# CSE3PPE / CSE5003

Professional Practices and Entrepreneurship in I.T.

# Lecture 6

Semester 1, 2024

La Trobe University CRICOS Provider Code Number 00115M

# Recap from last week

Last week we covered **cost structures**, **revenue streams** and **key metrics**. Key takeaways:

1. Start-up costs can be significant. These will change as you start making sales. Be conscious of the two main types of costs, and how they might change as you grow:
    a. fixed costs – the costs that you have to pay regardless of whether you have sold anything such as rent, electricity, CEO costs, etc, and
    b. variable costs – costs that change as your business grows (or shrinks) such as raw materials, manufacturing labour, sales teams, customer support, etc
2. There is more than one way to generate revenue – have you explored all options? Can you have multiple revenue streams?
3. Pricing strategy should consider the market and how you want to place your product within it.
4. Measure elements that help you move through the start-up phase (feedback, product rates, etc). Number of sales and profit targets are not as relevant in the early days.

# Lecture 6

# Financing Entrepreneurship

# (Part 2)

It costs nothing to set up a business?

# Start-up costs

- Registering a business name (ASIC, $37 p.a. ($2021)
- Domain name registration, DNS hosting
- AWS services
- Registering your company with ASIC (between $422 and $512 ($2021))
- Annual company review fee $276 p.a.
- Accounting services (variable)
- Accounting software?
- Utility costs: electricity, water, internet, phone, rent?

# Start-up costs

- Development of ideas (prototyping)
- Testing with customers and collating feedback
- Further iterations of prototype
- Production costs (development)
- Hardware/software requirements
- Testing
- Scaling

- Marketing/channel costs
- Product/business launch
- Customer support
- Sales team

- Payroll systems

# Start-up costs

These are all potential costs that can be incurred before your first sale is made.

Your challenge is to find a way to finance these and ensure you don’t run out of money before your revenue stream kicks in.

