Understanding the U.S. Capital Market Structure for Capital Raising Success

Diana Raedle, Deer Isle Group

The capital markets in the United States are the world's largest which makes them very attractive for both domestic and international companies that want to grow and expand. In addition to the public equity markets which represent approximately 55 percent of all global public equity markets, the United States has the most developed private capital markets for companies that are not yet ready to go public or who do not want to go public. Since U.S. markets are so diverse, the range of capital providers is large and the competition for this capital is fierce. This chapter will describe some of the institutional players in the U.S. market as well as give some tips for effectively raising capital given the analytical nature of the U.S. institutional investment decision making process.

Capital Provider Landscape in the United States

Given the dynamism and complexity of U.S. capital markets, the range of potential investment opportunities for U.S. capital providers is broad. The public equity markets may be most well known and most liquid, but a U.S. capital provider can choose multiple investments from many well-developed regulatory, legal and market dynamic investment options. These options can include funds, direct company investments and structured products in a wide range of sectors and products – each offering their own risk adjusted returns. Any company that successfully raises capital from U.S. capital providers needs to understand the various U.S. capital market players in order to best position their investment opportunity to compete with the other investment opportunities into which the capital provider can invest.

U.S. capital providers usually invest into funds or companies (not both – although there are exceptions to the usual). Those that invest into funds provide the capital for the funds to invest into companies.

Below is a general summary of the largest capital providers in the private markets – a market that has many participants.

Capital Provider Type	*Primary Investment Type*	*Typical Investment Range*	*Additional Comments*
Pensions	Funds	$10 to 500 million	Pensions will analyze their investment opportunities using portfolio construction analytics and seek to achieve a balanced portfolio of debt and equity fund investments that match their long-term liabilities and preference for lower risk. They have large investments in mutual and other public funds but also invest in many private equity fund strategies since they do not need short term liquidity and they would like to earn the expected return premium that comes from investing into private investments. Pensions are highly regulated and need to consider regulatory constraints when making investments.
Endowments and Foundations	Funds and increasingly active in co-investments to improve returns	$5 to $250 million	Endowments and Foundations analyze investment opportunities using portfolio analytics and seek to achieve the highest absolute returns across a wide range of economic scenarios. They are more flexible and more willing to take risks with smaller or more niche private investment strategies including hedge fund, special opportunity funds, private equity, and venture capital funds since they tend to believe that these will generate the highest returns. Endowments and Foundations are lightly regulated and have a high degree of flexibility in making investment decisions.
Large Cap Private Equity Funds	Large Cap private companies – sometimes taking public companies private	$75 to 500 million	In the private markets, the definition of large cap can vary as compared with the public markets where it is usually defined as those companies with market capitalizations of over $10 billion. These are the largest names in private equity and often use leverage to execute their strategy (sometimes called Leveraged Buyouts) of improving returns on large companies with reasonably sustainable and stable operations. Usually investments are restricted to those outlined to their investors in investment offering materials.

Capital Provider Type	*Primary Investment Type*	*Typical Investment Range*	*Additional Comments*
Mid Cap Private Equity Funds	Mid-cap companies with sustainable operations	$5 to 100 million	In the public markets mid cap is defined as companies with market capitalizations of between $2 and $10 billion. Mid cap companies are those who are in the middle of their growth phase and are attractive to investors since they have lower risk than small cap companies (their business model is defined and working) as well as higher expected returns than large cap companies since they are often growing market share or disrupting markets. Usually investments are restricted to those outlined to their investors in investment offering materials.
Growth Private Equity Funds	Small Cap, Fast Growing or Platform opportunities	$5 to 50 million	These investment opportunities are usually defined as sitting at the intersection of private equity and venture capital. Growth Private Equity Funds tend to focus on more traditional sectors where growth is due to fast revenue growth including through acquisition strategies rather than through market or product disruptions. Usually investments are restricted to those outlined to their investors in investment offering materials.
Late-Stage VC Funds	Venture capital backed companies that are pre-IPO (Series C or later)	$50 to 300 million	Late-Stage VC expects their investment to exit quickly – often through an IPO and is also known as Pre-IPO. Many investors like to invest into this stage since risk of failure if low and potential growth is still high. Average valuations in 2021 were $114 million for Late-Stage VC companies.1 Usually investments are restricted to those outlined to their investors in investment offering materials.
Early VC Funds	Venture capital companies that have passed angel and seed stage		Companies that have a defined business model and have a successful track record of generating revenue as well as prospects for continued growth. These investments are also known as Series A, B, or early series C. In 2021 average valuations were $46 million.1 Usually investments are restricted to those outlined to their investors in investment offering materials.

