25-02-2025 - Sources of financing

#Entrepreneur #Financing

Author: Abner Silva Barbosa
Date of construction of the document: 28/02/2025

Why raise capital?

- You need capital to start operating on a commercial scale
- Additional money will allow you to accelerate growth
- Their potential new partners can help a lot in growth
- Cash money can protect you from unmapped risks

What kind of capital to raise?

Explanation of Society within the world of enterprise

In the business world, companies need money to grow, and this capital can come from two major sources:

Liability capital (Debts and Obligations)

- **What is it?**
  - It is the money that the company captures through loans, financing or issuance of bonds. That is, **the company borrows money to invest and grow.**
- **Examples of Passive Capital:**
  - Bank loans
  - Financing
  - Accounts payable to suppliers (when you buy on time)
  - Debt securities sold to investors
- **Advantages:**
  - There is no need to give up the company's participation (there are no new partners or shareholde
  - If well managed, it can leverage the growth of the company.
- **Disadvantages:**
  - It generates interest and financial obligations.
  - The company needs to pay even if it has no profit.

Net Equity (Society, Investors)

- **What is it?**
  - Here, the company gets money **by selling a part of it** to partners or investors. This capital does not need to be returned, but investors become owners of a slice of the company.
- **Examples of Net Equity:**
  - Contribution from partners (social capital)
  - Venture Capital or Private Equity investment
  - Issuance of shares (for S.A. companies)
  - Profits reinvested in the company itself
- **Advantages:**
  - It does not generate debts or payment obligations.
  - It can attract investors that add experience and contacts.
- **Disadvantages:**
  - The entrepreneur loses part of the company's control.
  - It may be difficult to find investors willing to invest in the business.

Which Choice?

- If you **do not want to give up control** → **Passive Capital** (Loans, financing).
- If you **want to grow without generating debts** → **Net Equity** (Investors, society).

When to raise debt?

Raising debt means borrowing money (through banks, investors or issuance of debt securities) to finance the growth of the company. But it is not always a good idea. Debt makes sense when:

The business already generates enough cash to pay the debt + interest

- If the company already has positive and predictable cash flow, it can pay the interest and the principal amount of the loan without compromising its operations.

The business is close to generating cash

- If the company is not yet profitable, but is about to be, it can make sense to take a loan to accelerate this moment.

Some specific project is close to generating positive financial results

- If the company needs money for a punctual investment (example: expand a branch, launch a new product), and this investment has a high chance of bringing return on short term, debt can be a good way.

Pros of Debt

1. **Debt is generally not dilutive**
   - When you take a loan, **you do not need to sell a part of the company** to investors. In other words, the partners continue with the same percentage of participation.
2. **Cost of capital is lower than the investor's return expectation**
   - The interest rates of the loan are usually lower than the return that an investor would require when buying a share of the company.
   - Example: If an investor expects a return of **30% per year** and a bank charges **10% interest per year**, debt can be a cheaper way.

Cons of Debt

1. **Creditors can request bankruptcy of the company in case of non-payment**
   - If the company does not pay the debt, creditors can execute guarantees and even force the company into bankruptcy to recover the money.
2. **Debts are senior to the company in a liquidation event**
   - If the company breaks, the **creditors** (banks, investors who lent money) have priority to receive before the partners.
   - That is, in a liquidation, **the partners can end up with nothing, while the creditors receive first**.
3. **Payment of principal + interest consumes cash**
   - The company needs to constantly reserve money to pay the installments of the debt, which can limit investments and growth.

Abstract

Raising debt can be an intelligent strategy **if the company has predictability financial and a good growth plan**. But if the cash flow is uncertain, it can be a high risk, because the company may not be able to pay and end up compromising its survival.

Types of Investment in Startups

Startups grow in **phases**, and in each phase they need different types of investment.
We can divide into three major stages:

1. **Early Stage** (Beginning)
2. **Growth Stage** (Growth)
3. **Late Stage** (Maturity)

Now, we will detail each one!

1. Early Stage (Initial Stage)

This is the beginning of the startup, where the focus is on testing the idea, validating the product and starti gain traction in the market. The risk is still very high.

Pre-Seed (Pre-Seed)

What is it?

- First money raised to validate an idea and create a MVP (Minimum Viable Product).
- Usually comes from **founders, friends and family (FFF - Friends, Family & Fools)** or angel investors.
- Amount: **From US$ 10k to US$ 500k**.
- Example: Startup is still in the prototype phase and needs money to hire a developer.

Seed (Seed)

What is it?

