FINANCING PATHWAYS

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Financing Pathways

- Early stage ventures often need extra cash to fund their expansion, but struggle to get funding because they don't have enough of a track record
  - Over half of all startup founders say that a lack of financing is restricting their business's growth opportunities
- In this course, we will look at all the different ways a business can raise money, from loans and crowdfunding to angel investors and venture capital

Exploring all funding options

- Do not discount options before exploring them
  - Many assume that government grants aren't an option
    - Grants are indeed mostly for nonprofit organizations, but some are available for businesses too.
  - SBIR funding: Small Business Innovation Research program
- State and local governments have programs (check local gov sites, as well as federal government's site)
- Work social networks – remember that 72% of small businesses have raised money from friends and family
  - Formalize arrangements to avoid misunderstandings or recriminations down the road.
  - Sites like LoanBack.com help you create legally binding loan agreements, with a full repayment schedule

Financing Pathways: Fund it yourself

- Consider using your personal resources - self-funding may be an option assuming you have the money available
- Many people fund a business themselves (savings / credit)
- Mark Zuckerberg and Eduardo Saverin, for example, started Facebook in 2004 with their own personal funds
- One good reason to consider self funding is if it gets the business to a point where outside investors feel comfortable investing
- However, unless you have deep pockets, self-funding is not usually a long term strategy

Financing Pathways: Get a loan

- Loans might be hard without a long track record
- But borrowing money is not impossible – it happens often, whether from banks, credit unions or other sources
  - If you can afford repayments, debt is a good way of raising funds without giving up any ownership stake in your business.
- Key to getting a loan is putting together an impressive proposal.
  - Anticipate loan officer's questions and concerns, and address them up front, presenting your business as solid and safe
  - Give detailed view of finances, strategy, and repayment plan
- The Small Business Association runs a few loan programs, some general and some specific which aim to support particular groups like veterans, etc. (SBA website)

Financing Pathways: Crowdfunding

- Crowdfunding not an entirely new concept
  - Construction of pedestal for Statue of Liberty was largely funded by individual contributions from 125,000 people
- Technology has really helped to enable internet-based crowdfunding as a viable source of funding
- How it works:
  - You state how much funding and what you need it for
  - People view concepts and can contribute money
  - Sites such as Indiegogo, Kickstarter, Crowdfunder.com
- One advantage is that it can also win new fans for your business.
  - But you need compelling story / offer great rewards

Financing Pathways: Angel Investors

- “Angel” investors are not philanthropists looking to give away cash - they are regular investors looking for profit.
- Angels are usually wealthy individuals who invest in promising young companies.
  - You can pitch to angels via local networks
- Angels invest anything from a few thousand dollars to a few million. Some advantages are:
  - They may invest when others won’t
  - They’re usually experienced business people

Financing Pathways: Venture Capital

- Venture capital funding is money given by a company, not an individual, and is usually at a slightly later stage than angel investors
- VC investors usually invest higher amounts than angel investors
- Most VC deals work in the following way – the VC provides funding (usually to firms with high growth prospects) in return for equity
- VC money can really fuel your business's growth, but you will probably lose some control as a VC likes to ensure the business is making all possible choices to secure a return

Financing Pathways: Private Equity

- Like venture capital firms, private equity companies will invest in your business in return for a share of ownership
- Private equity firms invest in both a wider range of businesses, as well as in older, more mature companies
- They tend to make larger investments, and take larger stakes
- Private equity investments are usually oriented at turning around failing businesses or achieving rapid growth, but they always take control

Financing Pathways: IPO

- IPO – when a company sells shares to the public
- Advantages are that with potentially millions of people to buy shares, a business can raise serious amounts of cash
- Usually an IPO is for businesses at a later stage
- Likewise, there are disadvantages:
  - like loss of autonomy
  - cost of meeting regulatory requirements for public companies
  - complex process

Financing Pathways: What's Next

- We'll look at each of these financing options in more detail now
- Important to keep in mind is that each option has its own advantages and disadvantages

Closer look: Funding from your own pocket

"Bootstrapping" – referring to the famous saying about pulling yourself up by your bootstraps

