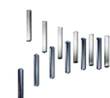


INTEGER WEALTH GLOBAL

Literature – Equity for Funding

Issue: 29 January 2019

The 'In's and Out's' of giving equity in exchange for funding.

For some entrepreneurs, giving away equity in your business can feel a bit like selling part of your soul. Other cash-strapped business owners eager to grow will take funding at almost any cost.

Equity 101

Very simply put, equity deals involve giving away a percentage ownership of your business in return for funding, resources or skills.
How these deals are structured can take a variety of different forms, but the basic principle is the same: equity is given away in order to gain the things that will help take the business forward to the next growth level. Because most entrepreneurial businesses are almost perpetually cash- strapped, they either can't afford to buy in the skills and resources needed, or they can't access the funding required to grow. In many instances, the only thing they possess is the equity in the business and this is used as a means of exchange for what they need but cannot access through other means.

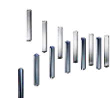
It is a common misconception that equity deals only involve funding. While funding is what most entrepreneurs lack, resources and skills are equally common reasons for giving away a share of the business.

For example, this might involve taking on a partner who brings to the table certain skills that the owner does not possess but which are needed to take the business forward. Alternatively, one might give away equity in return for resources such as equipment or contacts. Someone who can open doors to the right deals can be of immense value to a business and many entrepreneurs choose to give away equity to a person who brings such benefits to the table.

Equity changes through the business life-cycle

Marc Bandemer, Chairman of Integer Wealth Global explains that the equity needs and deals change as the business moves through different business development life stages.

"In the start-up phase, businesses are typically under-resourced, but they need skills to cement solid foundations and get sales going. Entrepreneurs are often strong in their particular 'subject' area but weak in others like marketing or financial management. So, they are faced with several options: They can try to muddle through their weak areas alone, however this often comes back to bite the business. Or they can hire someone who has the strengths they don't possess but being under-resourced presents a problem because they can't pay market-related salaries for good talent. Or they bring in a partner who possesses those skills and give that person equity in the business."



In the growth stage of the business, equity needs change. “Businesses can either grow organically, which is appropriate for certain businesses but can be frustrating and slow, or they can grow aggressively but for this they typically need funding,” says Phitides.

There are two key funding options: debt funding and equity funding. “You need assets to secure debt funding and you need to be able to pay back the loan as well as the interest on a monthly basis. Equity funding on the other hand means you don’t need to dedicate a certain amount of money every month, and at a time when money is most needed in the business, to service interest and repayments,” explains Phitides.

Of course, many entrepreneurial businesses simply can’t access debt funding, so equity funding is the only option available to them, unless they are able to raise capital on their own.

Before you take the leap

This last point is an important one. “Giving away equity is akin to giving away your future wealth. Entrepreneurs often don’t realise this. They are so desperate for the money now, that they don’t properly explore all alternative options,” says Bandemer. Before you rush into an equity deal, you need to make sure you’ve asked yourself some important questions, he says.

Most important of all is to determine whether the skills, resources or funding you think you need is really critical to the future of the business. Many successful businesses manage without funding, particularly in the early stages. Ask yourself if it is not possible for you to do the same.

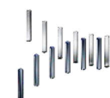
If you are looking for a certain skill sets but cannot afford to pay a salary for the right person, it might be worth exploring the possibility of paying a once-off fee to get what you need. In other words, you might choose to ‘bite the bullet’ and pay a marketer to put together a marketing plan for you, rather than taking on a partner with marketing expertise and giving them equity in return. Bandemer further says, “I generally don’t recommend giving away equity for once-off transactions. If someone does a referral for you but there is no long-term relationship, equity shouldn’t be given away, but rather pay cash if possible or give a payable note for a future date with interest.”

Colleagues of Bandemer agree, “The value that the person brings should be ongoing. If not, you might find yourself five years down the line and feeling very resentful about the fact that someone owns 25% of your now highly- valued business, in which they do nothing, just because they gave you a marketing plan or introduced you to a key client or lent you some money when you needed one in the early stages. I have seen this kind of deal lead to lots of bitterness, unhappiness and conflict.”

This is not to say that giving away equity is a bad idea in itself. “Often, it’s unavoidable. My view, however, is that it’s only a bad idea if you haven’t explored all alternative options and if you haven’t carefully considered the consequences of the deal – and made up your mind about whether you can live with them or not,” says Bandemer.

How it will change your business

Make no mistake, an equity deal has immediate and long-term consequences. “Once the deal is done, your business is seldom the same,” continues Bandemer.



