity• Capital | <ul style="list-style-type: none">• Collateral• Conditions |
|--|---|

Types of Bank Loans

- | | |
|---|---|
| <ul style="list-style-type: none">• Accounts Receivable Loans• Equipment Loans• Inventory Loans• Real Estate Loans | <ul style="list-style-type: none">• Character Loans• Installment Loans• Long-term Loans• Straight Commercial Loans |
|---|---|

SBA Loan Application Procedure

1. Assemble the information outlined below.
2. Take it to your bank and ask your banker to review the information and loan proposal. (It will be necessary for you to locate a bank that is willing to participate with SBA and make the loan since direct loan funds from SBA are quite limited and an unreliable source of financing.)
3. If the bank is willing to participate, ask the bank to forward the information to us for our review, along with their comments.

Information Needed for Loan Review

1. Brief résumé of business.
2. Brief résumé of management setting forth prior business experience, technical training, education, age, health, etc.

SBA Loan Application Procedure *(cont.)*

3. Itemized use of loan proceeds:

Working Capital	\$ _____
Land	\$ _____
Building	\$ _____
Furniture and Fixtures	\$ _____
Machinery and Equipment	\$ _____
Automotive Equipment	\$ _____
Other	\$ _____
TOTAL	\$ _____

4. Current business balance sheet and profit/loss statement.
5. Year-ending balance sheets and profit/loss statements for the last three years; or, if the business has been in existence less than three years, furnish the financial statements for each year it has been in operation. (Copies of the financial statements submitted with the income tax returns are adequate.)

SBA Loan Application Procedure *(cont.)*

5. If the business is not in existence but is proposed, furnish a projected balance sheet of the business showing its proposed assets, liabilities and net worth upon commencement of operations, together with projected annual operating statements for the first three years of operation.
6. Furnish a separate personal balance sheet showing all assets owned and liabilities owed outside of the business.

The above information is what a loan officer will need to properly analyze your loan proposal.

Private Equity Market (Enterprise Capital)

Individuals

- Individuals
- Angel Groups (networks)
- Angel Funds
- Family Offices

Venture Capital Firms

- Private Venture Capital Firms
- Small-Business Investment Companies (SBIC)
- Industry Sponsored Venture Capital Firms
 - Banks and other financial institutions
 - Nonfinancial companies
- Regionally Oriented Venture Capital Firms
- University Sponsored Venture Capital Firms

Private Equity Firms

- Limited Partners
- General Partners



Characteristics of Informal Investors

- Demographic Patterns and Relationship
 - Well-educated with many having graduate degrees
 - Will finance firms anywhere in the U.S.
 - Most firms financed within one day's travel
 - Majority expect to play an active role in ventures financed
 - Have clusters of 9–12 other investors

Characteristics of Informal Investors *(cont.)*

- Investment Record
 - Range of investment: \$10,000–\$500,000
 - Average investment: \$175,000
 - One - two deals each year
 - Venture preference
 - Most financings in start-ups or ventures less than 5 years old
 - Most interest in financing:
 - Manufacturing—industrial/commercial products
 - Manufacturing—consumer products
 - Energy/natural resources
 - Services
 - Retail/wholesale trade

Characteristics of Informal Investors *(cont.)*

- Risk/Reward Expectations
 - Median 5-year capital gains of 10 times for start-ups
 - Median 5-year capital gains of 6 times for firms under one year old
 - Median 5-year capital gains of 5 times for firms 1–5 years old
 - Median 5-year capital gains of 3 times for established firms over 5 years old
- Reasons for Rejecting Proposals
 - Risk/return ratio not adequate
 - Inadequate management team
 - Not interested in proposed business area
 - Unable to agree on price
 - Principals not sufficiently committed
 - Unfamiliar with area of business

Types of Venture Capital Firms

Types of Venture Capital Firms

**Private
Venture
Capital Firms
(General
Partners and
Limited
Partners)**

**Small
Business
Investment
Company
(SBIC)**

Industry- Sponsored

- Banks and Other Financial Institutions
- Nonfinancial Companies

**State
Government-
Sponsored**

**University-
Sponsored**



Venture Capitalists

- Evaluation Criterion
 - Strong management team
 - Unique opportunity
 - Appropriate return in terms of capital appreciation
- Evaluation Process
 - Initial screening
 - Initial agreement of terms
 - Due diligence (industry, market, players)
 - Go or no-go decisions
 - Document deal and close
 - Monitor deal

