

SCALING UP: SUCCESSFULLY GROWING YOUR TECHNOLOGY COMPANY

Key growth investment considerations for your technology business

- 1 Introduction
- 2 Preparing for investment
- 3 Business entity choices
- 4 Growth investment options
- 5 Navigating the fundraising process
- 6 Next steps

1 INTRODUCTION

Along with meeting the demands of developing advanced innovative digital solutions and services, technology companies like yours face a variety of complex business issues when considering how and when to scale your business. Knowing when to grow can play a major role in your company's long-term sustainability. From funding concerns to staying on pace with a rapidly changing marketplace, there's much to consider. At RSM, we're committed to providing our clients and industry executives relevant insights to help you stay on top of these issues as well as staying up-to-date on technology's investment landscape.

With that in mind, in this e-book you'll find a collection of insights related to preparing your business for future growth. Specifically, our topics include:

- Preparing for investment
- Business entity choices
- Growth investment options
- Navigating the fundraising process
- Next steps

We hope you find this content useful. And, for a deeper dive on any of these topics, please [contact us](#). We'd be happy to discuss your specific situation and share ideas on how we can work together to address your concerns.



Steve Ingram

National Technology Industry Leader

steve.ingram@rsmus.com

2 PREPARING FOR INVESTMENT

Any investment can give technology companies the funding and resources you need to advance to the next level. At the same time, investors are looking mainly for significant growth potential. They want to be in at the start of the next digital giant or, at the very least, a disruptive company that offers something new and could become a significant enterprise. When it's right, it can be a win-win relationship for both business and investor, but timing is everything.

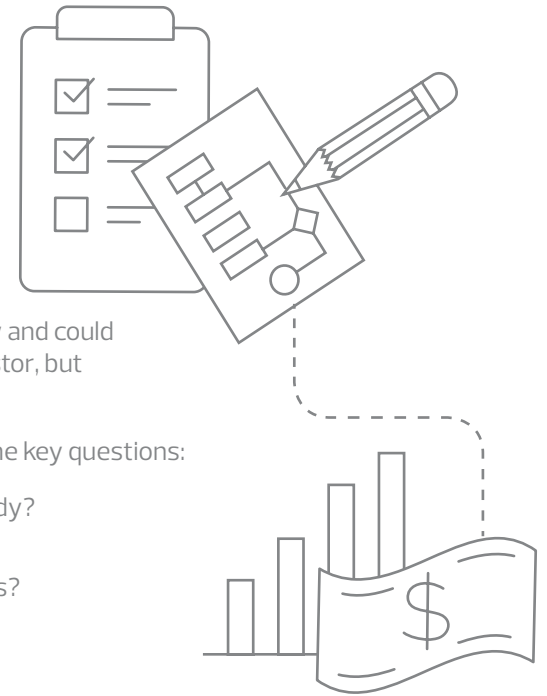
How can you ensure it's the right time and your business is at the right stage for investment? Consider some key questions:

- Have you tested, evaluated and formalized your technology products and services? Are they market ready?
- Are your business functions, products and services scaled for growth?
- Have you assessed your business finance functions and determined gaps, needs and improvement areas?
- Have you completed your own [due diligence](#) to maximize business value and avoid surprises?
- What are your anticipated future needs related to production, innovation, structure and expansion?

Weighing these questions and others, as well as understanding where your business may accelerate, will help you determine the right funding option for your growth stage. Likewise, addressing these issues with appropriate planning, systems and workflows can fortify your position with investors.

Related content:

[Technology and capital: Still growing together?](#)

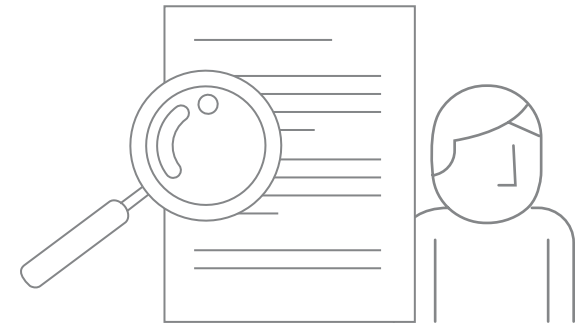


INVESTOR APPEAL

What do smart investors consider when determining potential technology businesses to invest in?

[Here are a few areas they might weigh.](#)

② PREPARING FOR INVESTMENT



INVESTOR APPEAL

What do smart investors consider when determining potential technology businesses to invest in? Here are a few areas they might weigh.

Customer retention

Due to the highly recurring nature of revenue in the technology industry, particularly for software as a service (SaaS) products, the customer retention rate for a business is crucial to a company's valuation and leverage, and of great interest to investors. Customer retention can be defined in several ways and may be misleading if certain components are not appropriately factored into the calculation (e.g., excluding downsell from customer retention rates or netting upsell against customer attrition rates). It is important to understand the impact of differing definitions as they could affect future enterprise value.

