Resources for brewers
Raising Capital

The Key Ingredient in Every Craft Brewer's Recipe – Money

1. Friends and Family

After exhausting personal resources, entrepreneurs often turn to friends and family for (usually) smallish amounts of early capital. No surprise here, and done right (and particularly if everything goes well) often no harm, either financial or relationship-wise.

Friends and family can be a great source of very early capital. The keys are making sure everyone knows and appreciates all of the terms; that everyone knows that there is a very good chance the capital will never be returned; and that the terms do not get in the way of future capital raises.

For most entrepreneurs, doing it right starts with two key rules: (i) don't take capital from a friend or family member if it will seriously impact their financial security if they don't get it back; and (ii) make sure the friend or family member providing the capital knows that there is a very good chance they won't get any of it back. Violating one or both of these rules has ruined a lot of important personal and family relationships when start-up dreams don't pan out, and friends and family find themselves wondering what happened to their capital.

The next big challenge with friends and family capital is making sure the terms (express, implied, and assumed by both sides) are (i) well-understood by everyone involved, and (ii) do not put up any obstacles to raising downstream capital from sophisticated investors. That usually means preparing a written document. If the money is a gift (best case, you can always find a way to say thank you down the road), say so. If it is a personal loan, ditto. If the funder expects something specific, like a piece of the business, nail down exactly which piece.

As to deal terms for friends and family, a few pointers. You can give anyone pretty much any piece of your business you want for whatever price. At this point, if you own all the company, it's yours alone to give. But, under no circumstance give someone any sort of "evergreen" ownership stake. That is, don't give anyone X% ownership that is not subject to dilution as future investors buy stakes in the company. This is almost always a deal breaker for downstream investors. Don't give them a right to participate in future financings – or, at least, don't give them a right to purchase more than say, 20%, of any future financing, preferably limited to the immediate next round. And, do not give them any rights to block any future financings.

2. Angel Investors

The next step on the financing ladder after friends and family is often "angel" financing. Angels range from wealthy individuals who have no clue about building a high impact start-up, but like to think they know more than you (very dumb money), to very sophisticated folks with lots of good experience investing in, and perhaps even building, successful high impact businesses (very smart money). They run both in packs and as lone wolves. Unlike venture capitalists (VCs), they primarily invest their own money as opposed to managing money for other folks. However, in recent years, so-called "Angel Funds" or "Super Angels" have emerged that are managed by a small group of angels on behalf of a larger group of mostly angel investors.

Because angels come in so many shapes and sizes, it is very hard to generalize about working with them. Working with the least sophisticated and experienced angels is a lot like working with unsophisticated and unexperienced friends and family investors. On the other hand, deep-pocketed, well-connected, experienced angels often bring as much to the table (including value-add besides capital) as a good venture capitalist brings. Two things to remember in all angel deals: first, stick with rich ("accredited" per the relevant securities laws) angels; second, as with friends and family, make sure everyone understands the terms of the deal, and that those terms do not unduly complicate your ability to raise future rounds of financing from other investors.

While following applicable securities laws is ALWAYS important, there are often readily available self-executing exemptions when you are simply working with a close knit set of friends and family (the "private offering exemption") which doesn't require filing any registration materials with state or federal authorities. The "private offering exemption" is very limited and you should always consult with an attorney.

For an in-depth discussion on compliance with applicable securities laws, view our webinar: "Securities Basics: Legal Concerns When Raising Money". While there, feel free to view other webinars of interest such as:

- "Introduction to Sweat Equity for Startup Companies"
- "Top Five Mistakes Entrepreneurs Make"
- "What is Your Early Stage Company Worth?"
- "The Early Stage Business Plan"
- "Your Company's Technology and the Importance of IP"

3. Venture Capital

Venture capital funds have been the primary source funding high impact entrepreneurship for more than 50 years. The typical venture capital fund consists of a pool of capital provided by investors, generically referred to as LPs, managed by a small team of investment professionals – the people known as the venture capitalists. Sometimes a venture fund has only a single investor, typically a corporation (e.g. Google) or a wealthy family (e.g. the Pritzker family). Venture funds often specialize in particular technologies (e.g. blockchain); particular industries (e.g. fintech); particular geographies (e.g. the Midwest); or particular stages (e.g. early stage). Some "families" of funds mix and match various strategies and are often managed by different teams of VCs within the broader fund group.

