

CREATING LASTING VALUE IN SMALL BUSINESS

This is the second in a series on the developing market for investment opportunities in local businesses. Last month, I described with the help of my friend, Barry Herskowitz, some of the hurdles small business owners face when trying to attract additional capital without having to go to a bank or to family members for loans.

There is a great deal of interest on the part of investors to find an alternative to the stock market since the prospects for stocks to produce anything close to double digit growth over the next few years are dim. Likewise, investors looking for income are tired of earning practically nothing on their bank deposits. With many bonds being called or maturing, the country is awash in cash looking for a home!

Local small business venture capital funds are pretty much a brand new investment venue. Taking their structure and part of the name from the better known venture funds that abound on the east and west coasts, many think of information technology and biotech as the only focus for these investment dollars but this is not the case. In locales such as New Mexico, local venture capital is targeting service businesses and natural resource based companies.

In 2004, almost 6 billion dollars were put into venture capital funds of all sizes, mostly through a bicoastal network of around 80 well known venture firms. This is twice the pace of 2003 and it has many experts worrying that there is too much money chasing too few good deals. There are internet organizations, much like investment clubs, which are connecting angel investors, those with blocks of \$100,000 to \$2 million, with direct investment opportunities.

Not to be left out of the fray, government agencies and retirement systems have allocated portions of their portfolios to this burgeoning arena. The U.S. Small Business Administration is also in the act now, as are universities and endowment funds. Pennsylvania, Indiana, and Utah have led the way in directing state funds into local businesses. How can you get a piece of the action?

At the present time, it is not easy for individuals who have smaller sums of money to invest to get access to local businesses. Generally speaking, doing it through some kind of fund is advisable. There are several of these in the formative stage here in New Mexico. Sometimes, government or nonprofit entities make job creation top criteria for their

investments or finding companies that will stick it out and help communities in poorer regions. Be careful to understand the social screens used by different managers and try to insure there is a fit between your goals and theirs.

Local small business venture capital firms are faced with unique challenges. In looking at the team in place at a local small business, outside investors, be they funds or individuals, often perceive that there are one or more business skills which are lacking and that this may inhibit the small business' growth beyond its current stage. Small business owners looking for outside investors should be prepared for the introduction of a new management team member who will help the small business grow as well as protect outside investors' interests.

Management teams are often held together by employment and non-competition agreements. Outside investors look to these in order to ensure that intangible assets such as people, reputation, and service levels do not dissipate once there is a new stock owner, along with the founders, on the scene.

To attract outside investment capital and to properly run a business requires reliable financial statements. This does not mean that small businesses have to hire expensive accounting firms. Having clear, concise, and reliable financial statements that correspond to the reality of the business is crucial to keeping outside investors informed.

The preparation of forecasts is also important for businesses to show how growth in the future will impact investors' returns. Without projections, the business plans for the future may lie locked inside the mind of the entrepreneur/founder. This does no one any good. If you can't get a satisfactory plan in writing from your prospective investment, you are better off looking elsewhere!

I think it is worth considering creating a council of outside advisors, people in the community who are friends to the business and who like interacting with the founder and management team, who can come together on a regular basis. The council can review, critique, and offer suggestions to the founder and management team about ways to grow, operate more efficiently, put structures in place that will help attract capital from these new local business venture capital funds and have more fun.

When a small business decides to get bigger or the founding member nears retirement age, everyone gets nervous. Change, while difficult for most people, is a constant in the business world. It is better to prepare for change and to involve everyone in consideration of all the options rather than to keep information bottled up inside one person and wait for

things to happen.

In order to get value from an enterprise that took much effort to create, entrepreneurs would do well to investigate efficient and appropriate ways they can attract outside investment capital and interested investors. Investors dissatisfied with traditional investment opportunities should investigate avenues by which they can directly funnel some of their capital back into their communities by taking a stake, however small, in one or several local companies in which they believe. How can this be done? Stay tuned!

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