# Sourcing Finance

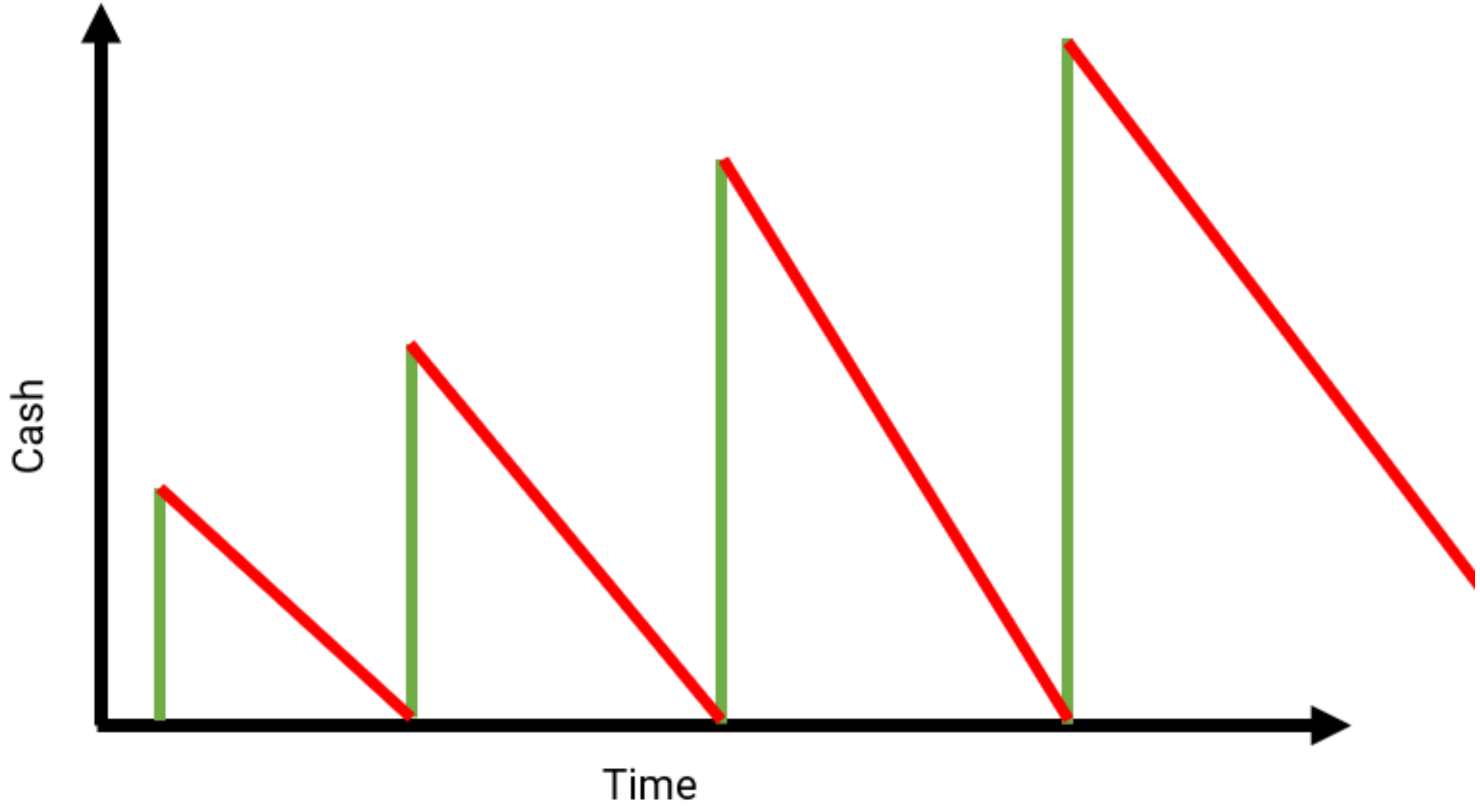
# Sourcing finance

While the costs can quickly mount up for new businesses, we must also be mindful on how we source finance. There is always a cost involved with finance. Be aware of the risks of each and ensure the option you select does not add to your underlying costs unnecessarily.

There is also an order with sourcing finance. You cannot secure investors unless you have progressed your solution to a point where they are willing to commit to you.

Therefore, you need a base level of finance to begin with.

# Sourcing finance





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# Funding Series

The term funding series relates to the different stages a start-up goes through as they seek finance and continuing building and scaling their business.

| | |
|---|---|
| **Pre-seed funding** | This stage usually refers to start-ups that are funding their operations through their own financial reserves (called bootstrapping) or from friends, family and those who might be enthusiastic about your solution. |
| **Seed funding** | Usually the first attempt to seek investor finance. Can be sourced from family, friends, enthusiastic supports, or from company founders themselves. Investment can be sourced from venture capital firms specialising in early stage finance, or through grants or finance from accelerator programs. Investors are likely to seek a share of equity in return for their finance. |

Source: [Investopedia]



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# Funding Series

The term funding series relates to the different stages a start-up goes through as they seek finance and continuing building and scaling their business.

| | |
|---|---|
| **Series A funding** | Typically you have a solution that works and your customers have shown demand for. Demonstrated sales growth. This stage is dominated by venture capital investment firms. Scale of money raised varies depending on product, market, and anticipated growth. Negotiations around equity common. |

| | |
|---|---|
| **Series B, C, funding** | Demonstrated continued growth. Current revenue covers production, COGS, but finance needed to continue expansion into new markets or build production capacity. Further negotiations on equity and exit options in term sheets. |



Source: Investopedia

# Early stage financing options

The following cover finance options common in pre-seed and seed funding stages

# Early stage financing options:

## Personal savings

| Pros | Cons |
| --- | --- |
| • Don't have to pay for the 'cost' of acquiring finance.<br>• Retain ownership of your company<br>• Also known as boot strapping. | • Need to have the savings in the first place<br>• Risk of losing all your money<br>• Risk missing out on wealth creation from using your savings on other investment strategies<br>• You might still run out of money |



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# Early stage financing options:

## Credit card

| Pros | Cons |
|---|---|
| • No one a… are spen… • Easy to o… | • Cost of finance extremely high (interest … might mean … ales … position when applying for other sources of finance |

**NOT RECOMMENDED**



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# Early stage financing options:

## Family, friends and fools

| Pros | Cons |
| --- | --- |
| • More likely to be able to convince people to invest in you – they know you!<br>• Terms can often be favourable, avoiding high interest or significant loss of equity<br>• Pressure to succeed can spur motivation (don't let Grandma down) | • Less likely to be able to convince people to invest in you – they know you!<br>• Risk of losing your loved ones money can lead to stress, burnout, and breakdown of family relations and friendships |

# Early stage financing options:

## Crowdsourcing

| Pros | Cons |
| --- | --- |
| • Double benefit: cash AND promotion of your concept<br>• Typically you retain equity | • Need a product to be able to sell – very rare for early stage start-ups to succeed without a prototype/proof of concept<br>• Rewards associated with crowdfunding can distract from product development and testing<br>• Relies on traction – broad interest |



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# What about after the early stage?