Venture Capitalists *(cont.)*

- Venture Portfolio Goal
 - 20% early stage—50–60% ROI
 - 40% development financing—40% ROI
 - 40% acquisitions and leverage buyouts—30% ROI
- Typical Venture Portfolio of 10 Deals
 - 4 belly-up
 - 3 walking wounded (or living dead)
 - 2 hits
 - 1 home run

Venture Capitalists *(cont.)*

- Factors in Pricing a Deal
 - Return
 - Amount of money needed now and later
 - Quality of deal
 - Quality of team
 - Amount entrepreneur is investing
 - Prospects of company in future
 - Upside potential
 - Downside potential
 - Form of investment—collateral
 - Liquidity
 - Exit avenues

Advantages and Disadvantages of Going Public

Advantages

- Obtaining capital with less dilution to founders
- Enhanced ability to borrow
- Enhanced ability to raise equity
- Liquidity and valuation
- Prestige
- Personal wealth

Disadvantages

- Expense
- Disclosure of information
- Pressures to maintain growth pattern
- Loss of control

Criteria for Selecting an Underwriter

(What does the company going public want?)

- Value/price for stock
- Stable/rising price after sale
- Create strong following with security analysts
- Distribution capability—push stock out through
 - Retail—individual investors
 - Institutional
 - International vs. domestic

Criteria for Selecting an Underwriter *(cont.)*

- Market marking—OTC market deal with buy/sell stock over NASDAQ
 - Devote capital to long and short positions so that stock will remain liquid, price supported
- Research capable—analysts who follow the industry in which your company competes
- Future financial advisors on
 - Dividends
 - Mergers/acquisitions
 - Future equity offerings

Process of Going Public

- Select an underwriter
- “Due diligence”
- File registration statements (includes prospectus)
- Wait period—distribute “red herring”
 - Selling effort
 - Road show
 - Underwriters “book” indication of interest
 - Form syndicate
 - SEC review and potential comments/questions
- Registration declared effective/final prospectus
- Pricing: lots of dollars, time, effort spent and now it is too late to turn back
- Closing

Process of Going Public *(cont.)*

Issues Firm Can Negotiate with the Underwriter

- Price
- Fees
- Hold-back
- Amount of secondary offering
- Members of syndicate
- Road show/selling effort
- Post-issue support
- Size of offering
- Timing
- Over-allotment

Process of Going Public *(cont.)*

Underwriter's Perspective on Price

- Wants price to raise 10% or so upon offering
 - Give purchasers warm feeling
 - Less risk of being unable to sell stock
 - Less capital at risk “stabilizing”
- Less price = less risk

Selling Company's Perspective on Price

- Any increase in price is money left on the table
- Precipitous drop means you get more than full value, but probably will have upset investors

Selecting an Underwriter

I. Ten Questions to Ask a Potential Underwriter

1. Will you be leading the team that works on the deal?
2. How long have you personally been in the banking business?
3. Of the similar transactions your firm has done, how many have you personally handled?
4. Which other banks will co-manage our deal, and which banks will be included in the selling syndicate?
5. Which analyst will cover our company's stock?
6. How long has that analyst been with your firm?
7. What assurances, if any, can you offer that this analyst will stay with your firm after our stock offering?
8. Can we count on your analyst to issue a research report on our stock immediately following our offering?
9. How frequently will this analyst issue additional reports on our stock?
10. How much aftermarket support will you provide for our stock following the offering?



Selecting an Underwriter *(cont.)*

II. Five Things an Underwriter Does Not Want You to Know

1. All of our fees are negotiable.
2. Our profit margins are enormous.
3. While our analyst who follows your industry is the best in the business, he/ she is about to leave our firm.
4. We've done lots of deals in your industry, but most of the people who did them now work for our competitors.
5. We're not really an underwriter.