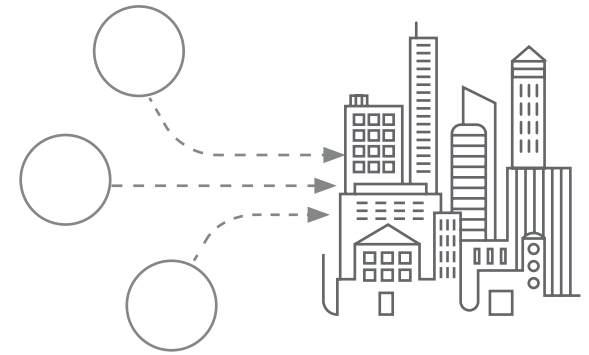
Security and privacy

Cybersecurity is an issue that affects all companies to varying degrees, but for technology companies, in particular, it is a critical area of concern. Depending on the company, there could be significant exposure to threats on multiple fronts. Companies that operate repositories of data could prove to be a suitable target for attackers. Savvy investors understand that technology companies who have a detailed security and privacy plan can mitigate harmful financial and operational threats, which in turn protects investment funding and business profitability.

Capitalized software development costs

Investors want to know what a technology company's EBITDA looks like with and without capitalized internal use software development costs. One common pitfall is that management teams sometimes fail to recognize that the accounting guidance for the capitalization of software development typically differs for software and SaaS businesses. Risks can live throughout the business and at many different levels, from [governance](#) processes to [data privacy and security](#). [Enterprise resource planning](#) (ERP) may be an area to help you identify and improve your business functions so investors truly understand you are primed for growth.

③ BUSINESS ENTITY CHOICES



Your business entity structure should align with your business needs and goals. For instance, if your technology business is in its early stages, you may initially structure your company as a flow-through entity, either an S corporation or LLC. This structure frequently aligns well with the early-stage seed investor you might work with in your early years of the business (typically an angel investor, family or friends) as flow-through entities provide investors tax deduction benefits while also helping the business avoid double taxation. Investors at this stage aren't looking for returns immediately, so if business losses are incurred and the investment is spent, having the tax deduction is a short-term desirable outcome for the investor.

As your business matures, however, you may have to convert the organization to a C corporation structure in order to meet the expectations of other types of investors, including private equity and venture capitalists looking for longer-term returns on their funding. There are additional tax benefits and considerations also to weigh. To help you determine what business entity structure is right for your business, consult an attorney knowledgeable in the technology industry and entity structuring. Likewise, engage a competent tax professional to help you assess key tax considerations and planning needs. In addition, be flexible in your entity set up. Just because your business was initially established as a flow-through, graduating to a C corporation eventually may be important to your business growth. Be sure to share these aspirations and goals with your business professionals so they can provide optimal guidance.

A word about international expansion

Many technology companies will eventually [expand internationally](#) perhaps due to offshoring research and development needs or new sales opportunities. When expansion is needed, you must typically choose between setting up a branch or a subsidiary in the overseas territory. Each has its own benefits and drawbacks. The right structure will always depend on individual business circumstances.

Related content:

[Converting from S corp to C corp: Select issues for consideration](#)

[Tech Connection shares international expansion best practices](#)

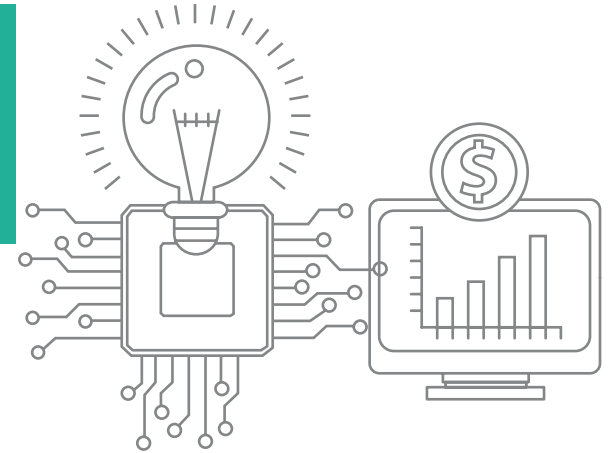
[Know before you go](#)

[GDPR enforcement is here...is your company prepared?](#)