This is typically when your business idea has developed to a point where you have a working model and some customers, and can demonstrate the market wants your solution.

(Seed and Series A funding)

# Seed/Series A financing options:

## Crowdsourcing

| Pros | Cons |
| --- | --- |
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# Seed/Series A financing options:

## Venture capital firms

| Pros | Cons |
| --- | --- |
| • Self-confidence: they are investing in you!<br>• Provide cash and guidance – some may join your board or act as advisors<br>• Leverage for further investment from other VCs. | • Difficult to secure, especially the first one<br>• Funding agreements (term sheets) can be overly complex in the early stages and favour the VCs (need good legal advice through this phase)<br>• Loss of equity |


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# Seed/Series A financing options:

## Corporate Partners

| Pros | Cons |
|---|---|
| • Share the pain of the problem you are solving – keen to see you succeed<br>• Quality and frequent feedback on prototypes and concepts<br>• Guaranteed sales once ready to launch | • Difficult to arrange (partner may be wary of innovation despite needing solution)<br>• Focus on partner's needs can restrict broader sales potential<br>• Terms may require pay back on investment/free product, impacting future cash flows |

# Seed/Series A financing options:

## Government / University Grants

| Pros | Cons |
|---|---|
| • Small cash grants usually available. Most require demonstrated sales<br>• Lower equity share requirements<br>• Connections to researchers, alternative investors, and foreign markets | • Some programs have restrictive clauses such as a required return of investment once you hit a revenue target<br>• Funding amounts may not be enough for your requirements<br>• Sometimes required to match funding |



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# Seed/Series A financing options:

## Vendor Support Programs

| Pros | Cons |
| --- | --- |
| • In this scenario, companies invest in their suppliers to build their capacity or develop new product iterations<br>• Business development skills, R&D funding common | • Similar to company partners, the solution needs to align with the major company's interests.<br>• May be difficult to access these programs without a track record<br>• Contractual obligations to continue supplying company |



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# Accelerator Programs

Accelerator programs are becoming more popular.
There are clear benefits from being involved in these, such as:

- Ability to develop skills in areas you may not be confident in (for example, managing people, negotiating finance, administration)
- Access to in-house speciality skills
- Networking with other co-founders
- Introductions to potential venture capital investors
- Grants or awards as part of the program

Accelerator programs can be run privately, by Universities, and increasingly by Government.

Some specialise in particular industries or by the profile of the founder, for example She Starts for women-led start-ups in Australia that specialise in tech.

# Accelerator Program Examples

**Private accelerator programs**

Blue Chilli
Startmate
Antler
muru-D

**Government run programs**

Launchvic

**University-run start-up programs**

Incubate – University of Sydney
Melbourne Accelerator Program – University of Melbourne
La Trobe University Fishburners Founders Hub

**Speciality start-up / accelerator programs**

CyRise – for start-ups specialising in cyber security
The Good Incubator – for start-ups specialising in the disability, health and wellbeing sectors

# Exit Strategies

# Already planning an exit?

Perhaps the most ironic part of entrepreneurship is the need to build your venture every day with some idea of how you will exit.

The reason this is important is that there are different options for exiting your venture.