Whatever their particular makeup, today's VCs invest mostly as they did in the past. They buy ownership (equity) stakes in portfolio companies in the form of convertible preferred stock. This is stock with a variety of preferences (board seats, voting rights, dividend rights, rights to the proceeds of any sale of the business, etc) that also has a conversion to common stock feature that can be exercised by the holder, or in some cases, (critically a qualifying IPO of the business,) by the business.

Is venture capital financing right for your business? It is likely not the right path for most brewers. If you need millions of dollars in capital, you don't have any cheaper alternatives (venture financing makes even junk debt capital look cheap), and you are willing to take on what amounts to a powerful, vocal partner in your business, who is going to be very interested in how your company is managed and have some serious rights to impact that, venture capital could be right for you. But, look very carefully before you leap. VCs except exceedingly high growth prospects and liquidity events such as an acquisition or an IPO. For more on working with venture capital investors, see Venture Best's "Entrepreneurs' Guide to Venture Capital Financing".

Michael Best, a proud UBG Sponsor, provides significant resources, guidance and information for start-ups and maturing companies seeking to raise money through any number of sources:

- Friends and Family;
- Angel Investor;
- Venture Capital Funds; and
- Debt, sweat equity and other sources.

Conclusion

We wish you success in raising capital and growing your brewery into a national brand. Begin with the end in mind so as not to lose control of the company you worked so hard to grow.

Pretty much every entrepreneur's nightmare includes being ousted from their company by their investors. "Founder redeployment" is indeed a nightmare many unfortunate entrepreneurs have lived through. For example, Steve Jobs was once demoted and then kicked out of Apple.

One way to make sure you aren't one of those unfortunates kicked aside by your investors is to not to let investors have any rights to do that. Like the Uber guy. Oh, that's right, he set up his shop that way and still got the boot. Or like Mark Zuckerberg at Facebook, who keeps a controlling share of the voting stock to himself.

The reality is, Zuckerberg-like control depends on a combination of Zuckerberg-like investor credibility and desperate investors. Either extreme might get you there, but you don't have to go very far from either extreme to find yourself in the vast middle ground where your investors will have meaningful control over your future role at what you are likely to think of as "your" company long after it is just sort of "your" company.

So what about retaining 51% voting control, that works, right? No, it doesn't. At least not with VCs or other sophisticated investors, who almost always invest on terms that include substantial rights to veto various corporate decisions, put people on the board of directors (usually by round two or three, a majority of the board), and special voting rights. The fact is, a VC syndicate with a 20% interest can and often does have a lot of control of your business, including what happens to you.

The good news is, if you know what you're doing, or have counsel to help you figure it out, you can negotiate around the edges of "standard" deal terms to substantially mitigate the amount of control your investors would otherwise have. At the end of the day, make no mistake: when you bring VCs or other sophisticated investors into your company, you are bringing in partners, not just investors. Partners with big egos, substantial capital at risk, and interests that are not totally aligned with yours (and usually drift further apart over time). Take investment guru Andy Grove's advice and be realistic, and be a bit paranoid. And get, listen to, and carefully process the advice of experienced counsel.

Michael Best's Venture Best® team has a wealth of entrepreneurship and risk capital investing legal expertise available to clients across the nation. The Venture Best® team includes professionals who have "been there, done that" themselves, as venture-backed entrepreneurs as well as angel and venture capital investors. Due to this background, our Venture Best professionals bring value added insights to our clients' opportunities and challenges, rooted in our diverse experiences on both sides of the counselor/client table. We think of ourselves not so much as legal advisors, but as business partners with our clients. Additionally, having offices in Milwaukee for over 100 years, our Beer, Wine and Spirits Group has seen it all and is ready to advise you in your growth.

In Salt Lake, please contact Josh, Ross, Plymouth and Brad. Feel free to email or call us or say hello at the next UBG event. We are always happy to provide initial advice for good drink and a good story.

	
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