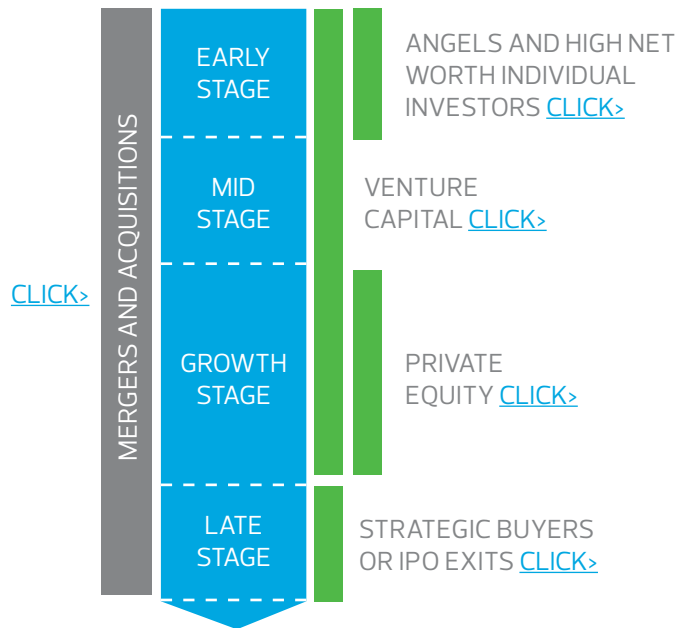
[Considering global expansion? It helps to have the right partner](#)

4 GROWTH INVESTMENT OPTIONS

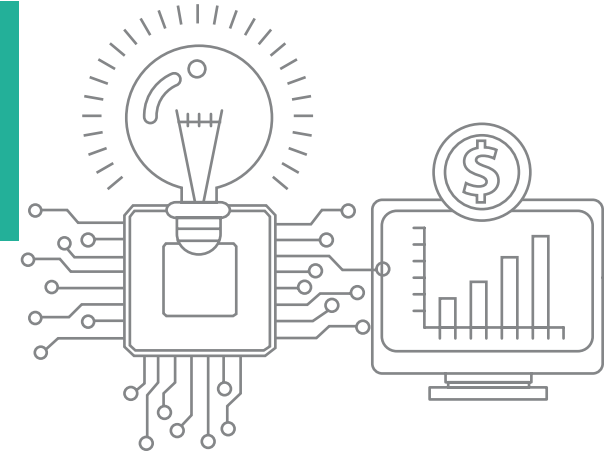
Your technology company may be primed for growth with a solid entity structure in place, but you will need funds to develop next-generation products, fortify your business model or build a sales team, for instance. Basically, you need capital to help the enterprise scale. Or, perhaps your infrastructure is lacking updated internal processes, systems, people and platforms. Funding could amp up your foundational strategies to support further growth. In addition, global expansion may be on your horizon and you require financial support to adapt products and services for a multilingual and multicultural consumer. Weighing your goals, evaluating your growth stage and understanding your financial needs will help you determine the best investor type for your particular growth maturity and related funding strategy. It is just as critical that you have the right investors as it is to have the right technology. Note the investor types for various business stages on the following page.



