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Funding Rounds for Startups

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Question # 1

How much money do I really need?

Question # 2

When collecting funds?

Question # 3

Who are the investors?

Question # 4

What's the value of my company?

Question # 5

How to present a business to potential investors?

1. How much money do I really need?

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Question # 1 How much money do I really need?

- You have to determine the “right” size of the investment

- Right means that you have enough money to sustain the activities before financial break-even, but not too much too early

- The most widely used indexes to calculate financial needs are **Cash Burn Rate** and **Runaway**

- **Cash Burn Rate** is the average monthly cash flows (if negative): it indicates what is your monthly financial need

- To calculate the Cash Burn Rate you have to determine the monthly cash flow statement

- **Runaway** is the correspondent number of months covered by your existing funds with the current cash burn rate

- Runway is calculated dividing the funds by the Cash Burn Rate

2. When collecting funds?

Question # 2 When collecting funds?

- In general, the later the better, when the value of your company has grown and the risk is lower
- The type and size of funds and the sources changes along the startup lifecycle
- Investors always try to delay their entrance
- At each stage the goal of fund raising (and the startup itself) is different
- At each stage, the size and the types of investors are different

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Startup Lifecycle & Funding – How the organization changes

The search of a business model | The execution of a business model

Scalable Startup → Transition → Company

Source
http://steveblank.com/2010/01/25/whats-a-startup-first-principles/

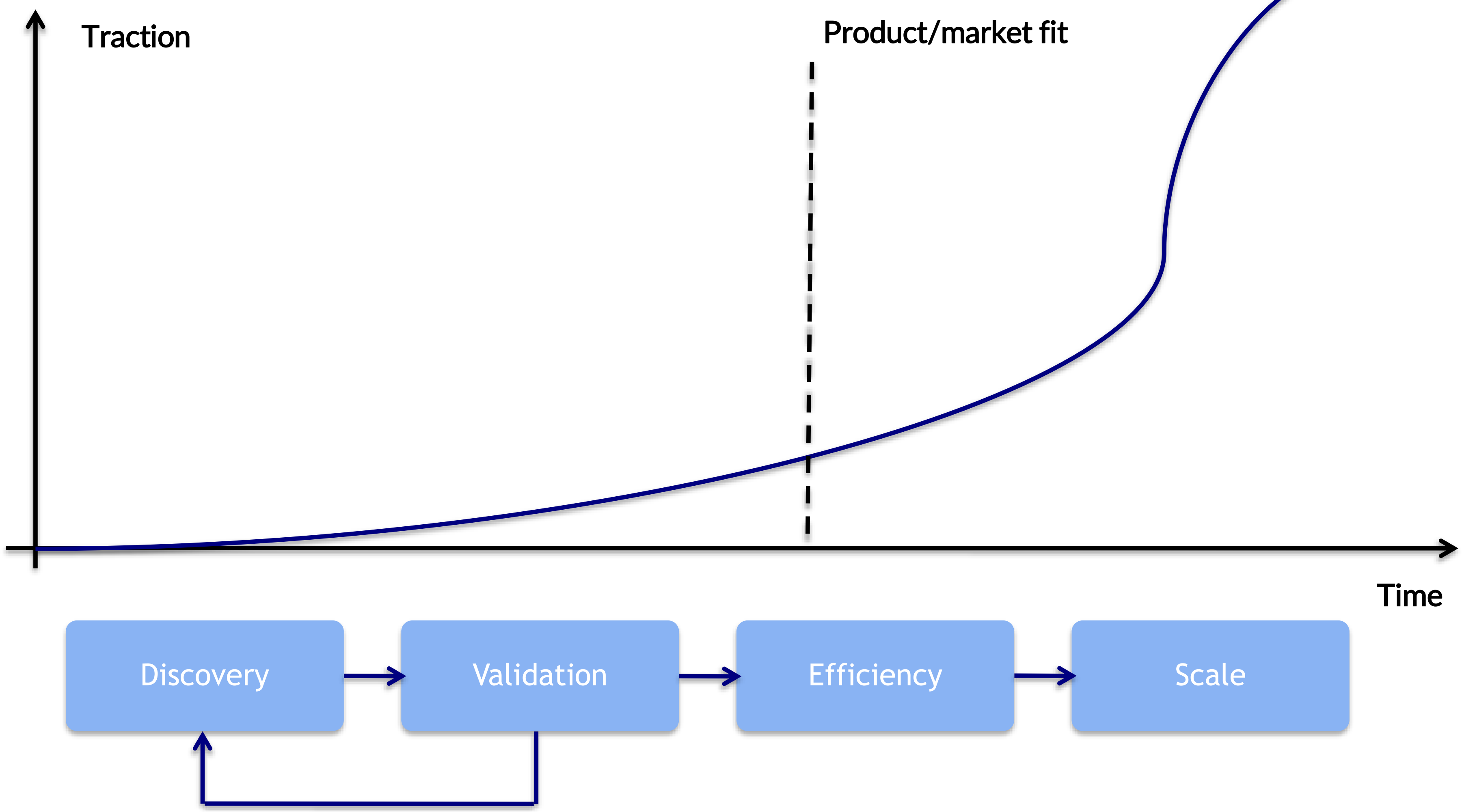
Startup Lifecycle & Funding – Different Approaches

