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FINANCIAL INVESTORS INTRODUCTION

File No. 2.040602 | 2017-06-01

Quick Summary: All investors expect at least an acceptable return on their investment as they define it.

Abstract:

Financial investors provide the funds and other tangible resources for the company to begin and scale operations. They make their investments based on their belief that the company will be good stewards of their investment and will provide, at least, an acceptable return on their investment. Different types of financial investors may have entirely different views of what an acceptable return is and when it will be realized.

Financial investors are the first investor category that comes to mind when considering Principle Three: “Provide an Acceptable Return to All Investors.” As was pointed out in the previous sections in this chapter, the return to financial investors is totally dependent on first providing acceptable returns to employees, business partners, and customers. These three other categories provide the economic engine that creates revenue, which sets the stage for financial investors to realize their return.

In only rare circumstances are financial investors involved in the early stages of a startup. Typically, an entrepreneur acting alone or with a small group of colleagues starts the business, finances it alone (“bootstraps” it), and receives some level of external validation before they are able to attract financial investors. Although it is common to first think of potential investors as venture capitalist companies, as discussed in the article in this series *“Investor Categories: A Baker’s Dozen,”* several different financial investor categories can have very different motives and expectations that drive their investment decisions. In fact, as pointed out in the article *“Company Success Versus Realized Investor Return,”* financial investor goals and company goals can be quite different. Finally, the various types of investors can offer the company different types and levels of support, guidance, and resources as discussed in the article *“All Money is Not Equal”*. However, the obvious common theme to all financial investors is that they expect, at a minimum, an acceptable return on their investment as they individually define it. It is crucial that the company clearly understands how each potential investor defines “acceptable” as well as the length of time they expect it to take for them to receive their return. Although it may sound obvious, the misalignment of the return goals can quickly lead to strained relationships between the company and the financial investors.

Since the relationship between the company and the financial investors, unlike investors in other categories, is typically documented in a lengthy legally binding document, the relationship is more formal. It usually involves regularly scheduled Board of Director meetings, formalized reporting, often

with annual external financial audits, and prescribed decision-making involvement in certain areas. Financial investors, independent of the actual percent equity that they may have, can exercise dominant control over the company by following the Financial Golden Rule: "He who has the gold makes the rules." Although some investors take a long-term view of the company and are characterized as investing "patient capital," many others focus on the company's short-term (as they define it) activities and their anticipated returns. This is graphically evidenced by the fixation of Wall Street with the quarterly posted earnings of publicly traded companies. Companies are regularly punished for missing earnings forecasts made by outside individuals that have nothing to do with the company's operation. A missed earnings forecast of two cents per share can result in the company's overall market capitalization (value) dropping by ten percent or even more. Of course, the company's intrinsic value did not drop by ten percent overnight as the drop in stock price would indicate.

Fortunately, startups and privately held companies are nowhere near as susceptible to the whims of Wall Street as public companies. However, maintaining the confidence of their investors through open dialogue is critical for the company. Fostering this relationship is the total responsibility of the company's CEO, who must act as the liaison between the investors and all other constituent groups associated with the company, specifically the three other investor categories: Employees, Business Partners, and Customers.