

# INSIGHT

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## In this issue

Make your investments recession-proof

Nonprofits struggle in a down economy

Overseas assignments jet propel careers

Twitters, blogs and Facebooks hit the office

Supply chain muscle wrestles hard times

Women in public accounting hit the glass ceiling

Get creative to save on training dollars

Find a new definition for recession era success

Tax changes impact US small businesses

Ira Solomon CPA, PhD takes a bow



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# INVESTOR Search

**Businesses get creative in their hunt for ever-elusive funding**

# Desperately Seeking Investors

*Businesses are searching high and low for scarce investment dollars.*

By Sheryl Nance Nash – July 2009

Finding money during a recession is a bit like walking into an empty field with a pair of binoculars and hoping to spot a pot of gold. And even if you haven't seen that telltale sparkle in the midst of all that dirt, the truth is, there's still money out there—if you look hard enough and long enough, and if you're prepared to be creative.

**“Before, in bad times good companies could always get financing. Now, it's really difficult, but not impossible, for good companies to find money,” says Van Conway, president and senior managing director of turnaround consulting firm Conway MacKenzie Inc.**

## Impress a Venture Capitalist

Risk-loving venture capitalists are more cautious today than they were just a few years ago. “The steady drum beat of bad news has made some VCs think twice,” says Bill Venema, a corporate lawyer with Epstein Becker Green Wickliff & Hall. “Consequently, they are taking moves to protect themselves when they enter what is a riskier environment and, in some respects, uncharted water as the economy resembles little that is familiar. They are putting in provisions that if certain milestones are not met as planned, then they will be eligible to take a larger percentage of the company,” Venema adds as an example.

But not everyone is running for cover. Google recently announced the creation of a venture capital arm, Google Ventures, which is expected to invest up to \$100 million over the next year. Google is reportedly targeting areas such as the Internet, clean technology and life sciences.

How do you impress a VC? For starters, “They'll want to see that you have some money in the bank, a revenue stream, customers and a stellar management team,” says Steve Lundin, head of Chicago's Big Frontier

Communications Group. "Venture capitalists are very attuned to who's in the spotlight," he adds.

Lundin's recent survey of US-based technology startup and early stage companies found that companies engaging in public relations campaigns were 30 percent more successful in attaining funding within one to three months than companies without a campaign. Beyond your public persona, though, one of the keys to attracting VCs right now is to have a scrupulously crafted business plan that pays attention to what's happening in the marketplace, explains Lenny Sokolow, president and vice chairman of National Holdings Corporation, an independent broker-dealer.

"Some popular VC sectors include clean technology, life sciences, certain consumer products, and online services that create exchanges. As in all things, it's important to do your homework, and discover what venture capitalists find of interest these days," he says.

Remember that you only get one chance to make a good impression. "If you screw up, the meeting is over. Have your ducks in a row, clearly state the value proposition, don't overstate revenue projections or you'll lose credibility," says Venema. In fact, it's best to be conservative. Then anything over your stated projections makes you look absolutely fabulous.

It's a good idea, too, to have a strong advisory board or board of directors in your corner. And "It's always best to meet prospective venture capitalists through an introduction, say your accountant, lawyer, friend, or through business conferences," says Sokolow.

"VCs on both coasts are active as always, but they are more stringent than before. If you have proprietary software or patents, you'll get their attention. If you have a business model that's little more than a new way to do French fries, you might not get very far," he warns.

Venema isn't as optimistic about the potential to capture VC interest, however. "VCs are most assuredly not as active as always," he says, quoting an April 2009 FierceCIO article: "Venture Capital firms are facing tough times these days," the article explains. "They logged just 549 deals during the first quarter of 2009 with \$3 billion in investment. That's almost 50-percent less than the \$5.7 billion investment and 866 deals in the last quarter of 2008."

**If you do get VC investment, it won't come cheap. "A lot of equity funds can get a senior position at 50 cents on the dollar, effectively owning the company. VCs are about return on capital, so they are expensive capital," says Conway.**

### Tap Heavenly Sources

While they still have their wings, today's angel investors are flying with a little less cash in their pockets. "Even wealthy, accredited investors have seen their net worth dissipate by 30-60 percent, and so we've seen a corresponding diminishing in angel investing," says Sokolow.

Not surprisingly, angels are benchmarking their expectations. "They know they won't get immediate returns on their money, so they are looking for companies promising greater returns than in the past from those who are considered less risky. Angels can seek 30 times their return over five years," says Lundin.

"The key to targeting angel investors is to understand their investment focus. Venema explains: "The Post-Investment Period of Business Angels: Impact and Involvement (Macht, July 2007) states that, "[B]usiness angels tend to invest in businesses within their own locality. This may be because active involvement may only be feasible if the business is within easy reach. Unsurprisingly, business angels also tend to invest in business sectors in which they have personal experience. One study...revealed that around a third of business angels invest solely in business sectors in which they have had prior work experience. Around two-thirds of business angels, however, have made at least one investment in a business sector with which they were unfamiliar."