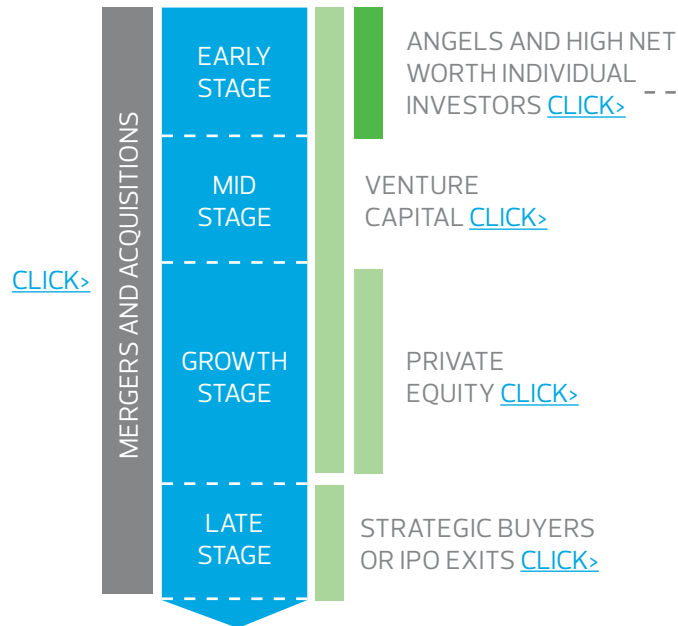
INVESTOR SPECTRUM



4 GROWTH INVESTMENT OPTIONS



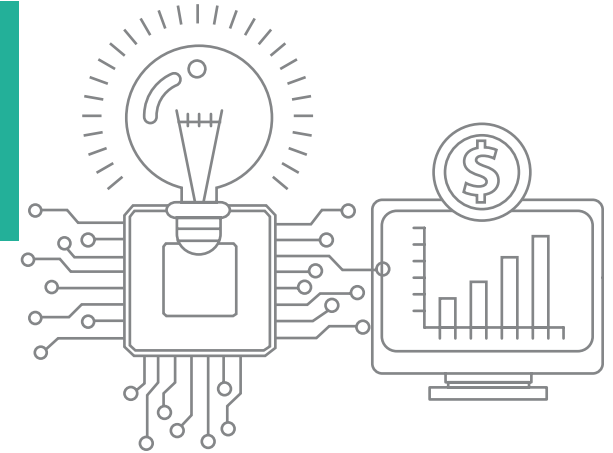
INVESTOR SPECTRUM



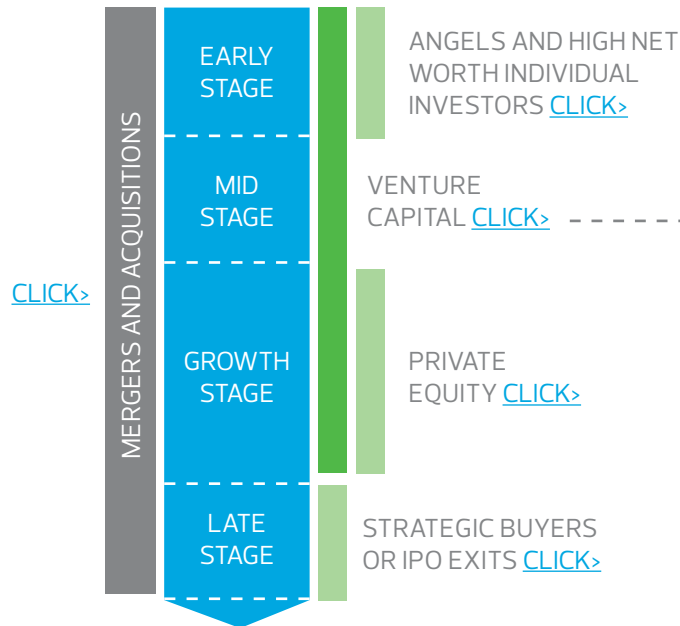
ANGELS AND HIGH NET WORTH INDIVIDUAL INVESTORS

According to urban myth, an investor gambled on Google in its very early stages with a one percent stake. The investor became a billionaire. That is what early-stage angel or high net worth individual investors—which sometimes can include friends and family—are hoping for when they put capital into fledgling companies. Angels and high net worth investors seek to fund exciting, new and innovative products, technologies and services at the smaller end of the technology middle market.

4 GROWTH INVESTMENT OPTIONS



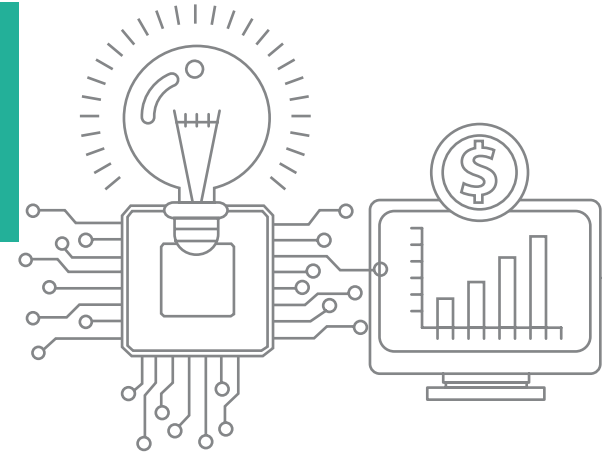
INVESTOR SPECTRUM



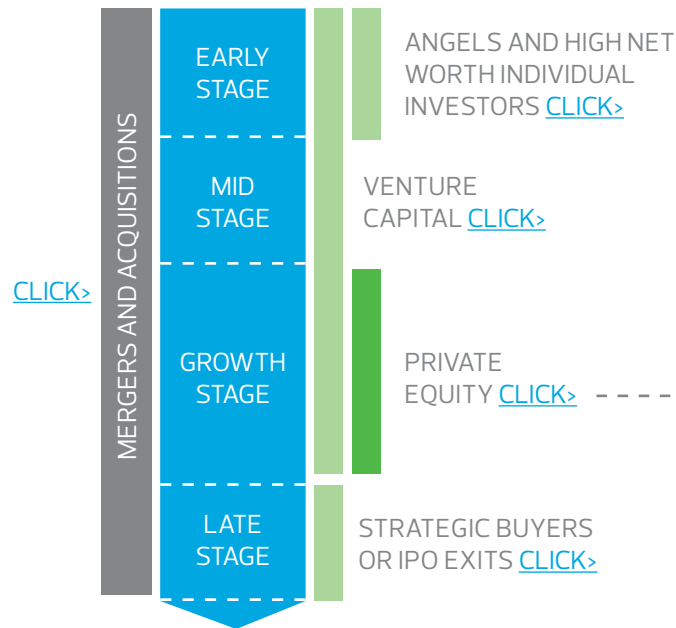
VENTURE CAPITAL

[Venture capital](#) (VC) funding is the next step on the funding ladder. VC is looking for revenue growth potential and will typically fund loss-making start-ups that are still developing their technology. VC targets are at all stages but many first invest at the pre-revenue phase of development. If the company continues to grow and its value increases, the VC will exit, selling the stake for more than its original purchase price post-initial public offering (IPO) or as part of a merger and acquisition (M&A) event.