Capital Provider Type	*Primary Investment Type*	*Typical Investment Range*	*Additional Comments*
Angel or Seed VC Funds	Venture capital companies who have a business plan and some revenues.	$1 to 5 million	More and more Angel/Seed investors are requiring revenue proof (such as proof of ability to generate revenues) prior to making an investment which is reflected in the higher average 2021 valuations. In 2021, average valuations for Angel companies was $6.3 million and for Seed companies was $9.3 million.[51] Usually investments are restricted to those outlined to their investors in investment offering materials.
Debt Finance Funds/Non-Banks	Companies with assets and revenues that can support debt repayment	$5 to 500 million	There are many non-bank companies including funds that provide private credit/loans to private companies. The provided debt is more flexible than bank debt, usually the credit decision is made more quickly, and the offset for these benefits is that often the lending rate is higher. These organizations usually pride themselves on being able to structure debt when the opportunity is complex.
Crowd Funding Sources	Startup Companies which appeal to retail investors	Up to $1 million within a 12 month period (by regulation)	Crowd Funding allows US retail investors to invest into start up opportunities that are offered by an SEC registered intermediary (either a broker or a dealer of a funding portal).
Reg A+ Sources	Smaller companies with 2 years of audited financials	Up to $50 million in a 12 month period	The main investors in a Reg A+ offering are retail investors. Reg A+ offerings are considered mini-IPO or IPO light offerings since there is an SEC registration process but the process is more streamlined than a public offering and the company must be based in the U.S. or Canada (there can be international operations).
Individual Family Offices	A wide range of potential investment opportunities including funds and companies.	$1 to 500 million	Individual family offices have the most flexibility in terms of their investments since they are only limited by the family's investment preferences and are not regulated. Often family offices have investment staff who act as fiduciaries to carry out the family investment program and, as fiduciaries, they are usually limited in their investment choices to a defined investment program.

[51] Pitchbook/NVAC Venture Monitor Q4 2021

Capital Provider Type	*Primary Investment Type*	*Typical Investment Range*	*Additional Comments*
Wealth Advisors	A wide range of potential investment opportunities including funds and companies with an emphasis on funds as well as direct investing into public markets.	$1 to 500 million	Wealth advisory firms usually represent a number (sometimes very high number) of wealthy families. Since Wealth Advisors have multiple constituents with potentially conflicting risk profiles, Wealth Advisors are regulated and must disclose their investment programs to their clients and regulators. Different Wealth Advisory firms focus on different investment programs with a wide range of risk factors and compete for wealth clients with their investment programs. Since Wealth Advisors need to focus on servicing their clients and providing a range of services, they often invest into funds to outsource the investment choice aspect of their job. Many Wealth Advisors put together specific public market trading strategies for their clients and trade public securities on behalf of their clients.

A basic understanding of these potential capital providers allows the capital seeker to understand how to best position themselves for capital raising success. Effective positioning is an important fundamental aspect of capital raising success.

Regulation

Raising capital in the U.S. is a highly regulated activity and can only be undertaken if the capital seeker understands the type of capital that they are trying to raise as well as the corresponding regulations under which they will have to operate. Each type of capital raise has its own set of regulated actors as well as regulatory framework. The below gives a basic framework for understanding the regulations but every capital seeker that would like to raise capital in the U.S. must consult with appropriate U.S. legal counsel to obtain definitive legal and regulatory guidance for their particular capital raise.

Bank Regulation: Banks provide loans to potential capital seekers and operate under many different regulatory regimes. These regulations include everything from the amount of capital that a bank must reserve for each loan it makes to fair lending practices that include anti-discrimination rules as well as anti-money laundering and suspicious activity reporting laws.

Public capital markets regulation: Public markets are heavily regulated by the SEC and other regulators. Companies that are public companies are large organizations which are raising enough capital to offset the costs of the required regulatory compliance of being a public company. The amount of regulation and compliance is high since public securities are sold to retail as well as institutional investors and the regulators/laws assume that the investors (since they include retail investors) are not sophisticated so the laws are organized to protect the unsophisticated investors from being the subject of fraud or other activities that would put them at an investment disadvantage. Therefore, the disclosure rules are extensive not only at the Initial Public Offering but also include extensive on-going requirements.

