

Larry and Barry on Cash – A novel approach to getting it ©

Lawrence (Larry) Lion and Bernard (Barry) Beaver have been used by Arthur Lipper to illustrate the reactions of typical growth oriented entrepreneurs. Larry and Barry first appeared in the monthly column of Arthur Lipper, as Chairman and Editor-in-Chief of Venture the magazine for business owners. Arthur Lipper's latest book is The Larry and Barry Guide to Entrepreneurial Wisdom has also been published by CITIC in Chinese and has sold well in China.

Larry: They must be nuts to give us a bunch of money and not want a lot of stock, possible control and 5 year profit projections.

Barry: Well, perhaps they have seen a lot of profit projections and will settle for a surer bet. They seem to think it easier to predict revenues than profits.

Larry: The only thing stopping our faster growth is that we don't have the cash to support the marketing campaign I've designed.

Barry: Well your friends, the ever more wanting VCs, are asking for a convertible preferred with warrant coverage all of which add up to their owning more than 40% of the company if all goes well and in control of the company if we stumble.

Larry: Well we need the money and the banks won't even talk to us and our friends and relatives are suffering investor fatigue. We've gone back to them too often.

Barry: How sure, really certain, are you about your current projections of both revenues and profits? Are we willing to bet the store on attaining the projected results?

Larry: Well, if we have the money for the marketing campaign I'd be highly confident of our making our numbers.

Barry: Ok. We can't borrow money. We are not likely to be able to go back to our current shareholders for more money and the VCs want too much for their money. Also we can't do an IPO until we get the results the new money will allow us to achieve.

Larry: So what do we do, leave our wives and then "marry well"?

Barry: Not yet. I've been presented with a new idea recently which is intriguing and just could work for us – if your projections can be achieved, really achieved.

Larry: Ok, so what's the new deal?

Barry: It's called Revenue Participation and it can be a great means of capturing capital if our projections are achieved, due to the high profit margins we should be able to enjoy – if your projections work.

Larry: How does it work and what's the downside?

Barry: In a Revenue Participation deal we have three things to negotiate. They are the percentage of revenues we assign to the capital provider, the length of time we pay the agreed percentage of revenues to the investor and the amount of capital we get for the Revenue Participation.

Larry: Ok. So we give the investor 5% of our revenue, which we can afford due to how much money we will be making on our sales and we do so for ten years. How do we determine the amount of capital we will get and in what form do we get it?

Barry: 5% of revenues will be a disaster for us if the projected profits do not materialize as the Revenue Participation is a fixed cost and even though we do not suffer any equity dilution the royalty payments could drive us into a lot of red ink.

Larry: But if we do make the projections look at all the real money we'd be making by not having to reduce our equity percentage in the company. It's not like the VC deals and I'm very sure about making the projections.

Barry: Hey. I am as greedy as you are and want to hang on to as much equity as possible as I know that we'll go IPO or be acquired as a result of the numbers being generated by the new marketing program. But remember the Revenue Participation goes on irrespective of our profitability. Sure, we keep more equity but it may be worth less as the cost of the money, which is bearable if all goes well become really burdensome if we are over optimistic.

Larry: Let me understand this deal. We get the cash, say \$3.0 million, for selling the investor 5% of revenues for ten years? Is it really this simple? Could it be 1% for 50 years or any place in the middle?

Barry: As I understand it we negotiate with an underwriter who then goes to investors to put up the money and the terms are what we and the underwriter agree to. Also we do not have to disclose our profits as the investor is only concerned with revenues.

Larry: Neat, but how does the investor know we will keep paying the Revenue Participation? Also why is the investment banker called an underwriter?

Barry: The underwriter and we agree as to what critical assets of the company we have which we can transfer to an escrow agent type of organization to hold pending our performance under the contract. When we have performed the agent transfers back to us the assets and in the meantime we have an exclusive right to use without any license fee or other payments. It's like a triple net lease with no lease fee.

Larry: And why the label “underwriter”?

Barry: Because the underwriter syndicates the say \$3.0 million offering into 300 \$10,000 contractual units. These contractual units are negotiable and can be sold by the buyers to others at any time.

Larry: Where can they be sold and for what value?

Barry: That’s not really our business. If the price gets too low then we can buy the contractual units ourselves and lessen the amount paid in royalties.

Larry: Again, my friend, where are these contractual units going to trade?

Barry: They said something about hoping to have a government approved exchange where Revenue Participation contractual units for a lot of companies trade.

Larry: Sounds like it might be a great idea, one that many privately owned companies would like as they don’t have to reveal their profits or worry about investors meddling in their business.

Barry: Yup. They also said they have filed patents protecting the whole idea of trading royalty contractual units on an exchange and having a process where investors can buy slivers of revenue for long periods of time in companies they think are promising.

Larry: Ok tell them we’re interested but want to negotiate each of the three elements; amount to be paid for the royalty, the royalty level and the duration of the royalty.

Barry: Oh! One more thing to negotiate it the critical assets we have to transfer to the escrow agent. Remember, if there is an event of default the agent then can sell those assets for the benefit of the investors having purchased our Revenue Participations. We can only deposit the money from sales in banks we agree on and the bank deducts the agreed percentage. They seem to have thought of everything.

Larry: Sure, it can be a tough deal if we don’t make our numbers but if we do we get to keep a lot of stock we’d otherwise have had to give up. Let’s go for it.

Barry: Ok. I forgot to tell you I believe the Revenue Participation payments we make will be tax deductible to us. They are not like dividends.

Larry: I sure like the idea of not having our customers know about our profitability. We won’t be under pricing pressure to the same extent.

Barry: And I like not to have to worry about a lot of regulations intended to protect investors and ending up enriching lawyers and accountants.

Five years later:

Larry: It worked. We made our numbers and kept our stock.

Barry: Yeah but it almost didn't when the profits you predicted were a year late in arriving. We nearly had to negotiate a deal with them and they had all the leverage, except for our personal knowledge and skills, which they knew they would need. It's really not too different than if we had taken the VC deal except the Revenue Participation deal was simpler and in the end better for us – because we made the numbers.

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