4 GROWTH INVESTMENT OPTIONS



INVESTOR SPECTRUM



PRIVATE EQUITY

Private equity (PE) buyers acquire businesses once they reach a profitable and steady state. Raising funds on the private equity markets can help technology entrepreneurs to release capital for private use and take their business to the next stage of growth, or exit.

The PE's ideal target is a growing technology company usually approaching or exceeding \$100 million in revenue. They also seek a strong management team that they may augment as the business grows, as well as a proven business model and good cash flow. They may even make a platform acquisition, building on complementary businesses to create a bigger group with a broader offering.

PE investors like technology businesses for one main reason: value creation. PE investors know that technology companies often achieve higher valuations than most other industries, including up to 10 times the revenue of other sectors. This ensures PE investors can make money more quickly due to expected high revenue growth.

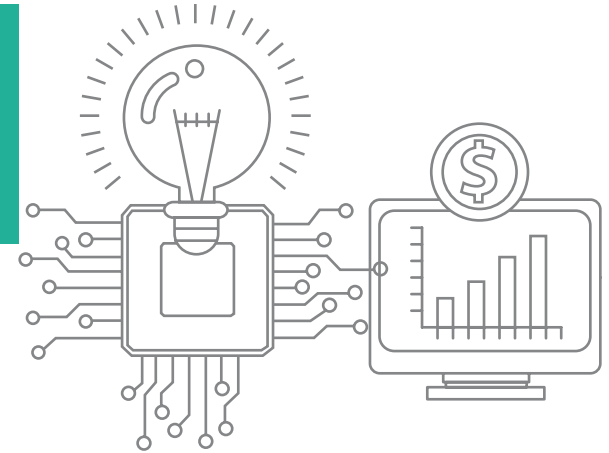
Related content:

[Technology industry fund environment: Takeaways from Tech Connection](#)

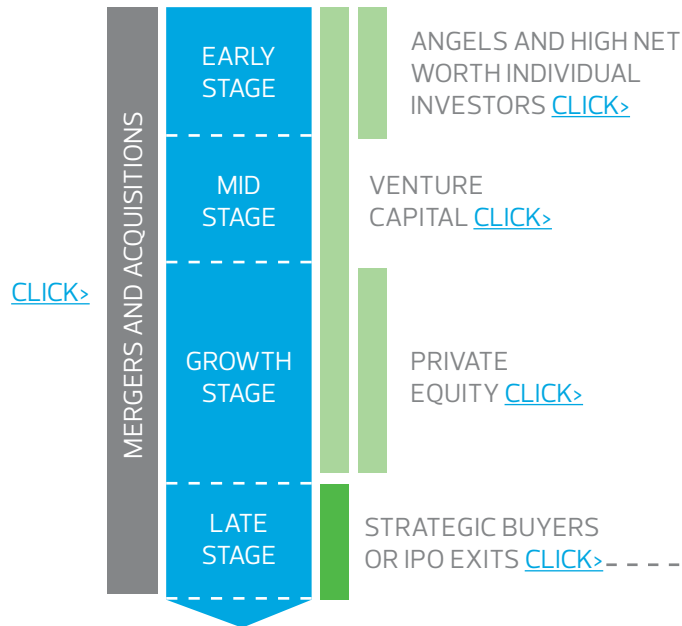
[Technology assets and detailed data: What private equity buyers want](#)

[Quarterly Tech Industry Spotlight Reports](#)

④ GROWTH INVESTMENT OPTIONS



INVESTOR SPECTRUM



STRATEGIC BUYERS OR EXECUTING AN IPO

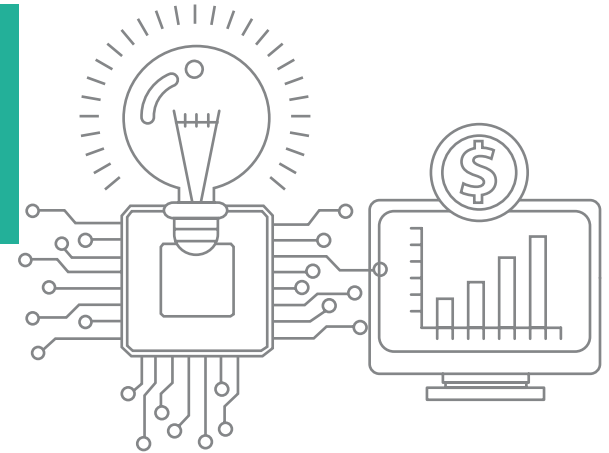
Selling to a strategic buyer or making an IPO is usually seen in a mature technology company that has been through two or three rounds of fundraising, expanded internationally and gone from pre-revenue growth to revenue increases of 100 percent year over year. If your business is at this stage, you may be considering an end game. There are a number of options, including:

- Positioning the business for further organic growth to establish it as a truly international enterprise.
- Extracting value with a strategic sale to a technology titan, such as Apple, Facebook or Google. Often these companies pay well to secure a piece of software or a small-scale rival. For start-up management, a trade sale may offer a lucrative exit.
- Finally, launching an IPO is a consideration; however, technology start-ups have delayed this step recently to hold out for greater market capitalizations, and because there is an estimate of \$1 trillion of dry powder seeking investment.