Each stage has a different business goal
Each stage has different financial needs
Each stage you have to contact different types of investors
Each stage has a different **traction**: a **“Quantitative evidence of market demand”. Traction is proof that somebody wants your product. Ideally, it should communicate momentum in market adoption**

1 Search → 2 Build → 3 Grow

Source: http://steveblank.com/2015/02/12/what-do-i-do-now/

Startup Lifecycle & Funding: Different Business Goals



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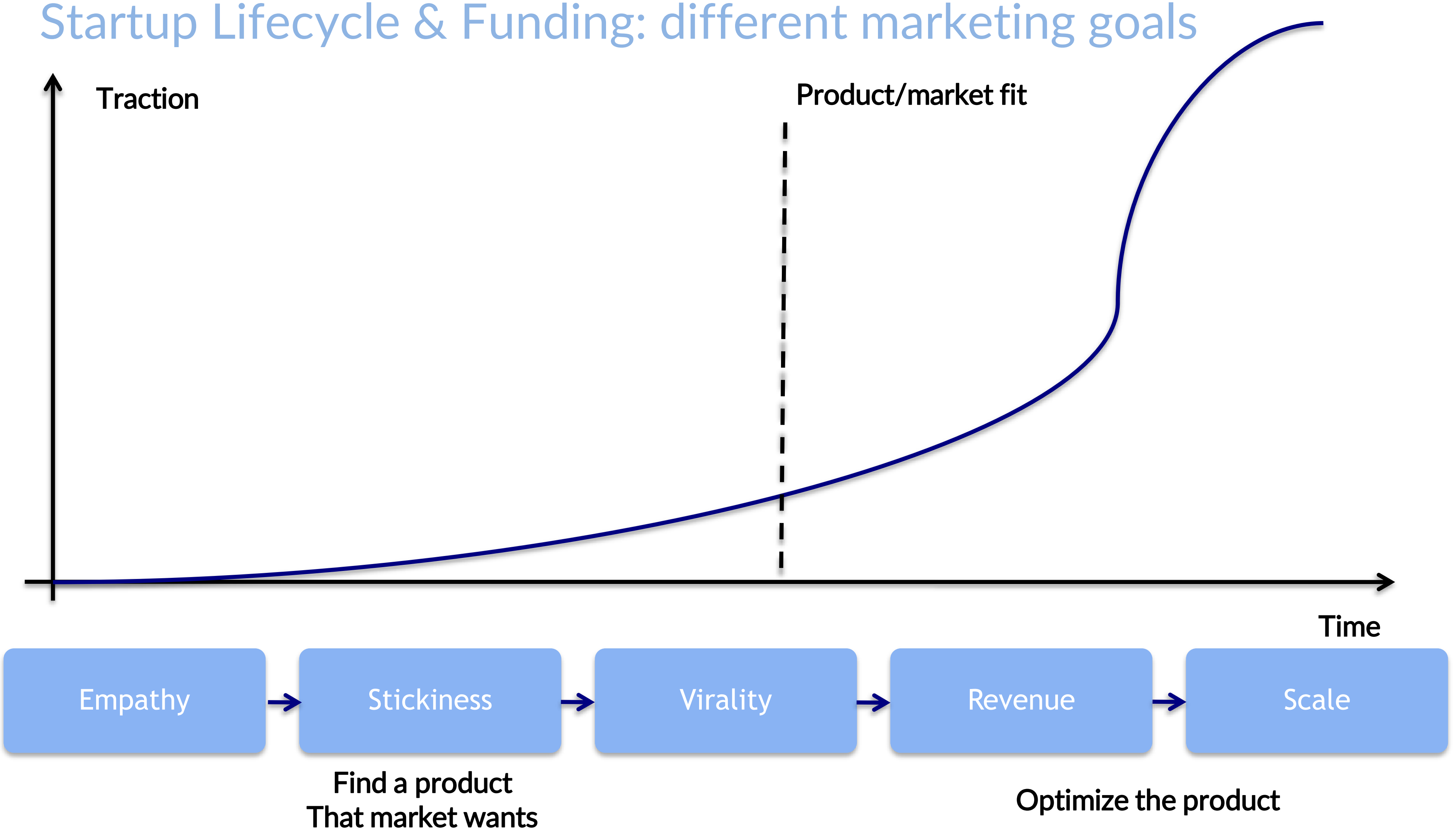
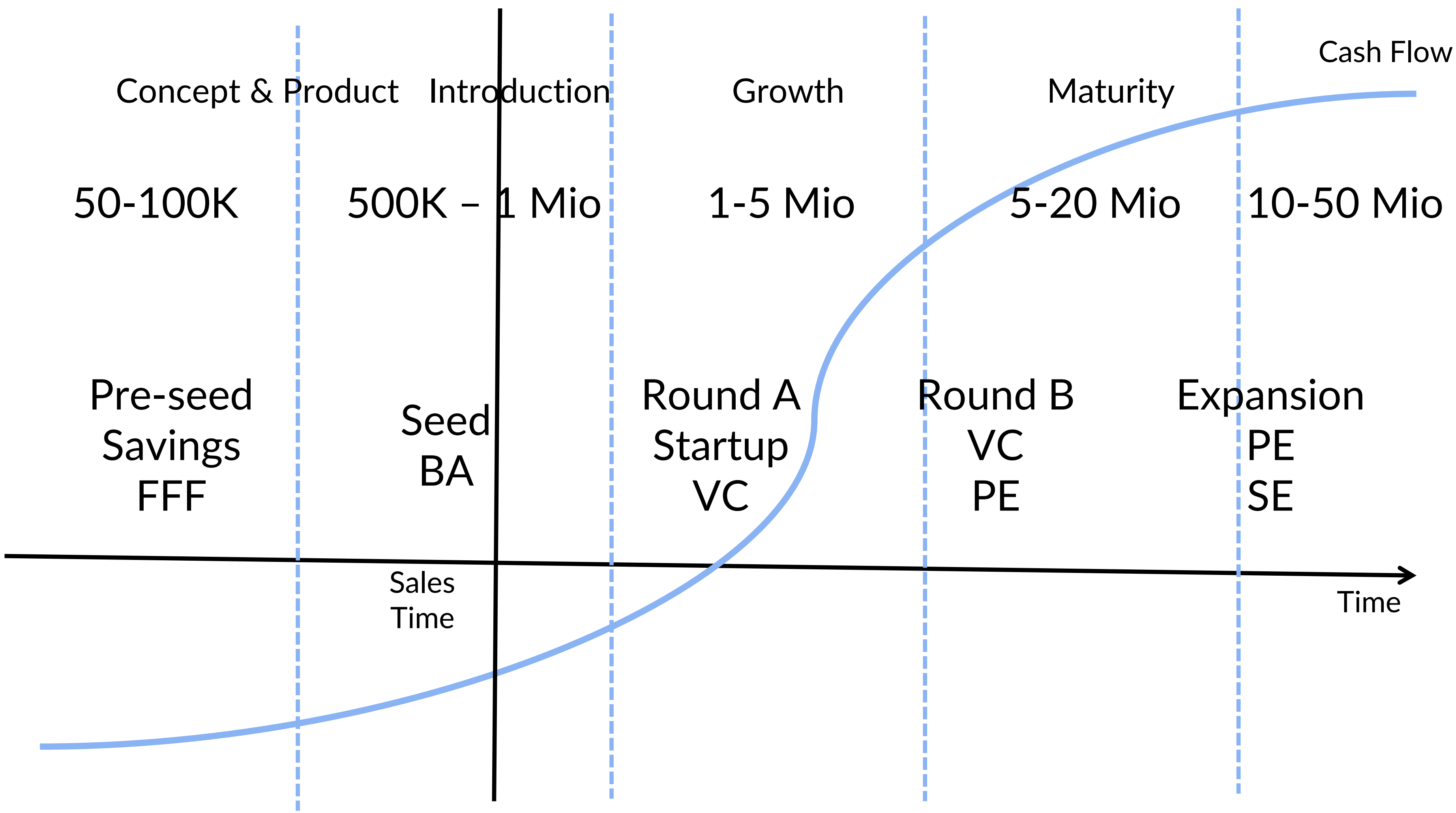
Startup Lifecycle & Funding: different marketing goals

