Bringing *investors* into your business. Is this a *good idea* for you?

by Jeremy Streten

Most SME owners are in business to take control of an aspect of their life. It may be that they were unhappy with their previous employer or business. It may mean that they had a great idea for a business but didn't want to involve their previous employer or business partner. Whatever the reason, it is often about taking back control.

Bringing an investor into a business is not a decision that is right for every entity. It requires a substantial degree of thought, and careful attention to documentation formalising the investment.

How might an investor be brought into a business?

There are two main ways that can be used by business owners to bring in investors. First, it could be by way of a loan. The investor may loan the business money, to be repaid over a period of time, and other loan terms including the interest rate and fees charged.

Secondly, an investor may invest in the business in exchange for a percentage of ownership.

When can an investor be brought in?

There is no "on size fits all" right or wrong time for an investor to be brought into a business. It can be about maximising business success after the owner has started the business and hired staff so as to protect intellectual property.

The business will be most attractive to an investor when all of these parts are in place. Many business owners think when they have taken all of these steps that they can jump straight into expansion. The truth is that a business is better consolidated, ensuring that everything is set up correctly, before it expands (significantly).

What to consider when bringing investors into a business

The factors that go into deciding if a business owner should bring in an investor:

1. The business owner;

2. The type of business; and

3. The investor.

Key considerations are:

Advantages for the Business Owner

• What's in it for the business and owner – they need to think about what they will receive in exchange for the investment. This may take the form of a cash injection or the investor's knowledge and experience.

• What are the business owner's goals – all business owners should have some goals and ideas about where they are going in business?

• How are the goals aligned with what the owner and business will get out of the transaction?

Disadvantages for the Business Owner

• What is the business owner losing as a result of bringing in an investor? Whether an investor loans money or buys equity in the business they are taking something from the owner of the business. The owner needs to think about whether this will work for them in their business.

• Can the business owner and investor work together? The owner needs to assess whether they can work with the investor, what the level of involvement the investor will have in the business and their history. An investor will have their own ideas about what is to happen in the business. An owner needs to carefully consider this, and decide if it is right for them and their business.

Type of Business

• Not every business is the right type of business for an investor. Some businesses are regulated in a way that they cannot bring in an investor without getting a government body's approval, or if they don't have certain qualifications.

• An investor is like another partner in a business. Some businesses require decisions to be made quickly and having an investor can slow those decisions to the detriment of a business. The business owner needs to have a think about that decision making process to make sure that workable rules are set out for the investment.

Advantages for the investor

• Investors may want to make passive investments in a number of businesses to diversify their risk.

• An investor will usually have experience in business and so it is important to understand what strengths or weaknesses they bring to the business table.

Disadvantages for the investor

• If the business owner takes a large amount of control the investor may not have enough influence over how their investment is used.

• The investor could lose their money through no fault of their own.

Who is investing in your business?

The main consideration is whether owner and investor can work together. The terms of any agreement need to set out clearly the responsibilities and boundaries of the parties, so that there is a clear understanding of the risk and reward for all.

There is no single way of analysing the investor. Business owners need to evaluate all factors relating to the investor carefully.

Once a decision is made to proceed with an investor, the business owner needs to properly document the arrangement to ensure that there are no misunderstandings.

A good document, whether it be for a loan or an investment needs to deal with the rules of the relationship and also what happens if something goes wrong.

Where one party does not want to sign formal documentation, this should be a red flag.

An investment, like any business relationship is important to get right. Where either party refuses, the other party should be concerned.

Jeremy Streten is a lawyer and the author of the Amazon best seller "The Business Legal Lifecycle" www.businesslegallifecycle.com and www.facebook.com/bizlegallifecycle, which is designed to help business owners understand what they are doing in their business from a legal perspective and give them a plan for the future.