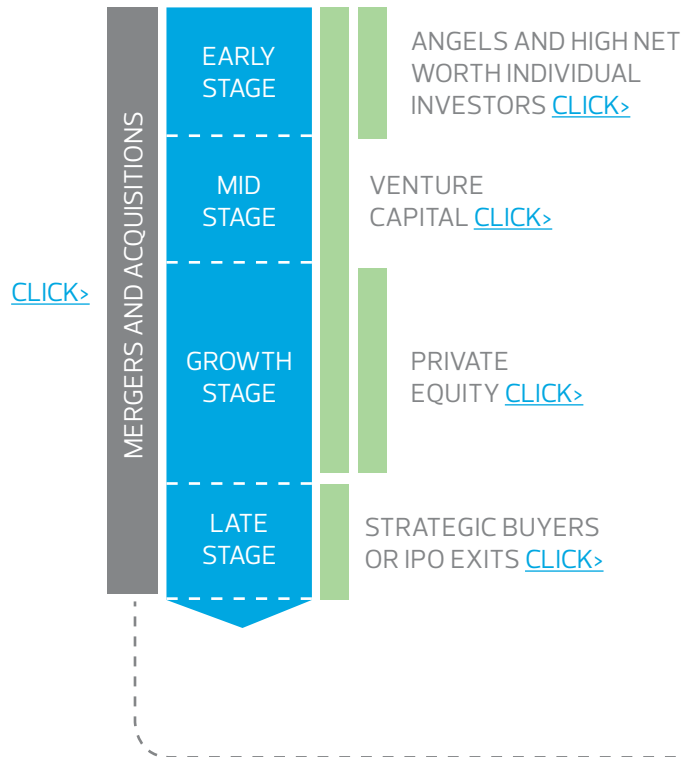
Related content:

[5 tips for technology companies when preparing for an IPO IPO readiness](#)

④ GROWTH INVESTMENT OPTIONS



INVESTOR SPECTRUM



MERGERS AND ACQUISITIONS

An M&A strategy can be a key growth consideration for some technology companies. M&As help companies acquire talent and resources to boost technological innovation and production. However, many M&As don't live up to their expected results, unfortunately. That's not surprising given the many risks associated with M&A activity, including combining processes and differing cultures or considering the [various tax considerations](#). The best time to plan for integration is before the deal closes.

Related content:

[Failing to plan is planning to fail](#)
[11 key due diligence considerations for the technology industry](#)
[Strategies for successful merger integration](#)
[Post-merger integration: Not too late to optimize transaction value](#)

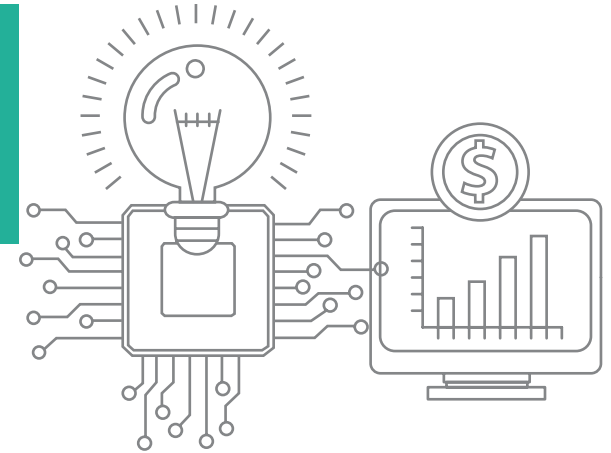
④ GROWTH INVESTMENT OPTIONS

A WORD ABOUT DEBT FINANCE STRUCTURING

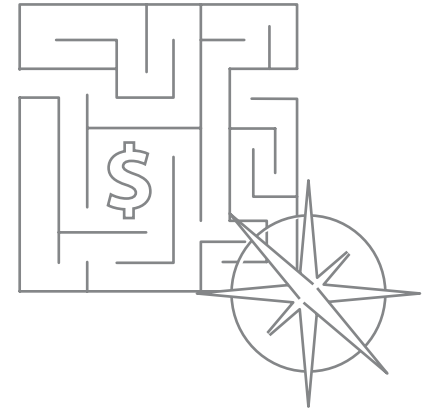
In your initial fundraising phases and early stages of business, strategically structuring debt may seem a little cart-before-the-horse. After all, most bank or venture debt lenders require companies to have an established investor base, assets and cash flow before they would consider lending funds. However, it's important to keep financing debt on the horizon. For many technology businesses, securing an appropriate mix of private investors, bank lending and venture debt is the ideal structure from a financing perspective, but it can differ with each company depending on the type of business, goals and of course, business maturity. Partnering with the right lender is key here, and networking with other company chief financial officers is also important to capitalize on their lessons learned.