- Money to validate the business model and acquire the first customers.
- Investors: **Venture Capital Funds (VCs), angel investors, accelerators**.
- Amount: **Between US$ 500k and US$ 3M**.
- Example: The startup already has a functional MVP and initial users, but needs capital to grow.

Series A

What is it?

- Money to scale the business model and expand to new markets.
- Investors: **VC funds and institutional investors**.
- Amount: **From US$ 3M to US$ 15M+**.

- Example: Startup already has **recurring revenue** and wants to scale its operation.

2. Growth Stage (Crescimento)

Here, startup has already validated its product and business model and is growing rapidly. The focus is **to scale the operation and expand to new markets**.

Series B

What is it?

- Capital to expand team, marketing, infrastructure and new product lines.
- Investors: **Larger VCs and institutional funds**.
- Amount: **From US$ 10M to US$ 50M+**.
- Example: Startup already has strong revenue and wants to grow globally.

Series C

What is it?

- Capital to accelerate aggressive growth, acquisitions or international expansion.
- Investors: **Private equity funds, sovereign funds, investment banks**.
- Amount: **US$ 50M to US$ 100M+**.
- Example: Startup already dominates the market and wants to consolidate its position globally.

3. Late Stage (Maturity)

At this stage, startup has already become a major company. The focus is **sustainable , IPO or acquisition**.

Series D

What is it?

- Cash for final expansion before an IPO (capital opening on the stock exchange) or merger/acquisition.
- Investors: **Private equity, hedge funds, strategic investors**.
- Amount: **US$ 100M+**.
- Example: Startup already dominates markets and wants to achieve a billion-dollar valuation.

Mezzanine

What is it?

- Last round before the IPO.
- It may involve convertible debt, loans or sale of equity to investors institutional.
- Investors: **Investment banks, sovereign funds, institutional investors**.
- Example: The startup is already close to the IPO and needs a last financial boost.

Abstract

Stage	Objective	Investment
Pre-Seed	Validate idea and MVP	US$ 10k – US$ 500k
Seed	Acquiring customers and validating a model	US$ 500k – US$ 3M
Series A	Scale the business	US$ 3M – US$ 15M+
Series B	Aggressive expansion	US$ 10M – US$ 50M+
Series C	Global expansion	US$ 50M – US$ 100M+
Series D	IPO or fusion/acquisition	US$ 100M+
Mezzanine	Last round before IPO	Variable value

How to raise capital?

A company can raise capital in **two main ways** in the financial market:

Primary Investment → Issuance of New Shares

What is it?

- The company issues **new shares** and sells them to investors.
- The **money collected goes directly to the company's cash**.

Example:

- A startup decides to expand its operations and needs R$ 50 million.
- It issues new shares and sells them to investors on the stock exchange or in a private round.
- The value collected enters the company's cash and can be used for new projects, hiring, R&D etc.

Advantages:

- The company receives **new money** without having to borrow.
- It reduces the need to raise capital via debt (avoids interest).

Disadvantages:

- Dilution: As new shares are created, current partners start to have a lower participation in the company.

Secondary Investment → Purchase of Existing Shares

What is it?

- In this case, **no new shares are created**.
- The money from the sale **goes straight to the pocket of the partner or investor who is selling their shares** – the company itself **does not receive new money**.

Example:

- One of the founding partners of a startup wants to sell part of its participation.
- He sells his shares to a new investor (like a venture capital fund).
- The company **does not receive this money**, only the partner who sold his shares.

Advantages:

- Allows initial partners and investors to make profit without the company needing to raise new money.
- Attracts new investors without needing to issue more shares and dilute the company.

Disadvantages:

- The company **does not receive new money** to finance its growth.
- If many partners sell shares at the same time, it can generate distrust in the market.

When to use each type?

- **Primary Investment** → When the company needs money to grow (expansion, new acquisitions, product development).
- **Secondary Investment** → When partners and investors want to sell part of their participations to make profit.

How to prepare to raise capital?

Before seeking investors, it is essential to have clarity about **how much money you need, for what and how you will use it**. This avoids wasting time and increases the chances of getting a good investment.

Keep in mind what you want

Before talking to investors, define:

- **How much money do you need to raise?**
- **What is the purpose of the investment?** (expansion, marketing, technology, hiring etc.)
- **What kind of investor do you seek?** (VCs, angels, private equity)

Tip: Many entrepreneurs start doing the **pitch deck** without first structuring well these answers. The **pitch deck should be the last thing you do** – first, understand your business deeply.

Structure your story well

Investors do not only look at the product, but at **the business history** and the potential for growth. For this, you need to show clarity in **three pillars: Market, Team and Product**.