Private capital markets regulation: Private capital market transactions are usually issued under SEC Regulation D ("Reg D"). Under U.S. regulation, securities must either be registered with the SEC (ie: public securities) or meet certain qualifications that exempt them from registration. Generally speaking, securities offered under a Reg D exemption, do not have the same disclosure requirements that apply to a registered offering and are, therefore, limited to being offered to "Accredited Investors" or Qualified Purchasers" (ie: investors deemed to be sophisticated enough and to have enough capital that they are able to negotiate their own disclosure and other investment safeguards such as investment terms.

Investment Company Act: The Investment Company Act of 1940 is an act of Congress that regulates the organization of investment companies and the activities in which they engage. It is the primary source of regulation for wealth advisors, mutual and closed end funds as well as impacts the operations of hedge funds, private equity funds and some holding companies.

Crowd Funding/Reg A+: The JOBS Act in May 2016 enabled crowd funded offerings with the idea of enabling small and retail investors the opportunity to invest in new companies such that they would be able to enjoy some of the benefits of venture capital investing that had been limited to Accredited Investors or Qualified Purchasers (ie: sophisticated investors). The JOBS Act in 2015 also created Reg A+ offerings which is meant to provide retail investors access to smaller companies that are in a high growth phase so that investors who are usually prohibited from investing in private investment opportunities since they are issued under Reg D and limited to sophisticated investors would have access to them.

Crypto/Digital Assets: Crypto or digital assets are the latest available investment opportunity and regulations are currently being formed. In general, the SEC would like Crypto or digital asset issuance which acts, feels, and seems like traditional equity or debt securities to be regulated like those securities. There is debate about crypto or digital asset issuance that could be considered a currency which is defined as having a "use case" that is not tied to passive appreciation in value. However, if the digital asset has a use case – there is some argument that it should be regulated by commodity regulators (CFTC). Since there are many open regulatory issues with regard to issuing digital assets in the U.S. and it is best to obtain strong legal advice in order to understand the latest regulatory framework as this is an evolving topic with a lot of regulatory attention.

How to Ensure the Investment Proposition Matches Capital Provider Goals

The most effective way for a capital seeker to successfully source capital is to understand the investment goals of their potential capital providers and to have a clearly articulated investment proposition that addresses the capital provider's goals.

Capital providers usually want to see a two-page intro and a summary presentation ("Presentation") in order to assess the opportunity and fit prior to holding an introductory meeting or call that would be the first step in a full due diligence process. If the capital provider does not understand from the Presentation materials how the proposition fits their goals, they will not want to move forward with their investment process.

The Presentation should provide the investor reasonably concrete information in order for them to understand how the investment opportunity might help them meet their investment objectives and provide them with an attractive risk adjusted return. However, the Presentation is *not* intended to be an opportunity for the investor to learn about your company."

> **Your investment opportunity or company is the vehicle through which an investor meets their investment goals and risk adjusted return expectations. Your investment opportunity or company is not the direct purpose of the investment!**

The specifics about your investment opportunity or company are clearly important. Investors have specific areas of interest, expertise, investment guidelines or preferences and therefore want to know the details of your investment opportunity and company. However, an investors desire to know about your investment opportunity and company is to help them determine whether they think your particular opportunity meets their investment goals and risk adjusted return objectives.

Investors are comparing your opportunity to others to which they have access. Gaining access to capital is a competitive endeavor - your investment proposition will be compared with many others (some that will seem similar to yours and some that will seem different) and your ability to meet the investor's goals/return requirements needs to be strong enough to stand out from the pack.

Presentation Best Practices

The Presentation is your opportunity to present yourself in your best possible light and as you want to be seen. Just as first impressions are made when you first meet someone, your presentation materials make a first impression and investors will draw conclusions from them. An investor's impressions are an important part of their decision-making process.

The Presentation is also your opportunity to leave behind the specific information that you want the investor to remember. If you rely on the investor taking notes during your presentation, then it is impossible to know what information they have retained.

It is usually best to actually use the Presentation during your meetings. You have spent time and effort organizing your thoughts around the investment opportunity while preparing the Presentation and it should represent all of your important investment considerations. In addition, by using the presentation during your meeting, you will be reinforcing to the investor which information you think is important and where the investor can find it later should they want to use it in for an internal write-up or conversation.

Some best practice considerations for a Presentation (see Appendix for more detailed descriptions) include:

- Design and Formatting
- Vision and Path to Executable Returns
- Concrete and Supportable Information
- Delivery and Meeting Dynamics
- Regulatory and Legal Standards

Shorter is best but there is no "right" number of pages
Be as short as possible (one to two pages per topic) while still conveying important (i.e.: concrete supporting) information.

