Financing Pre-Revenue Projects Using Royalties ©

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Most start-up businesses fail to achieve the desired objective within the founder's estimated time and budget. Many truly good ideas are never tested due to an inability to finance development to the point of proof of concept product or service. We are all the poorer as a result of many concepts not being tested as to user benefit.

Funding requires capital providers prepared to accept the financial risk of creating the enterprise. From the investor's perspective the possible gain must be a multiple of the amount invested to justify taking the risk.

Those who develop the concept and desire to create a business need more money than they can personally provide, and wish to retain as much of the ownership of the business as possible. This leads to underestimating the amount of money and time required, as the greater the amount, using a transfer of ownership, the greater will be the investors' demand for ownership and control. The all-too-frequent underestimation is in many cases a fatal flaw, as the cost of money in terms of equity dilution for tapped-out projects is enormous.

It should also be noted that an overestimation of the likely early stage profitability of the business both causes deal-passing reactions from experienced investors and probable disappointment from those lured into investment, with a lot of unpleasantness resulting.

Therefore, believing that prediction of revenues is easier and more likely to be both achieved and accepted by investors than estimated per-share profitability it seems reasonable to base financings on the transfer of a defined percentage of the company's revenues than ownership of the entity creating the revenues.

This is what royalty financing is all about: getting investor support for business owners on fair terms without the requirement for any transfer of ownership or change control.

The sale of a fixed or even moderating royalty rate for a company achieving revenues of sufficient growth rate to attract investors will result in a much higher payout over the royalty payment period than one which includes an initial debt component that is not personally guaranteed,.

This concept is fully described and made available in the website calculator REXdebt-shareRoyalties.com.

Of course, a Royalty Issuer Assured Return would be more attractive to investors than simply returns based on projected revenues and therefore would be more effective and possibly available on better terms than a non-assured return. The website calculator REX-RIAR.com allows users to set their own multiples of investment in agreed periods as targets and deals. Of course, it is recognized that the quality of the assurance is based on the viability of the assurer and the degree of risk reduction is dependent on circumstance.

Another of the website calculators developed to allow for a carrot and stick approach to encourage issuers to be highly conservative in their making of revenue projections is REXScaledRoyalties.com. In this approach the parties agree that if the revenues are greater by an agreed percentage in an agreed period of time there will be more favorable terms applied in the future than originally negotiated. The stick is that if the revenues fail to achieve the projected levels by an agreed percentage in an agreed period there will be a penalty applied.

Those interested in learning more about the use of royalties in the financing of companies, especially pre-revenue companies are invited to review Royalties.Website and the library of PacificRoyalties.com.

The ever-continuing quandary is the investor's need to balance risk and reward, especially in the case of early stage companies where both the risks and the rewards are far greater than in the case of dealing with established companies.

The risk-reducing "debt plus royalty" approach is the best for all parties and will be increasingly used. Also, this intelligent approach to the financing of pre-revenue companies will allow many to be developed, which might not otherwise reach the market -- and that would be a pity.

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