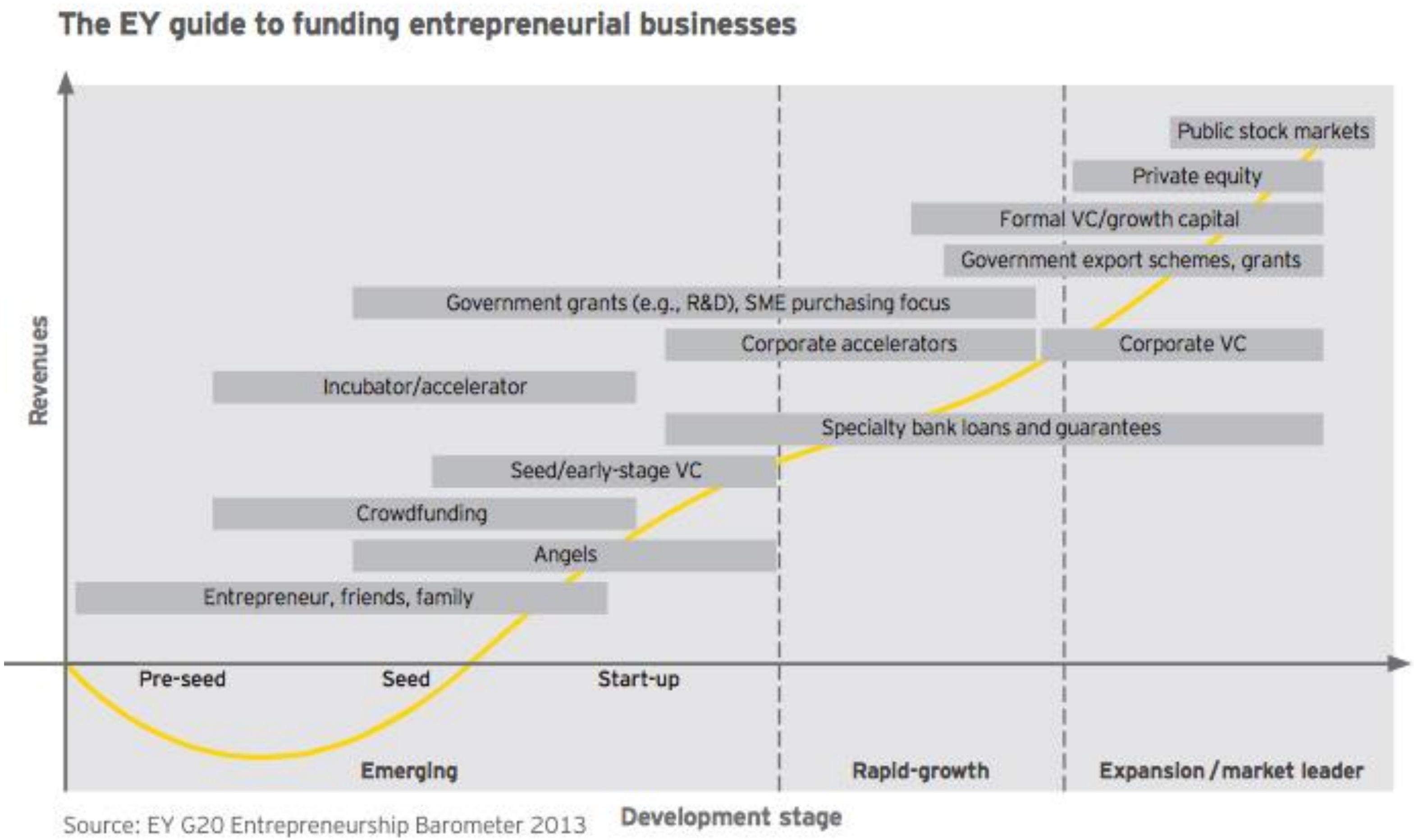


Startup Lifecycle & Funding



Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Startup Lifecycle & Funding – Different Approaches



