MORE THAN MONEY: 5 THINGS TO CONSIDER WHEN CAPITALIZING A STARTUP COMPANY

It's one of the most exciting times in any entrepreneur's life: you've got a great product and a solid business plan. You can attract customers and generate revenue. Now you're ready to bring investors on board. Maybe you've even gotten some interest from a few. It's time to break out the champagne, right?

Not so fast. Getting to the funding stage is a tremendous milestone, but it's also the point at which many startups take a wrong turn. The decisions you make now can determine how the risks and benefits of the venture are distributed. Onerous funding structures can siphon business-critical working capital from the business to pay investors. Complex funding arrangements can leave founders with too much risk and not enough reward. And if the company underperforms or fails, owners can face ruinous financial obligations.

To help you avoid these mistakes, here are 5 things you can do right from the start.

1. START EARLY. Start looking for capital before you need it. By doing so, you can be selective about your capital sources rather than getting desperate and going with the first investor who asks you to the dance. It also means you have more time to evaluate terms and negotiate. If you only search for money when you're burning through the last of your bank account, you won't have those luxuries.

2. CHOOSE THE RIGHT PARTNERS. Who funds your business can make a world of difference to your growth and success. There are many equity investors and lenders who are more than willing to use their relationships and expertise to add value to the businesses they partner with. There are also many whose hearts are in the right place but don't have the savvy to add value to your business. And, sadly, there are those who just want to make a quick buck. Seek those who have a solid track record of contributing more than money to the success of their investments. Also, choose lawyers and accountants who truly understand startup financing and can make a positive contribution to your business. Even the right commercial real estate agent or insurance broker can be a significant asset.

3. KEEP IT SIMPLE. Sometimes complex funding structures are unavoidable, but some investors use them to maximize their short-term profit and minimize their risk at the expense of the company they are funding. Understanding terms and minimizing complexity can protect against these one-sided arrangements. These commonly used structures can work well in moderation and need to be understood:

- Convertible debt: You owe the investor interest on the money they put into the company as if it was a conventional loan, and the investor can convert that debt to equity at the same price as new investors.
- Warrants: Like stock options, warrants empower investors with the right to buy additional stock in the future at a previously agreed-upon price. This enables them to delay investing until the company is more valuable.
- Liquidation preferences determine who gets money back if the company goes under. Most investments have them as part of their terms, but it's very important to understand them before entering in to an agreement. Some liquidation terms can be very onerous to company owners.

4. FOCUS ON THE BEST, PLAN FOR THE WORST. Most startup founders have a dream exit strategy. But if things flatline, you may be looking for the back door instead. Often, the problems inherent in a capital structure do not become apparent until things take a turn for the worse. Understanding what can go wrong and the impact of funding arrangements can prevent a financial catastrophe.

5. GET THE NUMBERS RIGHT AND SET REALISTIC EXPECTATIONS. Especially for a new company without a track record of profits, getting the key numbers right is critical to success. Investors are trusting you with their money. Restating results or changing equity arrangements after the ink is dry can cause a crisis of confidence. Creating realistic expectations about the value of the company and the amount of funds to be raised is also important. Shooting for pie-in-the-sky numbers and falling short is, at the very least, disappointing; setting an attainable bar (and perhaps flying over it) keeps the positive buzz going.

Starting a new company and seeing your idea succeed in the world is one of life's greatest pleasures. How you get the money and under what terms can be as important as the money itself to the future of your business. With a solid head start and the right partners by your side, you can make sure your company steers a true course long after the champagne is gone.

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