A) Market

Investors want to know if the **pain you solve is real** and if there is a big opportunity.

Questions you need to answer:

1. **Is customer pain real?**
   - Who suffers from this problem?
   - Why haven't they solved this yet?
2. **What is the size of the opportunity?**
   - Is the market large enough to value the investment?
   - What is the TAM (Total Addressable Market), SAM (Serviceable Available Market) and SOM (Serviceable Obtainable Market)?
3. **What are the existing solutions?**
   - Who are your competitors?
   - What does your solution do differently or better?

Tip: If the market is too small, it may not attract investors. The ideal is to show that the opportunity is big and growing.

B) Team

Investors do not only bet on the idea – **they bet on the people who will execute it**.

Questions you need to answer:

1. **Does the team have Founder-Market Fit?**
   - Do founders have experience in the sector?
   - Why is this team the best to solve this problem?

Example: If you are creating a fintech startup, but no one on your team has experience in the financial sector, it can be a problem. The ideal is to show that the team has **complementary skills and market knowledge**.

C) Product

Investors want to understand **why now is the right time for your startup to grow** and what differentiates your product.

Questions you need to answer:

1. **Why now?** (Why now?)
   - Is the market changing?
   - Is there some new technology, regulation or trend that favors your growth?
2. **Competitive advantage**
   - What prevents competitors from copying your solution?
   - Does your technology have something unique?
   - Is there any network effect (e.g., the more users, the better the service)?

Tip: Startups without clear competitive advantage may have difficulties raising capital, because investors want something that has **entry barriers** for competitors.

Process summary

1. **Define what you need (money, objective, type of investor).**
2. **Structure your story (Market, Team and Product).**
3. **Only then do your Pitch Deck!**

If you can answer these questions clearly, your chances of convincing a investor increase a lot.

How much to raise?

This is a critical question for any startup, because raising too much money can be harmful, just as raising too little can be risky. The goal is to find **the balance**

Right.

Raise the minimum possible

Why?

- **The more you raise, the more of the company you give up (dilution).**
- Each R$ raised now represents a **percentage of participation** that could be avoided.
- If your startup grows and is worth more in the future, **the next rounds will have a dilution smaller**.

Example:

- If you raise R$ 1 million now and sell **20% of the company**, it means that the startup is worth R$ 5 million (R$ 1M ÷ 20%).
- If you had waited to grow more before raising this money, perhaps you could have raised the same R$ 1M selling only **10% of the company**, because the startup would already be worth R$ 10 million.

Conclusion: Raise only the necessary to reach the next stage and increase its valuation.

Have a clear financial plan

A common error is to raise money without a solid plan of how to spend it. To avoid this, you need:

Define which levers will take your startup to the next milestone (close to the great growth objective).

- What needs to happen for the startup to grow and increase its valuation?
- This money will be used to scale a product, acquire customers or develop technology?

Be conservative in calculations

- Make financial projections considering **realistic and pessimistic scenarios**.
- Plan **all possible lines of entry and exit of money**.

Important rule:

> **Raise enough capital to sustain the startup for at least 18 months.**

This "pocket rule" of the **18 months of cash** comes from the fact that:

1. The fundraising rounds take time to close (6 to 9 months).
2. You need space to grow without constantly raising.

If you raise less than 18 months of cash, you might end up needing money before the time and raising at a bad moment.
If you raise much more than 18 months, you might be giving up equity unnecessarily early.

Be flexible, but VERY realistic when discussing the round with investors

What does this mean?

- Investors may try to negotiate a different value than you planned.
- Be **flexible**, but **be clear about what your startup really needs**.
- **Do not raise more just because the investor wants to put in more money.**

Final tip:

> **"I'd rather be vaguely right than precisely wrong."**
> (It is better to be **vaguely certain** than **precisely wrong**.)

This means that, in financial planning, **it is better to have conservative projections, even if inaccurate, than trying to hit an exact number that may be wrong**.

What is Valuation?

Valuation is the estimated value of a company in the market.
It is **fundamental to raise capital**, because it defines **how much of the company you will have to give in exchange for investment**.

Example:

- If your startup has a valuation of **R$ 10 million** and you raise **R$ 2 million**, it means that you are selling **20% of the company** (R$ 2M ÷ R$ 10M).

But how to reach this number?

How to Define the Valuation of your Startup?

As startups **não têm lucro previsível como empresas tradicionais**, o valuation geralmente é baseado em **comparação com o mercado** e projeções de crescimento.

Comparar com Empresas do Mesmo Ramo/Nicho

A melhor maneira de estimar o valuation é ver **quanto empresas similares estão sendo avaliadas**.