**Whatever their focus, one thing is true of all angels: You'll need to show them that you have business in the pipeline. "If you have a great idea, but no money, you'll likely have no deal. It will be harder to find money," says Conway.**

What's more, in this down economy, your presentation has to be flawless. "If they don't get it, forget it," says Lundin.

### Knock on Your Banker's Door

Despite all the bailouts and stimulus activity, it's still tough to get

money from a bank. "A lot depends on which bank you approach, what industry your company is in, and how you plan to use the proceeds," explains Scott George, managing director of Plante and Moran Corporate Finance in Chicago.

"Banks are still gun shy," says Lundin. "If you do get a loan, it may cost you more in time, effort and interest. Loan limits are lower and loan committees are getting more stringent. If you're a good customer with a bulletproof plan and have collateral, then you can get a loan. If you don't have stellar credit, you're unlikely to get a loan. The banks can't afford any more screw ups like the housing defaults. Be prepared to jump through the hoops to get the money," he says.

"I have a deal that I'm working on where a 9-year-old, established company wants to purchase land and a building for a medical facility," says Venema. "The bank wants 30-percent down, guarantees from key investors and more. The company had existing credit with the bank and now it's trying to renegotiate. But the bank is asking for a much higher interest rate and still may not give the loan. Credit is the life bread, the air of the economy; the lending situation is distressing," he says.

Though banks aren't lending much on the commercial business side, since early 2009 there has been a loosening of leasing credit, says Sokolow. "Interest rates for leasing credit might be high, but there's some blue sky visible there, and it promises to open up in just a matter of time."

The government is playing in as well. It currently guarantees up to 85 percent of loans in the SBA's 7a program on amounts below \$150,000, and up to 75 percent on larger loans. The government will temporarily increase the guarantee to 90 percent to entice banks to open the lending gates. The SBA's 504 program guarantees up to \$4 million worth of economic development projects for small businesses. And the Obama Administration will temporarily eliminate fees for lenders and borrowers participating in the program. What's more, the government will temporarily eliminate upfront fees for 7a loans that banks charge borrowers—typically as high as 4 percent for larger loans.

### Fish in Other Waters

It's time to venture beyond traditional avenues if you want to up the odds of filling your coffers. "We're starting to see smaller, intermediate

peer-to-peer lending becoming increasingly popular," says Sokolow. "These channels, such as TheLendingClub.com, use something similar to the micro-lending models to allow investors to circumvent the banks and make personal business loans of up to \$25,000, with an average of \$10,000," he explains. "It's a very sophisticated, elegant solution that's gaining a lot of traction."

Utilize free resources such as [www.vfinance.com](http://www.vfinance.com), Sokolow advises. This is a primary online connection point between serious-minded entrepreneurs and the capital industry.

Borrowers are also exploring specialty financing sources such as GE Credit and Goldman Sachs Specialty Lending Group. Shop around to find the one best suited to your needs and industry, says George.

Mezzanine financing is also getting a second look. This hybrid of debt and equity financing is typically used to either finance the expansion of existing companies or fund acquisitions. It is essentially debt capital which usually provides the lender with the right to convert a portion of its investment into an ownership or equity interest in the company.

What's the attraction with mezzanine financing? It's treated like equity on a company's balance sheet and may make it easier to obtain standard bank financing. "Borrowers can use this money to bridge the gap between available senior debt and the total funding requirement of the borrower. But mezzanine capital can be expensive, with all interest costs currently in the 17 to 23 percent range," says George.

Also consider a private equity fund. "While most PE investors primarily seek to make control investments, many are becoming much more open to purchasing minority stakes in businesses, while allowing current management to retain control of the company," George explains.

For mature companies, a private placement might be a good choice. In this scenario, a group of people or institutions provide equity or debt capital to a company. Private placements are privately offered and are restricted to qualified individuals, usually defined as someone with a net worth of at least \$1 million.

What's the key benefit? The securities being sold do not have to be registered (which is very expensive). Confidentiality, however, has been

reduced by recent changes in Regulation D, says Venema, which now require Form Ds to be filed electronically, making them readily accessible to the public.

“There are federal and state rules that have to be followed closely, and potential investors would have to have significant cash to spare. But there are entities that have cash on hand like pension funds,” he says.

Be Realistic

Grasp the realities of the current economic climate. Don't look back at prices and terms that you could have gotten a couple of years ago. That's history. Expect to get less than you planned. Don't wait until you are desperate to seek money.

“Anticipate your financing needs as far out as possible, since the more time you have to explore your alternatives, the better your options will be,” says George.

Lastly, says Sokolow, “Beware of people making easy promises, and be wary of upfront payments. Be diligent, be patient, be persistent.”

**If realistically there is no chance for you to raise money today, “The best thing to do is wait until the lenders crawl out of their caves,” says Conway. “You don't want to go down the path of seeking capital where you have zero percent chance of being successful and take your eyes off your business. Focus on your business and wait. Things will turn. ”**