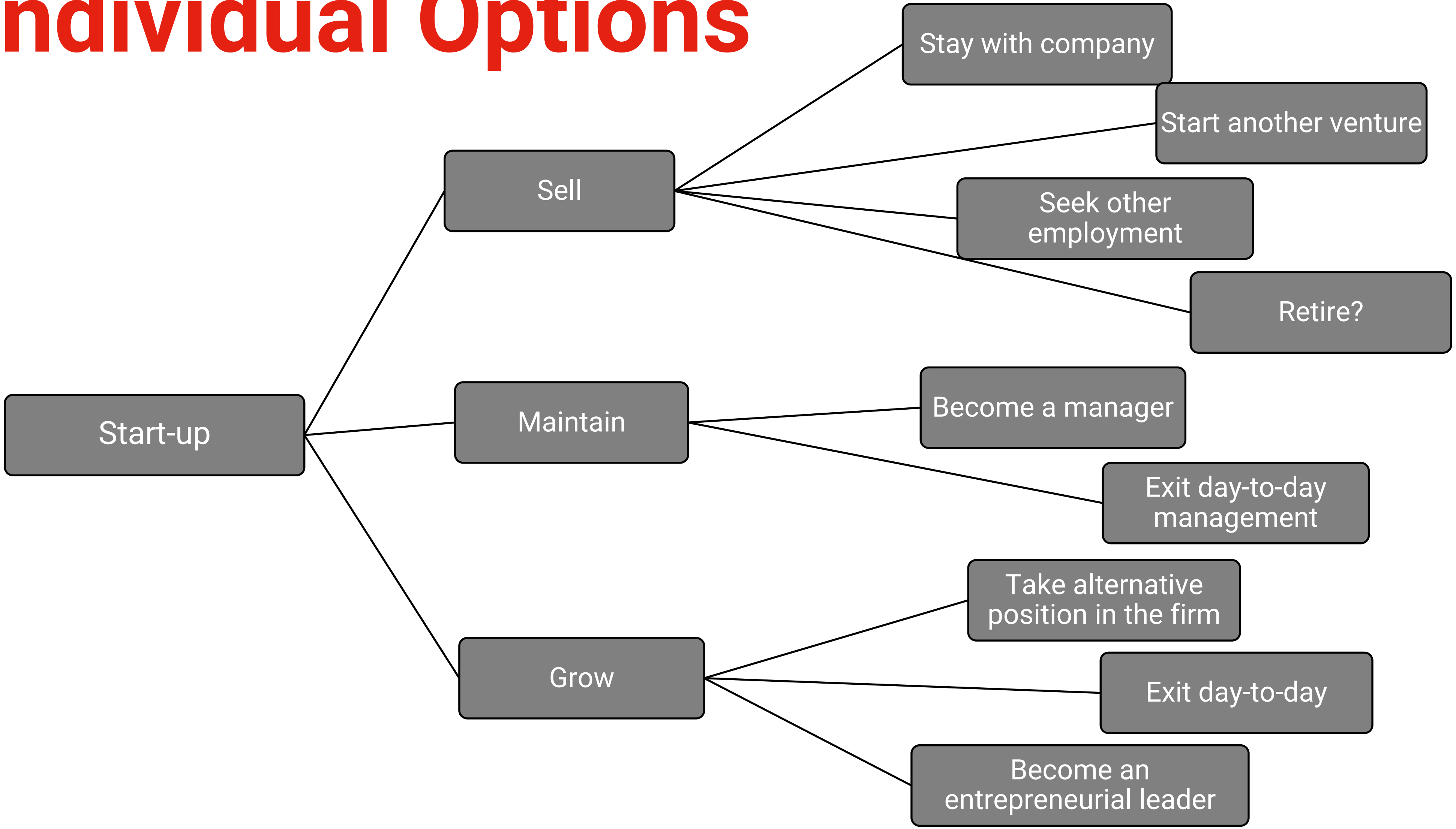
# Ways to go

Each option requires that you build your venture in different ways.

For example, if you intend to pass your venture on to your partners or family members, there are things that you should do to prepare them for a smooth succession.

On the other hand, if you are planning on exiting your venture via a sale of stock on a public stock exchange you will be focusing on different types of things.

