The Benefits of a Structured Offering

By Ken Hollowell

No doubt you have heard people who have attempted to raise money for their startup companies state many nightmares they encountered in dealing with investors. The general consensus among individuals wanting funding from investors is "they beat you up" and "they want more from me than I am willing to give".

Those are common statements from individuals unprepared to discuss with investors their opportunity and deal. The biggest mistake a person makes is when they approach a potential investor with only a business plan. A business plan is important and has its place among the tools of the business owner but to use the business plan solely for the raising of money is usually disastrous. Business plan should never be used solely for raising funds because they are not designed for such use.

Business plans provide basic and general information about the company and concept of the businesses. Investors appreciate business plans but it does not provide the structure for the raising of money. Neither does the business plan address the need for multiple investors. Merely stating the amount required or needed does not provide the structure for the raising of the money.

The business plan and this weakness is probably the one reason why so many companies fall short in their attempts to raise capital from investors. Raising capital effectively and properly from investors requires very specific documentation that far surpasses what a business plan provides.

Public companies don't raise capital from investors by putting a business plan in front of potential investors. The same holds true for private companies seeking capital from investors. Don't expect an investor to invest unless you have presented them with a securities offering such as a REG D 504 or 506 Private Placement Memorandum. Business plans serve a purpose (especially for start-up companies) - but they should not be relied upon as investment documents.

How to Properly Raise Capital for your Business

There are certain fundamentals that you must have in place in order to raise **any amount** of capital from investors properly (whether it be one investor or one hundred):

First, you must have proper transaction structure in place before you interact with investors. The overwhelming majority of companies that are just using a business plan to raise capital (whether for $50,000 or $1,000,000) typically have very little transaction structure beyond "we're selling 20% of the company for $1,000,000". This is wholly inadequate.

How many shares or units are being sold? Preferred return or common ownership? What is the share/unit price? What is the total authorized share/unit pool and how will it affect future dilution of the investment? What is the exit strategy? How is the investor return modeled? Are the securities convertible?

Not addressing this information places the responsibility for creating proper transaction structure on the investor - which is very unprofessional and reflects poorly on the subject company. To raise private capital successfully you need to go well beyond simply stating to investors an aggregate amount of capital needed and providing information on the business. Do not expect investors to have any interest in your opportunity without providing them concise terms and conditions regarding their capital investment in your company. If you were an investor - would you not want the same information and structure provided for your investment?

Second, proper documentation for raising capital from investors is of critical importance. A business plan is not even the bare minimum needed for raising private funding - of any amount. The specific documents needed for raising private capital are:

- Private Placement Memorandum: The Private Placement Memorandum, or "PPM", is the document that discloses all pertinent information to the investors about the company, proposed company operations, the transaction structure (whether you are selling equity ownership or raising debt financing from the investors), the terms of the investment (share price, note amounts, maturity dates, etc.), risks the investors may face, etc. Do not confuse the detailed corporate disclosures, SEC disclosures, and transaction structure in a PPM with the general information a business plan provides - they are not the same.
- Subscription Agreement: Business plans do not even provide the documentation necessary to allow the investor to **actually invest**. Don't expect investors to provide you funding based on a handshake. Would you invest funds into a company without signing a document that sets forth the terms and conditions of the investment? The Subscription Agreement sets forth these terms and conditions - this is the document the investor signs and returns to you with their investment check. You will have a very hard time raising debt or equity capital without this basic document.

Third, in order to sell securities to investors you must follow the rules and regulations that govern these sales as set forth by the Securities and Exchange Commission and State securities regulators. The SEC has specific rules concerning how a private company solicits capital from investors - even if very few investors are involved. The Regulation D Offering program is the exemption program designed by the SEC for private business. It is the most widely used program the SEC offers and provides the proper exemption needed to raise capital from investors. Not raising capital properly can provide investors with a "right of rescission" in the future - meaning they can get their investment back regardless of the circumstances.

Don't rely on your business plan to perform a function it was not designed to accomplish. Structure a Regulation D securities offering for your transaction and begin raising capital the right way.

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