Source: EY – VC Report
http://www.ey.com/Publication/vwLUAssets/Global_venture_capital_insights_and_trends_2014/$FILE/EY_Global_VC_insights_and_trends_report_2014.pdf

Startup Investment Phases

<u>Funding Rounds</u>

1. Pre-seed
2. Seed
3. Round A
4. Round B
5. Later Stages

During these first stages, the founders don't sell their shares, they are locked in and must work in developing products and market

<u>Exit</u>

1. Trade Sale
2. Buyout
3. IPO

During these 3 stages, founders and first investors sell their shares. Founders usually are locked in for a while and can't create a competitive business for a period.

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Funding Rounds for Startups

Pre-seed

- Funding: from savings, FF, crowdfunding, grants
- Size: € 10K – € 100K
- Business Plan, Prototype
- No revenues (or very small)
- Teams formed by founders who develop the product
- Financial objective: Cash Burn Rate (as low as possible)
- Corporate objective: conceive and develop the product; test and understand the market

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Seed (early-stage)

- Funding: from savings, FF, crowdfunding, Business Angels
- Size: € 500K – € 1 Mio
- Very small revenues
- Prototype, product
- Teams formed by founders who develop the product
- Financial objective: Cash Burn Rate (as low as possible)
- Corporate objective: develop the product and match the market

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Startup (early stage and Round A)

- Funding: Business Angels, Venture Capitalist Funds
- Size: € 1-5 Mio
- First revenues, toward breakeven
- Teams formed by founders and first contributors
- Financial objective: Prove the revenue model works
- Corporate objective: find the product-market fit, search of customers, business model test

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Round B

- Funding: Operating Profit and/or Venture Capital Funds, Private Equity
- Size: € 5-20 Mio
- Operating Profit
- Boards with founders, VC, other experienced C-Levels
- Teams formed by engineers and business developers
- Objective: Break-even, operating profit, scale-up

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Later Stages: Expansion

- Funding: Private Equity, Stock Exchange
- Size: € 10-50 Mio
- Stabilization of cash flows
- Boards with founders, VC, other experienced C-Levels
- Structured team
- Corporate organization
- Founders can have a minority stake
- Objective: Cash Flows, stabilization, exit (for early stage investors, ventures and founders)

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Italian Market – pending issues

Pre-seed	Early Stage	Round B/Expansion
Seed investments are (as average) too small	Few VC's active in the startup phase (they manage capitals too small). Gap filled with seed investments	Too few exits. There is the need to involve big Italian and international firms to increase exit opportunities for ventures

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Investment Readiness Level

Is your startup ready for investment?
Steven Blank invented this tool to measure whether your startup is ready to get funds.
The steps are the phases defined for the Customer Development Model.
Check where you are, and consider that the size and the type of funds should be aligned with the phase in the life of the startup.

Source:http://steveblank.com/2014/02/25/is-this-startup-ready-for-investment/

How to get funds

- Raise money only if necessary in the right moment (startups don't raise money! Startups grow fast)
- Stay focused on fund raising when you are raising funds (and vice versa: don't get distracted by fund raising if the goals are some others)
- Get introduction to investors
- Talk to investors in parallel (non serially)
- Judge yourself (where are you now?)
- Get first commitment
- Have multiple plans
- Underestimate what you want
- Be profitable
- Understand how to evaluate the company
- Don't sell more than 25% in phase 2
- Stop fundraising if it's not working
- …

Source: http://paulgraham.com/fr.html

3. Sources of Funds & Investors

Question # 3: Which types of Funds & Investors exist?

- There are different sources of funds that a startup can rely on
- Different types of investors invest at different stages of startup lifecycle
- Each investor has a different impact on the life of the startup
- External investors get “shares” of your company
- You need a valuation of your company to decide the share of ownership sold
- Ideally, the startup should receive the minimum amount of money to enforce plan activity till next round or break-even
- There are many overfunded and underfunded startups

Sources of funds

The source of funding can have a different impact on your financial structure, composition of the ownership, level of risk, etc.

Financial resources are in the right part of the balance sheet and are part of 2 main families:

- Equity
- Debt

Debt can be financial (loans, short term debts) or commercial (accounts payable)

Sources of funds

Ultimately, a company can fund itself via:

- Commercial debt
- Financial debt
- Operating activities
- Grants
- Equity

Each of them has a different impact on the structure of the company, the balance sheet, the ownership, the level of risk and the cost.