Related content:

[Debt finance and technology companies: Insights from industry insiders](#)



5 NAVIGATING THE FUNDRAISING PROCESS



Navigating the fundraising process can be a complex and time-consuming endeavor. Consider the following tips to manage the process.

Not all investors are created equally

Each investor brings different value in terms of sector knowledge, relationships, mentoring and advice. At the same time, they have varying risk appetites, investment time horizons and preferences on deal structures. It's important you find the right investor for your business while not being distracted from running and growing the business day-to-day. Narrowing your focus to a targeted and relevant shortlist of investors with the appropriate risk appetites and skill sets will help save valuable time.

With high-growth tech companies, the risk profile can eliminate a large pool of potential investors straight away. That being said, you can find a good investor if you pitch the opportunity well and network with other executives who have taken money from firms you are targeting or considering. Here it will be crucial to be able to show the market opportunity and effectively communicate the positioning of your business.

Only raise what you need

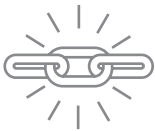
There is always a temptation when fundraising to raise as much money as you can to fund the longer-term growth plan. However, this can be a dangerous trap to fall into as you may give away more equity than necessary. Investments can be phased over time, and raising money when you need it means you are more likely to get better terms, and ultimately, retain a greater share of your business for the founders and employees.

Create demand

In order to ensure you are getting the right deal, you need to have an idea of the appropriate valuation to raise. [Valuations](#) for tech companies can be a difficult subject and can ramp up quickly between fundraising rounds. Traditional metrics, such as revenue or EBITDA multiples, may not be relevant to high-growth technology companies and valuation will be affected by what an investor believes will be achieved on exit. A good business adviser, such as a corporate attorney or business consultant, will help you package and present your company to showcase the opportunity and generate a demand that leads to better terms for you.



5 NAVIGATING THE FUNDRAISING PROCESS



Demonstrate scalability and strength of the platform

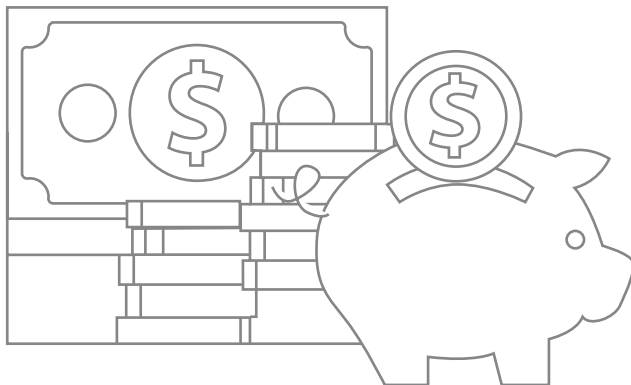
In order to support a step change in the scale of the business, the technology needs to be robust with well-thought-out contingency planning to cope with increased demand. The technology platform will be subject to much scrutiny during due diligence; after all, it is part of the intellectual property that the investor is interested in.



In the early stages of development, poorly written code or a quick fix solution may not be the best solution in the long run and may not give investors the comfort they need. Any work that needs to be done in modifying the code can be time consuming and creates additional risk during fundraising. Vendor due diligence can help to identify and mitigate risks in your business before going to market.

Related content:

[Business valuation post– Tax Cuts and Jobs Act](#)

