

HOW DOES THE INVESTOR THINK

by Ken Hollowell

Private investors are everywhere ready to invest in a project that captures their attention and imagination. Most private investors are looking at many different opportunities at any one time therefore your project needs to “jump” out and grabs the investor, otherwise it will be passed over.

Most private investors consider investing in start-up projects like gambling in Las Vegas -- A private investor keeps placing bets in hopes that one of the bets will hit big enough to more than pay for all of the other losses that virtually every private investor is bound to take. Private investors spend a great deal of time on due diligence and hedge their bets by funding several different startup businesses at any given time. They do not just slap down money for every idea that comes across their desk. However, despite their best efforts, most of these bets fail. However, when one of their funded companies hits it big, it *really* hits it big! A private investor wants “home runs”, not “base hits”.

What is a home run?

A home run for most private investors is a significant return on their investment, somewhere along the lines of 10 times their original investment within four or five years. There is no absolute definition of what a home run looks like to every private investor, but it is certainly not “doubling their money in ten years”. You can do that with the stock market on just a modest gain. There are countless businesses that are great ideas and can be well executed, but just cannot provide the potential returns that an early stage investor requires.

Is my idea a home run?

Does it have the potential to make hundreds of *thousands* of dollars? Or does it realistically have a chance at making tens or hundreds of *millions* of dollars? If your idea can return five to ten times to a private investor and you and your management team can execute on the Private Placement Memorandum, then you might be a good candidate for early stage investment. If you have a proven business model and just need funds to quickly scale the growth, then it could be time to shop your business around to private investors. They'll be the first to shoot holes in your dreams of being the next Google. And if they like your idea, you might be able to sale your stock to the private investor.

It's all about making money

As with any type of investor, a private investor is looking to make more money with the money that they already have. Sure it's nice to have the luxury of existing capital, but managing these investments is a full time job. Unlike you, this is what they do for a living, not as a side job.

Private investors spend a great deal of time weeding through new funding proposals looking for a great opportunity--and if the planets are aligned right, they might hit the next Google.

In the meantime, only a few of the deals that they fund will make them any money at all - most will go bust. But, as with anything, the gamble usually pays off in the end if they make more good investment decisions than bad. That means that they can't afford to make many mistakes - this is their primary source of future income and any mistakes will cost them dearly.

To help offset some of this risk, the majority of investors will do a great deal of research and analysis before funding any venture. They can't catch everything though! So, rest assured, any credible private investor is going to thoroughly check the facts before sending any money your way.

The finer points of the private funding deal

Now that you have a broad sense of the startup funding game, there are a few general details that you can bank on encountering when taking on a small business investment.

What you can definitely count on

Your deal won't be funded overnight. Without question, a private investor will want to do a fair amount of research before forking over their hard earned cash to finance your dream. Expect the funding process to take a few weeks if not months.

Here is where one of the benefits of a Private Placement Memorandum comes into place. The private investor knows if he does not act soon, the offering will be sold out or he might be able to purchase the amount of shares of stock he would want.

The best way to expedite this entire experience is to focus on refining and growing your business to make it much more attractive to potential private investors. Remember there are thousands of entrepreneurs out there looking for funding at any given moment and your idea had better stick out above the rest.

Another benefit of the Private Placement Memorandum is the private investors usually accepts the offer in the Memorandum as it is written. When you use a business plan or executive summary to attempt to raise your funds the private investors will always want a portion of ownership in your company (equity) in exchange for the capital that is usually beyond your comfort zone. Some "Angel" investor have asked for interest on their money, a pay back date, managerial controls, plus equity. That would be very difficult for most small business startups to swallow.

The Actual Funding Process

Here's the basic funding process from start to finish in a nutshell. We've left out some details and not every private investor will work the same way, but you can bet on a standard startup funding negotiation process following these basic steps:

Step One

Private Placement Memorandum is presented to the private investor.

Step Two

If the private investor is interested in the opportunity, he or she will reply and request further information about the deal. This might be done through personal contact, phone or e-mail.

Step Three

From here, the private investor will conduct due diligence (research) on the investment opportunity to be sure that they agree with your projections. Any respectable business investor won't just throw money into every opportunity that comes their way. You can bet that thorough research will be conducted.

Step Four

If the opportunity looks like a good fit, the private investor will complete the subscription agreement form and fax it to you.

Step Five

The private investor wire transfers the funds into your bank account.

Step Six

Prepare the stock certificate in the amount and name of the private investor and overnight it to him or her.