It's possible to add grants, prizes, and forms of incentives. These usually don't have an impact on the ownership and have no monetary costs if you don't have to pay interests on them

Equity

The majority of the funds collected by startups have an impact on the ownership, as they are equity. This means that, if these are external people or entities, the company is giving away part of the ownerships. The founders loose part of the control. It is pretty delicate, because the size and the type of resources and funders can have a strong impact in following funding rounds.

At the beginning, the best is to rely on personal savings and resources, then the startup can involve external people, like FF, BA, etc.

During first rounds (seed, early stage, round A&B) with VC's and BA's, the founders are locked in: they cannot sell their shares and monetize the investment, but they get diluted, giving away part of the ownership and control during the increase of capital.

- Founders' savings → seed
- Family & Friends → seed
- A Job (Consulting) → seed
- Business Angels → Early Stage / Round A
- Seed Funding Firms (incubators or others) → Early Stage / Round A
- Venture Capital Funds → Round A / B
- Private Equity → Later Rounds and Exit
- Trade Sale → Exit
- Stock Market → Exit

Savings → seed

- Founders keep complete ownership
- First phases (idea generation, first prototypes, sometimes first product)
- The risk is high
- The fund raising would be meaningless
- Don’t waste time in fund raising when you don’t have the product yet
- Typical size: € 10/20 K

As a general rule, it is better to postpone the entrance of external investors, when the value of startup is a bit higher. The value of an idea is Zero

Family and Friends → seed

- First phases (concept, business plan, prototype, or MVP, Test A/B, etc.)
- They know you
- They usually don't ask too much for their money
- You don't have to provide metrics, business plans, results
- They could be a problem in later rounds as they are not professional investors
- They don't offer any additional support
- Typical size of investment (in total): € 20-50 K

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Angel Investors → early stage & round A

- Seed stage (product ready, market entry, first metrics)
- They are private, like former managers or entrepreneurs, with a large savings that want to invest (in part) in startup
- They can offer managerial or entrepreneurial support
- They have networks
- They are much tougher than FF and you need an Exit Strategy
- They want to see some data but most of all “fall in love” with founders and eventually their product

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Angel Investors → early stage & round A

- They invest in the team (even more than in the product)
- You have to negotiate their participation: size and share of the ownership
- Sometimes they keep a strategic role and you can be tight
- Giving them more than 20% in this stage can block future capital increases
- Often they invest in group (IAG for example)
- Often fixed criteria in early stage (if they are in group)
- Their interest is to delay the entrance (the later they enter the lower the risk)
- In Italy, they invest between € 50K to € 1M

Seed Funding Firms → seed & early stage

- Seed stage (product ready, market entry, first metrics)

- They are similar to Business Angels but are companies

- They offer you services and consulting

- Part of their investment can be in services like the office, the internet connection, mentorship, etc.

- Difficult to assess the value of non monetary services

Seed Funding Firms → seed & early stage

- Usually they have similar behaviors as business angels

- But they are company and can be more strict on some terms

- The deal is the result of a bargain, there are no fixed rules

- Although, in seed investment, seed funding firms (and business angels) often have fixed policies like the size of the investment and the valuation of the startups, and thus the share of the ownership

- This is because giving a value to a early stage startup is like guessing, and it makes no sense to waste time in negotiation

- Most famous one are rigorous, second tiers can be more aggressive

Venture Capital Funds→ round A/B

- Round A / B
- They are companies and have fixed rules to select investments
- They manage portfolios of their clients and follow guidelines
- You must have a competitive exit strategy
- They are valued by their success stories
- Most of the startups fail, but few outperform and repay all the other investments

Venture Capital Funds → round A/B

- They become parts of the board, and sometimes they assign the CEO role to an experienced manager and not to a founder, especially if she/he has a technical background

- You must create a relationship with them

- If you speak with a junior, she/he can have genuine enthusiasm (they want to discover the next Uber)

- Senior fund managers are more objective

- They invest some millions

- Founders are usually not allowed to sell their shares till final exit

Private Equity, Stock Exchange, Private Sales → Exit

- This is the phase of exit
- Usually founders can sell part of their shares and monetize
- At the same time, they are locked into the company for a few years
- In this case the company is no more a startup, and thus ready for PE funds and even the stock exchange
- Competitors, incumbents, bigger entrants can buy the company through a private deal to acquire products, markets, technologies

Venture Capital Process

Let's have a look at the process of proposing a VC the investment in our startup. Remember that this is a deal. They must see the opportunity to multiply in few years the value of their investment.