# Individual Options





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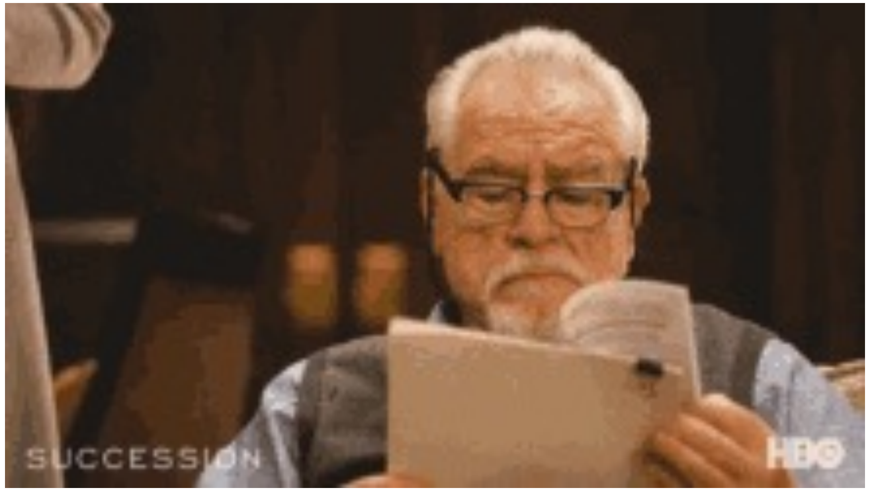
# Types of Exits: Succession

Succession is a common exit strategy used in family-owned businesses. Such ventures often are handed down from generation to generation.

Some of the largest private companies in America, such as Koch Industries, and Milliken & Company are family owned and continue to be run primarily by members of the Koch and Milliken families, respectively.

These companies have developed detailed succession planning guides that help them groom and prepare the next generation to take over the company.



# Types of Exits: Succession

Many family-owned businesses aspire to keep the business in the family via succession, but they don't plan very well for it.

As a result, many family-owned businesses suffer setbacks and occasionally bankruptcy because of poorly designed succession.

# Types of Exits: Acquisition

Before the entrepreneur can build value attractive to a potential acquirer, they must understand the buyer's perspective.

Most acquisitions are undertaken because the acquiring company sees one or more strategic advantages that can be obtained by buying another business.

These advantages, or value drivers, vary from industry to industry.

They also change over time in specific industries because of evolving product life cycles and external developments that affect the industry.



Reference: Technology entrepreneurship : taking innovation to the marketplace Thomas N. Duening author. | 2015 | Robert D. Hisrich author. | Michael A. Lechter author

# Types of Exits: Acquisition

Generic categories of strategic value drivers include:

- **Broadening product lines:** The buyer adds complementary products to increase revenues. This is a common strategy for both product and service companies.

- **Expanding the technology base:** The buyer adds technology skills or intellectual property that enhances or complements the company's current base.

- **Adding markets and distribution channels:** The acquirer obtains channels it doesn't currently serve. Companies that start out with a vertical strategy can add new industry expertise by widening its distribution capabilities. A vertical strategy is one where a venture develops expertise in a given industry that can be expanded to other industries with only slight modifications.



Reference: Technology entrepreneurship : taking innovation to the marketplace Thomas N. Duening author. | 2015 | Robert D. Hisrich author. | Michael A. Lechter author

# Types of Exits: Acquisition

Generic categories of strategic value drivers continued:

- **Increasing the customer base:** The buyer adds a company that is similar in product offerings or in its business model, yet focuses on a different customer segment. This strategy is enhanced if the target company has a good reputation or strong brand. It also can expand the acquirer's geographic coverage.

- **Creating economies of scale:** The combined company can offer a more efficient use of physical assets or overhead—a critical need in consolidating industries.

- **Extending internal skills:** The buyer can add new capabilities such as consulting or service offerings, international management skills, or various types of management and business skills. These skills can be offered as independent revenue producers or enhance a company's competitive edge



Reference: Technology entrepreneurship : taking innovation to the marketplace Thomas N. Duening author. | 2015 | Robert D. Hisrich author. | Michael A. Lechter author

# Types of Exits: Acquisition

Many acquirers hope to leverage several value drivers in a single deal.

Google, for example, has regularly used acquisitions as a strategic tool to bring in new skills, new technology, and, sometimes, new customers.

Google has developed expertise for integrating these newly acquired technologies into their complete product offerings.



