**Title:** Finding Capital in the New Economy (And Private Placement Red Flags for Investors)

**Subtitle:** In 2000, 40% of the IPO's in the world occurred here, in the United States of America. Today, the USA is the source of 4% of the world's IPOs.

**Meta Description:** If you are Finding Capital, you should be on the look out for the warning signs of a bad investment in the new economy.

**Date:** 0-2-2012

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The disappearance of most of the small (and many of the largest) brokerage firms in this country has had added impact in reducing the availability of the public capital markets to smaller companies here.

In addition, the continuing economic crisis has had a devastating effect, drying up many of the equity funding opportunities. While there are many private sources of funds seeking to invest their capital, finding capital has become a challenge. The disappearance of most of the smaller brokerage firms who previously were prime sources of capital formation for small to mid-size businesses has led to a rupture in the American capital formation industry that government and regulators have proven unable to repair.

This has led smaller businesses to search for capital more directly, through personal and business contacts, often referred to as "friends and family" rounds. These are usually relatively small raises of several hundred thousand dollars to as much as several million dollars.

While the offering business owners are usually well meaning (after all, they are literally approaching "friends and family"), if you are approached for this type of funding, you should be on the look out for the warning signs of a bad investment.

Below are the five "Red Flags" that a private placement is a poor investment choice:

There are many virtues of the friends and family round of private placements. In keeping with the oftentimes close personal relationships, such offerings often include high interest yielding convertible debt, collateral, or personal guarantees that would not ordinarily be available for other investments.

In the absence of the "Red Flags," the investment proposal that your cousin, neighbor, or brother-in-law offers you and other friends to participate in the growth of his or her business may indeed be a risk worth taking. This is a route more small businesses are using today to fill the void created by the absence of bank lending and the death of the American small business capital markets.

**Raw Content:** <!-- wp:heading -->
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<p>In addition, the continuing economic crisis has had a devastating effect, drying up many of the <span style="text-decoration: underline;"><span class="removed\_link" title="http://equity funding">equity funding opportunities</span></span>. While there are many <a href="https://scarincihollenbeck.com/law-firm-insights/business-law/accredited-investor-definition-expand/">private sources of funds seeking to invest their capital</a>, finding capital has become a challenge. The disappearance of most of the smaller brokerage firms who previously were prime sources of capital formation for small to mid-size businesses has led to a rupture in the American capital formation industry that government and regulators have proven unable to repair.</p>
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<p><strong>Below are the five "Red Flags" that a private placement is a poor investment choice: </strong></p>
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<!-- wp:list {"ordered":true} -->
<ol><li>A lack of formal documents that include a private placement memorandum that accurately, and in proper format and detail, in well-written, understandable plain English, provides all the information that a reasonable investor would require. This includes a detailed description of managements' business and educational backgrounds, the capital structure of the company, a description of the business, its market, principal customers, financial statements and a number of other items of material importance, such as litigation, regulatory issues, employees and union, intellectual property, material contracts, and, not to be taken lightly, a substantial description, in detail, of the risks of the investment.</li><li>In reporting its financial history, you ought to be provided with properly and professionally prepared financial statements of the company, preferably audited by a reputable independent accounting firm. While the inclusion of certified financial statements from an independent auditor is not a requirement of private placements offered only to accredited investors, if the offer is made to any investor who is not a millionaire or a person with a current history of earnings of more than $250,000 a year, the failure to have audited financial statements and a private placement memorandum in the form of a prospectus would, in most instances, be in violation of applicable laws and rules.</li><li>Inexperienced management with an unrealistic valuation of its business, so that you are paying too high a price for too small an equity piece in the business.</li><li>Lack of an "exit strategy." How does management propose that you reap the benefits of your investment? There is a problem if there is no clear end game strategy, such as: sale to or merger with an industry leader, a reverse merger into a publicly traded entity, a feasible plan for dividend payments and a "put" to the company at a stated calculable value related to the success of the business over time.</li><li>Vague or inarticulate presentation of any of the above, or, worse, finding that material facts or credentials have been misstated, through as simple a check as a Google search.</li></ol>
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