1. **Business Plan Submission**: entrepreneurs get in touch with investors and present their business plans, or metrics, or MVP and tests, etc.
2. **Due Diligence**: analysis if company's management team, market, products and services, operating history, corporate governance documents, and financial statements. This step can include developing a term sheet describing the terms and conditions under which the fund would make an investment.
3. **Deal - Valuation and Negotiation**: there is a pre-money valuation to assess what's the share of the new investors; the valuation can be as analytical as possible, but the price is the result of a negotiation.
4. **Investment**: VC enter the company and board, founders sign term sheets
5. **Execution** with VC control: usually investment is released in batches if targets are reached
6. **Exit**: VC's final objective is to exit within a few years through mergers, acquisitions, and IPOs (Initial Public Offerings)

5. What's the value of my startup and how can I assess it?

The Value of Ideas

Why assessing value

Once defined the financial need, and matched the need with the stage in the startup lifecycle, founders must find the right counterpart.

If you finance the company with your savings, operating activities, debt, grants, you don't have to share the ownership of the company with anyone else: founders remain the only owners of the whole company.

Instead, if you have to open your equity to external investors, you have to define what is the share of ownership given away for the money (or services collected).

How does this process happen? How to make this price? How to assess the value? Is it the same with FF, Business Angels, and Venture Capitalists?

Valuation, Price and Deal

Basically, the process is simple:

1. What is the pre-money value of the company?
2. How much do external investors put into the company?
3. What is the post-money value of the company?
4. How to define the price and share of ownership?

Consider that this is a deal: you have to start from a value, but at the end the final price is the result of many other factors, including the bargaining power (and interest) of the parties.

Main actors that can be involved into first stages of investment (FF, BA, VC) have different objectives, cultures, politics.

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Pre-money and post-money valuation

$$\text{post-money valuation} = \text{new investment} \cdot \frac{\text{total post investment shares outstanding}}{\text{shares issued for new investment}}$$

$$\text{pre-money valuation} = \text{post-money valuation} - \text{new investment}$$

Pre-money and post-money valuation

Shareholders of Startup, Inc. own 100 shares, which is 100% of equity. If an investor makes a $10 million investment (Round A) into Startup, Inc. in return for 20 newly issued shares, the implied post-money valuation is:

$10 million * (120 / 20) = $60 million

This implies a pre-money valuation equal to the post-money valuation minus the amount of the investment. In this case, it is:

$60 million – $10 million = $50 million

The initial shareholders dilute their ownership to 100/120 = 83.33%.

Source: Wikipedia

General Advices

- Share the ownership with non-founders the later the better (when your company's value is bigger)
- Don't give away too much too early: the risk is to make the following rounds impossible
- Don't undervalue or overvalue your startup: in the former case, you give away too much, in the latter, you could devalue the startup in future rounds. This is odd and usually a bad message for investors
- Have a long term plan: you probably need future rounds
- Select the investors not just for the money: firstly, because you will have to deal with them, second, because they can offer other assets, like networks, expertise, …

A Deal with FF

- Family and Friends are not professional investors.
- If they invest in your startup is because they believe in you and your team.
- They usually don't have an idea on how to evaluate a startup.
- They usually have doubts about your valuation and tend to pay attention to the percentage of ownership they gain with their money.
- They invest few money in very early stages, when you usually have just the idea, the business plan and eventually a prototype.
- Be careful not to give them too much for too few, even if it's early, if you block large percentage of ownership with these types of investors, you could have problems in future rounds.
- If you are an Italian "Startup Innovativa", you cannot pay dividends for the 4 years in which you are a startup innovativa.
- But, if you are a startup innovativa, investors have fiscal benefits (discount of 20% of the capital invested from taxes)

A Deal with a BA

- Business Angels are affluent private people
- Usually, they are former managers or entrepreneurs
- Often, they want to do something exciting, making some money, and with a “social role”, to stimulate economy
- They often act in teams
- They value your company in different ways
- Their goal is the final exit
- They try to enter later, when the risk is lower
- They invest in seed and early stages
- Startup should have at least a product ready for the market
- Often, they need to be sure that the business model is validated
- Considering the difficulties in assessing a value of something so early, they usually have general politics; e.g.: they invest € 50K for 10% of startups in seed stages (thus, the startup’s value is € 500K
- They perform light due diligence, but they judge above all the team