Reference: Technology entrepreneurship : taking innovation to the marketplace Thomas N. Duening author. | 2015 | Robert D. Hisrich author. | Michael A. Lechter author

# Types of Exits: Acquisition Examples

In 2012 Facebook bought Instagram for $1 billion as it was considered a threat to the Facebook model.
In 2020 Instagram contributed around $24 billion to Facebook's revenue, just under half of Facebook (Meta's) total revenue.

https://www.business-standard.com/article/international/mark-zuckerberg-bought-instagram-as-it-was-a-threat-to-facebook-120073000324_1.html#:~:text=Facebook%20bought%20Instagram%20for%20%241,billion%20to%20Facebook's%20annual%20revenue.
https://www.businessofapps.com/data/instagram-statistics/

# Types of Exits: Merger

Another method for exiting a venture is via a merger—a transaction involving two (or more) companies in which only one company survives.

Acquisitions are similar to mergers and, sometimes, the two terms are used interchangeably.

In reality, they are quite different, with the primary differences between mergers and acquisitions centreing on the relative size of the entities involved and on who is in control of the combined entity.



Reference: Technology entrepreneurship : taking innovation to the marketplace Thomas N. Duening author. | 2015 | Robert D. Hisrich author. | Michael A. Lechter author

# Types of Exits: Merger

Mergers generally occur when the relative size of the ventures involved is equal—or at least they are perceived to bring equal value to the merged entity.

When an entrepreneur decides to merge with another company it’s usually the case that the two entities are similar in size and offer similar value to the merged entity.

For example, it would be quite unexpected for Google to merge with a five-person technology start-up.

More likely, Google, with its tremendous assets and global reach, would be in control and simply acquire the smaller venture.



Reference: Technology entrepreneurship : taking innovation to the marketplace Thomas N. Duening author. | 2015 | Robert D. Hisrich author. | Michael A. Lechter author

# Types of Exits: Mergers for entrepreneurs

When two entrepreneurial ventures merge, the question of who will control the merged companies is part of the merger negotiations.

An entrepreneur who wants to exit a venture may elect to merge with another company, but it may take some time for the entrepreneur to wriggle free of the new company.

Often, when a merger occurs the merged company requires that the top executives from each venture stay with the merged entity to ensure its success.

Depending on the size of the new company, the entrepreneur may be able to negotiate a deal whereby he or she earns out of the company over a period of time.



Reference: Technology entrepreneurship : taking innovation to the marketplace Thomas N. Duening author. | 2015 | Robert D. Hisrich author. | Michael A. Lechter author

# Types of Exits: Merger Examples



Coles Myer Ltd.

1985 - 2006

In 1985 a proposal to merge two major retail players, the Coles Group and Myer Emporium was accepted.

While both retail chains (Coles as a supermarket, Myer as a department store), they both had also a large retail portfolio of acquired retailers.

The group was dismantled in 2006 when Coles was ‘spun-off’ and sold to Wesfarmers, before being ‘spun-off’ again and listed as an independent public company in 2018.



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# Types of Exits: Initial Public Offering

An Initial Public Offering is offered referred as an IPO exit.

Going public via what is called an IPO occurs when the entrepreneur and other owners of the venture offer and sell some part of the company to the public.

The resulting capital infusion to the company from the increased number of stockholders and outstanding shares of stock provide the company with financial resources and a relatively liquid investment vehicle.

Consequently, the company will have greater access to capital markets in the future and a more objective picture of the public's perception of the value of the business.

However, given the reporting requirements, the increased number of stockholders, and the costs involved, the technology entrepreneur must carefully evaluate the advantages and disadvantages of going public before initiating the process.

