The Challenge of Fairly Supporting and Profiting From Early Stage Company Investment ©

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Government and other investors who intend to assist early stage companies which will have a positive impact on society , if the projects are successful, have a problem. The problem is that when investors assist through an equity-related investment, there is an immediate focus on valuation of the enterprise. Also, when corporate ownership is affected by the transaction there is the ever-present, inevitable and irreconcilable conflict of interest between what is best for the investor and that which is best for the entrepreneur.

The conflicts include executive compensation, sales and marketing policies, dilutive financings, employee benefit programs and corporate transactions regarding acquisitions, sales and mergers.

The purchase of a royalty (percentage of gross revenues), at an agreed rate, for an agreed period of time and subject to a royalty issuing company's right of redemption, allows the royalty investor to share directly in the top-line success of the enterprise. The royalty investor is only concerned with the sustainability of the company and the growth of revenues, as there is no transfer of ownership.

Therefore, the royalty issuing company must present the prospective investor with evidence of the demand for the product once successfully developed to a point of proof of concept. To finance a pre-revenue business the investor is being asked to base the investment decision on product demand. Of course, this means the investor must also believe in a continually growing demand for the product.

The seeker of funding may obtain the necessary indications of market demand by engaging with important potential buyers of the product or expert consulting firms and/or academics specializing in the focus area of the product being developed. Recently in a presentation to a major company the response was "we don't believe you can produce the product but if you can we will be your biggest customer".

The investor will want a royalty structure which will result in royalty payments being sufficient to at least match the amount paid for the royalty, in about 5 years, or 25% of the total royalty payment period of 20 years. The shorter the royalty payment period. the higher must be the royalty rate to attract investors.

All of these issues are described in articles in www.Royalties.Website and in the following website calculators www.REXRoyalties.com, www.REXdebt-shareRoyalties.com, www.REXScaledRoyalties.com and www.REX-RIAR.com. The RIAR is an acronym for Royalty Issuer Assured Return, and for established companies already experiencing growing revenues this approach will yield the least expensive capital.

There are two other website calculators. They are www.REX-PV.com; the PV is for Present Value, which facilitates calculation of the premium a royalty investor must receive when selling a royalty so as to achieve a target Internal Rate of Return (IRR) and the likely royalty buyer's results if the projected revenues are achieved. Also, there is www.REXComparator.com, which allows two royalties of different deal terms to be compared when using the same projected revenues.

Will there be investor losses in buying royalties from companies yet to have any revenues? Of course, there will be some losses as many development projects are not able to produce the product conceived, bring it to market and compete on price and features. This is the reason why the investor must be convinced of the demand for the product, leaving only the question of development success open.

Therefore, the returns, realistically projected, must be such that the agreed royalty rate will produce at least the target IRR results. The logical way of reducing risk is for the investor to allocate sufficient funds so that a risk-reducing portfolio of royalties can be created.

Our country needs technology development. Unfortunately, all too often those responsible of the success of creating technologies do not receive the rewards anticipated, as experienced investors have provided financing on terms that are so dilutive to equity as to minimize the interests of business founders. Ratchets and convertible preferred liquidation preferences are terms business founders acceptive venture capital equity must come to fear and understand.

For both investors and entrepreneur's royalties are the better way.

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