A Deal with a VC Fund

- They are professional investors
- They invest money of other people
- They have politics on how to manage risk
- They have strict due diligence recommendations
- They want to see your deck (elevator pitch)
- If interested, they want to read the business plan as well
- They start from the valuation, but then it is a matter of negotiation (it is a deal at the end)
- They judge the team, but want to see metrics

When startups have to value the company

1. Fund raising: evaluate the share of ownership to sell during a round
2. Work for Equity and other 3rd parties participations; in order to match the value of labor and the value of ownership
3. Exit: evaluation of the price to sell parts of the company

6. How to present your business to investors?
Elevator Pitch vs. Business Plan

Question # 6 – How to present a business?
Elevator PITCH vs. Business Plan

- The Elevator Pitch is brief presentation to introduce your business idea, your product, your service, to summarize who you are, what you do and why an investor should invest in your venture

- Its name reflects the fact that you can deliver its content in the time span of an elevator ride

- Elevator Pitch is a short graphic and catchy presentation of the business; it is more emotional than rational, and its goal is to attract interest

- Business Plan is an analytical document, with analysis, plans, premises, and consequences, and all the details

Elevator PITCH

• The main goal of an elevator pitch is to persuade an investor to put some money in the venture and become owner of a part of the company

• You have to show her / him that your business is profitable, you have the skills to manage a company, you know the market, you will have positive cash flow after a while, you can control your costs, your business is scalable, you can create and sustain competitive advantages, the market is growing, you have a long-term strategy, etc.

• Your Deck gives the potential investors the first impression of you and your company

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Elevator Pitch Deck – The sections - SLIDE 1

Introduce yourself!

- Name of the startup and slogan
- Brief history (founded on …, in…, by name of founders)
- A brief statement to introduce the activity:
  Example:
  Buy from emerging designers
  Create your digital wardrobe
  Share your style with friends
- Contact

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Elevator Pitch Deck – The sections – SLIDE 2

Introduce the problem, client's pain, need / opportunity

- Describe the market need
- Describe the clients pain
- Explain why current solutions don't work or are fully satisfactory

Elevator Pitch Deck – The sections – SLIDE 3

Your Solution: your product

- What do we offer?
- Benefits of the product / services
- How do we relieve the customers' pain?
- What's the source of our competitive advantage? (types: market, technology, relationships, …)
- Describe the product (and show in picture, if you can)

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Elevator Pitch Deck – The sections – SLIDE 4

Your Team

- For each member: name, role, experiences
- Organizational chart of the company
- Capitalization table (major shareholders %)

Elevator Pitch Deck – The sections – SLIDE 5

What's done so far?

- Phase of the product /service development
- Date of foundation
- Capital invested
- Employees
- Revenues
- Gross Margin, Operating Profit, Net Profit
- Cash Burn Rate
- Metrics
- Clients
- Partnerships
- Patents, trademarks, licenses

Elevator Pitch Deck – The sections – SLIDE 6

Market (TAM) & Competitors

- TAM (Total addressable market)
- Size of the market
- Trends
- Main characteristics
- Potential Market – Available Market – Target Market
- Key Success Factors
- Description of main direct* and indirect* competitors
- Competitive Advantages
- Benchmark

Elevator Pitch Deck – The sections – SLIDE 7

Users / Sales / Cost Forecast

- Clients Forecast
- Sales Forecast
- Costs
- Metrics
- Targets (milestones)

If you have historical data is (relatively) easy, otherwise, you have to do assumptions and create your own plan

Elevator Pitch Deck – The sections – SLIDE 8

Cash Burn Rate / Runaway / Use of proceeds

- Monthly, yearly Cash Burn Rate
- Financial Need
- Use of proceeds (activity, objectives, milestones, …)

Elevator Pitch Deck – The sections – SLIDE 9

Valuation and Exit

- Valuation Method
- Comparables
- Analytical Method
- Exit Strategy

Elevator Pitch Deck – The sections – SLIDE 10

Call to action

- Who you are
- Where you want to go
- What you need
- Add your contact details
- Add your logo, payoff, name of the company