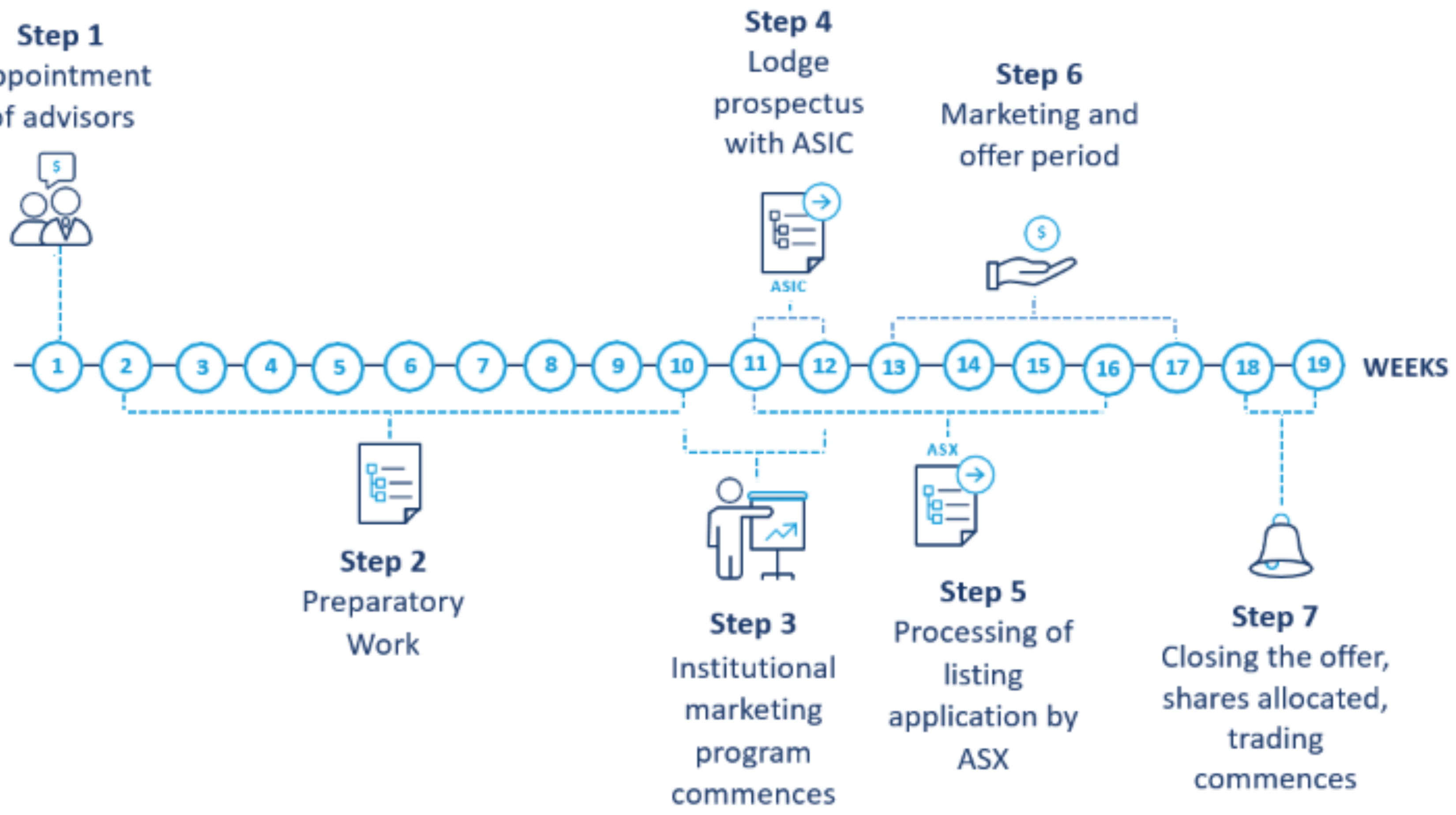


Reference: Technology entrepreneurship : taking innovation to the marketplace Thomas N. Duening author. | 2015 | Robert D. Hisrich author. | Michael A. Lechter author

# Types of Exits: Initial Public Offering

An Initial Public Offering is a long and expensive process.

The Australian Stock Exchange lists the process as taking around 19 weeks.




Reference: https://www2.asx.com.au/listings/how-to-list/the-listing-process



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# Types of Exits: Initial Public Offering

IPO on May 18, 2012.

If you had bought shares in **Facebook** when it launched it's IPO in 2012, you would have had a 23.3% annual rate of return as of May 14, 2020.*

IPO on May 10, 2019.

IPO value of shares were listed at around $45/share (USD)
In December 2020, one share would have set you back $53.79USD**
Today, one share is worth $29.01USD***

* https://www.investopedia.com/articles/markets/081415/if-your-would-have-invested-right-after-facebooks-ipo.asp#:~:text=Facebook's%20IPO%20launched%20at%20%2438,as%20of%20May%2014%2C%202020.
** as at December 2020
***as at August 22, 2022

# End of Entrepreneur Modules

# Additional Reading/Viewing

**Start-up Funding Rounds Explained**

This video runs for 7 mins and provides a short overview of each of the funding rounds that start-ups typically move through.

https://youtu.be/TCsOlrRQNcs



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# Thank you



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