Como fazer isso?

- Pesquise **startups no mesmo setor e estágio** que levantaram investimentos recentemente.
- Veja quanto essas empresas valeram nas rodadas de captação.
- Se possível, analise os **múltiplos de mercado** (quanto elas valem em relação ao faturamento ou base de clientes).

Exemplo:
Se você tem uma startup de fintech e vê que outras fintechs em estágio semelhante foram avaliadas em **5 vezes a receita anual**, pode usar isso como base para definir seu valuation.

Ferramentas para comparar valuations:

- Crunchbase
- PitchBook
- CB Insights
- Análises de mercado de fundos de Venture Capital

Fatores que Influenciam o Valuation

Além da comparação com o mercado, os investidores olham alguns critérios para definir quanto sua empresa vale:

Receita e crescimento → Empresas que já faturam e têm crescimento acelerado têm valuation maior.
Base de clientes → Número de usuários/clientes e seu valor para a empresa.
Tecnologia e diferenciação → Startups com inovação forte e vantagem competitiva valem mais.
Time de fundadores → Fundadores experientes aumentam o valuation.
Tamanho do mercado (TAM, SAM, SOM) → Quanto maior o mercado potencial, maior o valuation.

Métodos de Valuation para Startups

Startups are usually evaluated in three main ways:

A) Multiple Revenues

- Example: A SaaS that invoices **R$ 2 million per year** can be evaluated at **5x the revenue** → Valuation of **R$ 10 million**.

B) Comparison with Similar Startups

- Example: If a fintech with 50,000 users was evaluated at R$ 20 million, and your fintech has 25,000 users, it can estimate a valuation of R$ 10 million.

C) Investor Method

- Based on the return expected by the investor and the risk of the startup.
- If the investor wants a return of 10x in 5 years, he adjusts the valuation to reflect this potential.

Approaching Investors - How to Make the Right Way

Raising capital **is not just about numbers and pitch deck**. **Relationship and strategy** are fundamental to achieve quality investment. Here are the best practices:

Be Introduced to Investors

Investors receive thousands of meeting requests. If you are introduced by someone trustworthy, your chances increase greatly.

How to achieve a good introduction?

- Build networking **before you even need to raise capital**.
- Find **mentors, angel investors or experienced founders** who can you introduce to VCs.
- Participate in **events, hackathons and acceleration programs**.

Who can be a good 'godfather' to introduce you?
Well-connected angel investor
Startup founder who has raised capital
Follower fund (funds that invest alongside other VCs and can facilitate the connection with larger investors)

Practical example:
If an investor receives **100 cold emails**, he can ignore 90%.
But if a **founder that he respects** introduces you, he will pay attention.

Create Relationships Before You Need Investment

Do not expect to be eager for capital to start talking to investors!

What to do?

- **Connect with investors before the fundraising** → Send an email telling about your startup, ask for advice.
- **Keep them updated** → Send quarterly updates to create a history.
- **Interact on social networks** → Comment on investors' posts on LinkedIn and X (Twitter).

Ninja Tip:
Investors like to see **progression**. If you keep them informed about your evolution, **when you capture, they will already know you** and trust more in the startup.

Respond Quickly to Any Interaction

If an investor asks a question, answer as soon as possible.

Why?

- It shows that you are **agile and serious**.
- Demonstrates **respect for the investor's time**.
- If you take a long time to respond now, how will your agility be when scaling a company?

Tip:
If an investor asks for numbers that you do not yet have, **respond quickly saying that you are gathering the data and will send it in X hours**.

Be Ready to Present Without a Pitch Deck

Pitch deck helps, but investors want to see if you know how to explain the business without depending on slides.

How to prepare?

- Have a **sharp elevator pitch** (business explanation in 30 seconds).
- Know how to answer **what the key numbers are** (revenue, growth, CAC, LTV).
- Have **clarity about your market, team and competitive advantage**.

Tip:

If an investor finds you in an event and asks about your startup, you need to be able to **make him understand and be interested without opening a PowerPoint**.

Don't Leave an Interaction Without a Next Step or Deadline

Each conversation with an investor needs to move on to a next step.

What to avoid?

Vague conversation without follow-up.
"Let's talk and see how it evolves..."

What to do?

At the end of the meeting, ask:

> **"What is the next step? Can we schedule another conversation to dive deeper into the numbers?"**

Set deadlines:

> **"Can I send you a report on our customer acquisition by Friday?"**

Tip:

Investors like **proactive founders**. If you **don't guide the conversation to a next step, you may lose the timing of capture**.