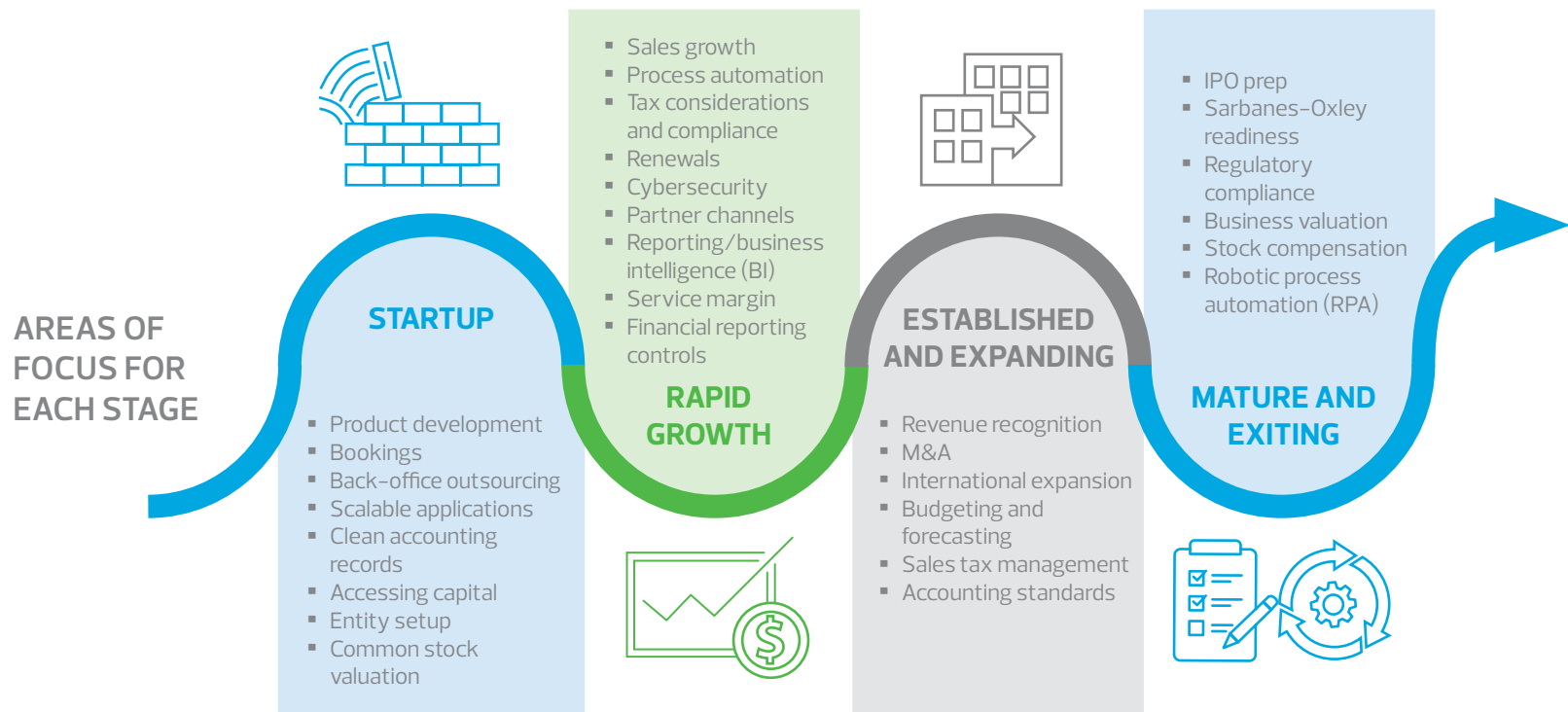


⑥ NEXT STEPS

NEED HELP WITH YOUR GROWTH JOURNEY?

We hope you enjoyed the insights provided in this e-book. Now it's time for action. The first step is determining where your technology company is in the growth journey. Are you a start-up, early in your growth stages, or are you established or ready for business expansion? It's important to know the stage of the company so you can build an appropriate strategy.

Note the graphic below indicating various business needs and challenges you may have at each growth stage. We can assist you with many of these concerns and next steps.



⑥ NEXT STEPS

CONTACT US

Optimally positioning your organization for growth can then set your business up for appropriate funding strategies and structure considerations. However, it doesn't stop there. As your business grows, you'll require more intricate and involved audit, tax and business consulting advice to address your evolving needs. At RSM, we have a variety of professionals poised to help and have connections with outside funding and financial resources to also meet your needs.

Steve Ingram

National Technology Industry Leader
+1 617 241 1147, Steve.ingram@rsmus.com

Rob Plutzer

Metro New York Technology Market Leader
+1 212 372 1685, Robert.plutzer@rsmus.com

Bob Burke

New England and Boston Technology Market Leader
+1 617 241 1339, Robert.burke@rsmus.com

Chuck Carr

Southeast Region and Washington Metro Technology Market Leader
+1 703 336 6561, Charles.carr@rsmus.com

Teresa Zagar

Chicago Technology Market Leader
+1 312 634 3929, Teresa.zagar@rsmus.com

Sarah Johnson

Central Region and Minnesota Technology Market Leader
+1 612 376 9366, Sarah.johnson@rsmus.com

Mel Hudson

Southern Calif. and Orange County Technology Market Leader
+1 949 255 6505, Mel.hudson@rsmus.com

Pat Carney

Los Angeles Technology Market Leader
+1 213 330 4648, Pat.carney@rsmus.com

Kevin Reagan

West Region Technology Market Leader
+1 408 572 4447, Kevin.reagan@rsmus.com

Will Vogelsang

Bay Area Technology Market Leader
+1 415 848 5367, William.vogelsang@rsmus.com

LEARN
MORE



Subscribe to our ongoing [Technology business insights](#) or our [Industry spotlight](#) to receive news on trends and issues affecting your industry

+1 800 274 3978
rsmus.com

This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute audit, tax, consulting, business, financial, investment, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. RSM US LLP, its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person. Internal Revenue Service rules require us to inform you that this communication may be deemed a solicitation to provide tax services. This communication is being sent to individuals who have subscribed to receive it or who we believe would have an interest in the topics discussed. RSM US LLP is a limited liability partnership and the U.S. member firm of RSM International, a global network of independent audit, tax and consulting firms. The member firms of RSM International collaborate to provide services to global clients, but are separate and distinct legal entities that cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party. Visit rsmus.com/aboutus for more information regarding RSM US LLP and RSM International. RSM® and the RSM logo are registered trademarks of RSM International Association. *The power of being understood®* is a registered trademark of RSM US LLP.