Negotiating and Valuing The Terms Wanted By An Investor In a Pre-Revenue Start Up ©

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Well-advised business founders should seek to preserve the benefits and prerogatives of ownership, while still attracting speculative investment when necessary.

The entrepreneur needs to to understand the investor's required minimum return from a speculative investment. This measure can be expressed in the number of times the amount invested is returned over a defined period. The measure of success can also be expressed in an Internal Rate of Return (IRR).

Unless the business ultimately creates revenue the value of the business is questionable, certainly to the investor, and without revenue the investor will experience a loss.

Therefore, focusing on the investor's return is logical, as the calculation and declaration of profitability in privately owned, non-audited companies is dependent on decisions made by the founders and managers of the business. These areas of founder discretion include; executive compensation, employee benefits, product pricing, marketing and sales expense budgets and the terms of trade in making the sales.

The mechanism for using a share of revenues as the basis for rewarding investors in a transaction is a royalty. The recommended approach tor using a royalty is that which we have been able to patent.

The parties to the transaction, the investor and the business manager negotiate the terms of a royalty. This negotiation is facilitated if the parties use the following website calculators.

REXRoyalties.com a simple transaction in which the amount of investment, the royalty rate and the term of royalty payments is agreed.

REXdebt-shareRoyalties.com in which there is initially a loan of an agreed amount, for an agreed period and at a rate fairly in excess of commercial bank rates. The terms to be agreed include

amortization and interest payment frequency. The royalty, which commences on the repayment of the loan, is modest as the investor having already received full repayment.

REXScaledRoyalties.com this is a website calculator designed to facilitate a negotiation resulting from the business owner believing that he has been too conservative in projection revenues and royalties in order to attract the investor and wanting to know the benefit of achieving the better results than projected. The website also provides for results to have been less than projected by an agreed percentage during the period selected.

REX-RIAR.com is a website for the approach which will result in the most favorable terms, as the Royalty Issuer Assured Return shifts risk from the investor to the royalty issuer. Therefore, if the RIAR is for minimum performance, leaving upside for the investor, the terms should be very favorable for the Issuer.

There are two other website calculators to help royalty users. The REXComparator.com allows two deals, with different deal terms, but using the sale revenue projections, to be compared in tables and charts. REX- PV.com is for royalty investors assessing the amount of premium they should be paid if they achieve their target IRR. REX-PV.com also indicates the results for the secondary and preferably no-tax-consequence buyer, assuming the revenues continue to grow as projected.

Therefore, entrepreneurs seeking funding for pre-revenue projects should learn the definition of success used by the investor and structure a royalty offering so the investor’s interest is achieved if the realistically projected revenues are achieved. If this is done then the only real negotiation will be focused on the revenue projections. As suggested in prior memos, the entrepreneur seeking non-equity diluting funding through the sale of a percentage of projected revenues for an agreed period, should obtain the opinions of recognized relevant industry experts or prospective customers.

By keeping the discussion focused on revenue projections, as the terms of the deal are pretty much agreed, there is no reason for the negotiations to be adversarial, as both sides seek the same result.