Presentation Covered Topics

There is a basic format for most Presentations which covers the breadth and depth of an investor's initial inquiry. Within this relatively standard framework, each Presentation will have varying degrees of emphasis and detail depending upon circumstances. Therefore, different structures and different stage companies will use different specific information to create the investor bridge. These areas include:

Vision	*Value Proposition*	*Who & What*
• Vision Statement / Summary Sales Points • Problem / Market Opportunity • Solution / Growth Opportunity • Macro Analysis / Market Size • Competitive Analysis / Advantage	• Investment Opportunity / Process / Attractive Characteristics / Why Now? • Pipeline / Case Studies /Traction / Sourcing • Concrete Plan / Operations / Risk Management	• Financials / Important Assumptions / Track Record • Team Biographies • Summary Terms & Conditions/ Current Capital Info / Use of Funds • Appendix: Footnotes Financials, Returns, Data, etc.

Presentation Results

The result of a well-constructed Presentation is that it provides the investor supportable, value-add introductory information about your investment opportunity, a meeting outline that is easy to present and the basis for continued engagement or due diligence.

The intended outcome is for the investor to enter formal due diligence and request more information from its Due Diligence Checklist.

Appendix: Presentation Best Practices

DESIGN & FORMATTING *Look and Feel is Important to Success*	*CONCRETE & SUPPORTABLE INFORMATION* *Provide Concrete Supported Data*
Keep slides simple and easy to read. Header of each slide should be active & easy to read. Understand pitch by just reading headers: Rather than "Problem," say: "Problem: Market Lacks XXX". Say in a few words what can be said in a few words: Avoid Prepositions ("of", "to"). Keep pages interesting: Use graphics, cartoons, product pictures, tables, maps, testimonials, etc. Avoid long bullet-point lists. Ensure that all fonts (styles, sizes, etc.) are consistent for each information level. Decide on color scheme and use throughout. Too many colors make information hard to read. Final review that only looks at formatting to ensure all formatting is consistent.	More concrete and tangible information gives investors greater comfort. Rather than "$XXX million Pipeline," state the Pipeline. Example: $XX / (Code) Name / Stage (Any Evidence of commitments – Memorandum of Understanding, Draft Agreement, etc.) Most important part of financial information is the historical performance, track record and/or assumptions. Historical performance or track record provides the foundation for making future assumptions. Assumptions should be supported by external information: historical data / track record, agreements (MOU, Draft, Signed), market or peer analysis. Anybody can make a model – hard to make a model with supportive assumptions that are accepted by the capital provider. Convey financial and other data in charts, graphics, and tables whenever possible.

VISION *Path to Executable Returns*	*DELIVERY & MEETING DYNAMICS* *Spotlight On – One Hour to Convince*
Keep investment thesis and value add simple. Ensure there is enough data to support thesis. Without data, a presentation becomes very generic and does not provide enough tangible information for an investor to have a meaningful opinion. Include: • Market analysis • Peer analysis • Performance information • Pipeline • Executive biographies Goal is to keep investor engaged and to agree to more due diligence. The goal is not to provide all information for an investment decision. Additional information will be provided in data room and Due Diligence Checklist.	Delivery matters: Be organized. (Use Presentation). Speak slowly: This conveys authority and is effective. Questions: Start meeting by asking questions. It sets the stage, so you know what might be important to highlight during presentation. It also starts a dialogue. Encourage questions by leaving space for them. Also check for questions during the presentation. End meeting with questions so that next steps and current impressions are clear.
REGULATORY AND LEGAL STANDARDS *Ensure that information adheres to regulatory and legal requirements*	

About CLA Deer Isle Group

Deer Isle Group ("Deer Isle") with its subsidiaries, Deer Isle Capital, a registered broker/dealer, and Deer Isle Financial, is a differentiated investment bank that provides "as needed" financial/strategy and closing advisory as well as proprietary technology solutions that enables a capital seeker to complete a "direct issuance" to a curated subset of 10,000+ institutional investors. Our business is built upon providing investors and capital seekers/issuers the right tools in order to ensure a transparent, smooth, and efficient capital solution. Our strength in these factors has helped drive our proven execution capabilities.

Deer Isle's successful track record includes having raised over $5 billion in private placement capital since our founding in 2007.

Disclaimer

This chapter was prepared by Diana Raedle from Deer Isle Group. Views expressed in this chapter are the authors' own, not that of the International Trade Administration. This chapter does not constitute legal advice. Readers interested in investing in the United States should consult legal counsel.