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How to raise capital without giving away your company

Anat Bar-Gera's opening remarks during a panel discussion at INSEAD's first Global Entrepreneurship Forum, would not make her very popular, she confesses. "If you want to make money, don't hold on to it too tightly – lest you jeopardise your success." Bar-Gera, an INSEAD alumna and co-founder of WiMAX Africa and several telecom start-ups, was a lawyer and a banker by profession. Her contribution to these ventures is raising funds and realising exits, of which she has made several successful ones.

Speaking to INSEAD Knowledge following the session on how to raise capital for your company, she said that one common mistake entrepreneurs make is overvaluing their contribution as well as their chances of success. This is normal, since a good entrepreneur has to be absolutely convinced of the future success of his company and his ability to bring about this success. "However, one should be aware that a deal is struck between a willing buyer and a willing seller – or in this case, between an entrepreneur and an investor. So if you don't adjust your expectations to that of the market, you might end up without a deal."

Don't take too long

Timing is another important aspect to consider when raising funds. The entrepreneur wants a high valuation, but he cannot afford to spend too much time shopping for investors and negotiating a deal, Bar-Gera says. Many things could happen: financial markets might close, so the next round of financing will become impossible; an IPO window will disappear; technology might become obsolete; or the competition might take over the market.

"Typically what you want as a founder is to get a good return when you sell the company, but that's in absolute terms – a certain USD or Euro amount. It does not help you if you own 90 per cent of a company which does not progress at all because it lacks financing," she argues. "It does help if the company is well financed and is able to grow and achieve its goals, even if you own less of the cake."

Create multiple investors interest

While the entrepreneur might be willing to meet the investor's expectations fairly quickly, some investors tend to delay making decisions. It could take up to a year these days. The more the venture capitalists (VCs) wait, the more distressed the company becomes as it runs out of money. The VCs know it and some of them exploit this to get a better deal in terms of conditions and lower pricing. "It would therefore be good to have several potential investors so that you can put some pressure on the other investors to decide quickly or lose the opportunity," says Bar-Gera. Having several VCs also provides a fall-back position, as many deals look as if they will close tomorrow, but the investors walk away at the last minute.

Engage an investment banker

Dealing and negotiating with several VCs can be quite burdensome for a small start-up, and the entrepreneur would be better supported by investment bankers who would take some of the processes upon themselves. "An investment banker typically costs 5 per cent or more, plus a retainer, but you will be well positioned," says Bar-Gera.

She recommends a corporate finance boutique which is ethical and of high professional standards, as they can add a lot of value – they hear things which the founder would normally not hear from investors. They can save the entrepreneur's time by making the approach, chasing the investors, making the follow-up, and pushing to close a deal. They know what the market is like and whether the entrepreneur's expectations are realistic. "The investment banker should also be able to create multiple investors interest and, ideally, excitement and hype around the company."

Create goodwill (and repeat customers)

The investor community can be very communicative, with a retentive memory. In a new venture, investors would sometimes ask the entrepreneur for a reference from his investors in a previous venture. "So if you don't want to be remembered as an entrepreneur who is difficult and makes money only for himself, share your financial success with your investors and management as it will help towards the next successful venture," advises Bar-Gera. "It is a good way to create 'repeat customers.'"

Beware of 'the last-minute trick'

Some VCs have a habit of blocking an exit at the last minute by asking for a higher remuneration than what they are entitled to under the existing agreement. Usually by this time, the founder is already exhausted from the exit negotiations so that all he or she wants is the money, and it's easy to give in to such pressure.

Bar-Gera tells the story of a company that was going to be floated on AIM, the London Stock Exchange's international market for smaller growing companies. The major shareholder told the entrepreneur 48 hours before the initial public offering (IPO) that he wanted an additional cut - to be taken from the founder's. The entrepreneur was obviously not happy. So he disappeared for 24 hours where he ate well and played video games – to contemplate what he should do. He then left a message for the major shareholder: "My lawyer is available to discuss matters with your lawyer." The major shareholder, realising he couldn't have the IPO without the CEO at this late stage, withdrew his request and the CEO got to keep his stake.

"It's like two drivers driving against each other on the highway – whoever blinks first goes off the road."

Get the balance right

As the fund-raising process takes between six and 12 months, start early, so that you don't run out of funds. "Many founders dislike raising money, so they tend to postpone it," says Bar-Gera.

On the other hand, the later you try to raise capital, the higher the valuation, as VCs tend to look at the last round of valuation and see what milestones you've achieved. The more progress there is, the higher the valuation would be. "So balance well between these two arguments."