“Entrepreneurs thrive on their independence and own leadership style in achieving their objectives. They find it challenging and stifling being confronted by the endless compliance and governance requirements of outside shareholders. Innocence lost is never regained, in a sense,” he adds.

Bear in mind that investors will want to see structures and systems put in place and will expect regular detailed reports on the business’s activities. If you don’t have the stomach for this, and many entrepreneurs don’t, then you don’t have the stomach for such an equity deal.

Bandemer adds another interesting point.

“Often, the reason that entrepreneurs aren’t meeting their goals is because they can’t work within the parameters of the investors. Frustrated or stifled, they lose enthusiasm and passion and deliver a lack-lustre performance where once they excelled.”

Whether you exchange equity for an active partner in the business, or a ‘silent’ shareholder, the fact remains that you give away a degree of autonomy when you give away equity. You will, to some extent, be answerable to others for the decisions you make.

“Your funder will want things rolled out and achieved as forecast in the business plan you presented and as agreed when you struck the deal. But I have never seen a business achieve its forecasted plan, ever, and this can leave entrepreneurs in an impossible position,” he says.

Depending on the deal, investors may become punitive. “The deal may allow them to increase their equity share because you have failed to deliver what was required and agreed, so you find yourself incrementally losing more and more ownership” he explains.

Common mistakes

This brings us to some of the common mistakes entrepreneurs make when doing an equity deal. “One of the worst and most damaging mistakes is that they don’t formalise the agreement, setting out clearly the expectations, deliverables and consequences. My advice is to watch The Social Network on the Facebook and LinkedIn story before you go into any kind of partnership,” says Bandemer, adding that most entrepreneurs don’t formalise their contracts because they lack money for a lawyer. “Things are agreed verbally but are hardly ever written down, and it leads to endless problems and conflict,” he says.

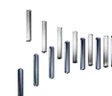
Another common mistake is for entrepreneurs to take on partners for the wrong reasons. Just because you like and trust someone doesn’t make them an ideal business partner. “When you’re starting out I suggest you find one partner to start the business with.

Bandemer suggests in a chuckle “Sign all the paperwork and contracts, while everyone is still friends”

One of you should have technical or product skills and the other should be business or marketing focused, for example. It’s comforting to go into business with a partner who is similar to you, but what’s actually needed is someone who has complementary, but different, strengths and skills. If you both enjoy sales and marketing, the operational and financial side of the business will get neglected,” he continues.

“Being too generous or too greedy is another pitfall.”

While you might believe that your business will be valued at £1 billion in five years’ time, remember that this is only a projection. Any investor who does an equity deal is taking a risk, so bear this in mind when you find yourself becoming greedy.



On the other hand, don't undervalue your business to the extent that you give away so much and find yourself five years down the line owning only 6% of something really valuable that you've put your heart and soul into building.

Valuing the business

One of the most difficult aspects of doing an equity deal is how to value the business, not only on paper but in your own mind. After all, you need to have a sense of what the business is worth to know what your top and bottom end will be for any equity deal.
Bandemer discusses how to weigh the decision: "If you bring on a partner or investor, you need to determine if the equity you are giving them will deliver a greater return on your existing equity than not having them will do.
Let's assume you have a business that is worth £1 million and that you own 100%. You give 50% to an investor who puts £1 million into the business.

So you now have 50% of the business, but it's now worth £2 million. In theory this puts you back in the same position, of 'owning' a share worth £1 million.

However, if you are able to use the cash to double the value of the business to £4 million then your 50% is worth £2 million and you're ahead.

The question to always ask yourself is: By taking on this partner, can I grow the business so that my new percentage of the grown business will be worth more than I have now?"

What makes for a good equity partner?

Insight into what to look for in an equity partner:

- An on-going contribution in one or, ideally, all of the following: funding, skills, resources and relationships.
- Someone who buys into and supports your vision. While you will be answerable to them to some extent, their involvement should not quell or interfere with your passion. It is this, after all, that drives the entrepreneur's tenacity and allows them to stick with it when the going gets tough.
- Patience. Nothing ever goes according to plan and it may well take longer than expected for an investor to see returns from an entrepreneurial enterprise.

Advice on equity contracts

If you can't afford a lawyer to put together your equity contract (and many businesses can't), we recommend you put together a deal sheet.

This should include who gets what percentage for what contribution, what each person needs to do in the business and what areas they are responsible for, and what the consequences are of not doing these things.

Lastly remember:

> "If given 8 hours to chop down a tree, I will spend 6 hours sharpening my axe" Abraham Lincoln