	Key points	Pros	Cons
Savings	• Need a healthy savings account • Tap retirement funds (if meet certain criteria can roll over IRA or 401(k) into a business start-up	• no costs except lost interest	• Risk of relying only on your savings • May not be enough
Personal Debt	• Relying on personal debt • Ranges from using credit cards, refinancing mortgage, to taking out home equity line of credit	• Easy (need good credit)	• Use with caution – as interest rates rise need to ensure can pay debt
Friends and Family	• Go into partnership with friend or family member • Pooling funds into business, or borrow from them	• Trust in someone you know	• Can put strain on relationship if things don't go as planned
Business Cash Flows	• Profits / cash generated by a business that is put back into the business; aka "Organic" growth	• low-risk, low-cost	• Requires the company is profitable enough • May not drive fast growth

Closer look: Funding from your own pocket - Strategies

	Key points
Set Parameters	• Draw lines between personal and business accounts • Pay yourself a salary: cover personal expenses and keep line between you and your company • If using friends and family make it very clear who owns what • Create formal agreements with terms, have everybody sign
Plan Ahead	• Taking inventory of your savings, loans and other resources • Decide how much you can commit to the business (stick to that) • Make a plan, list all the investments needed • Figure out break-even point; make sure you have enough funds • Consider worst-case scenarios: long product cycle, etc.
Stretch	• Come up with creative strategies to stretch resources • Practical ideas: delaying investments as long as possible, renegotiating payment terms, and minimizing inventory

Overall Self-funding

Advantages

- Certainty
- 100% Ownership
- Full Control

Disadvantages

- Slower Growth
- Personal Risk
- Smaller network
- Not the prom queen

Closer look: Debt and Borrowing

	Key points	Pros	Cons
Bank Loans	• Go to bank and asking for a business loan to borrow an amount for a fixed time, which you pay back monthly (with interest)	• Good ways to borrow; • L-term access to funds (rates better than other options)	• May be hard to get approval • Bank will often ask for personal collateral
Government -Backed Loans	• SBA loans help people get started • Still borrow from bank / other private lender (not from the gov)	• SBA guarantees loans; extending credit is easier	• Upon default, bank collects what it can; gov. trys to help w/ the rest
Business Credit Cards	• Convenient ways of getting short-term access to funds, and much	• Easier than bank loans	• dangerous to let balance build up; high interest rates
Business Lines of Credit	• Borrow fixed amount and can access funds anytime up to agreed amount	• Rates better than CC's • Business assets as collateral • Pay interest on money used	• dangerous to let balance build up
Factoring	• Leveraging (for example) sales where revenue has not yet been realized as a way to advance funds	• Good short-term solution when you've made sales and are waiting for the cash to come in	• but you'll need to look at other options if you want to fund your business for the long term.

Closer look: Debt and Borrowing - Strategies

	Key points
Take broad approach	• Approach different banks before choosing / accepting (not all will accept you, and you need to know terms across banks) • See if eligible for SBA programs
Go Small(er)	• Ask for smaller amounts if first attempts not successful • Try smaller institutions; easier to build personal relationship
Be Careful What You Commit To	• Most loans require some kind of collateral / guarantee • Walk away if not comfortable with the fine print • Offer business assets for collateral (not personal) • Limit exposure to protect family / home
Don't go it alone	• Take advantage of non-profit group SCORE; content, workshops, resources to help small business owners

Overall Debt & Borrowing

Advantages
- Control
- Retain Profits
- Access

Disadvantages
- Difficult to acquire
- Cost to repay
- Personal liability

Closer look: Crowdfunding

Tech advancements have created a viable funding option via the 'crowd'

- Put idea on crowdfunding site
- Explain how much money you need
- What the funds are for
- What you offer in return

Information and inspiration

Crowdfunding sites

- People pledge money to campaign

funds

Closer look: Crowdfunding

Tech advancements have created a viable funding option via the ‘crowd’

	Key points
Pros	**Creating Fans** - Both a funding and a marketing campaign rolled into one; if done right you raise money and build awareness **Availability** – Unlike some of the other options, anyone can try to raise funds via the crowd, just need to invest the thought and time **Social Proof** – if you can convince thousands of people to invest perhaps you’re on to something **Feedback – Whereas normally c**ompanies spend time and money on focus groups, crowdfunding provides immediate feedback from both people that donate and those that don’t
Cons	**Time** – successful crowdfunding experiences are usually the result of extensive time, thought, and energy put into every aspect of the project (team, product, marketing, branding, etc.) **Limited Funds** – Most campaigns raise less than (for example on Kickstarter) $10,000; very few raise more than $1 million **Only works for some ideas** – not all ideas are good for crowdfunding, i.e. those that are highly technical or complex may not benefit from a ‘general’ crowd approach **“Going for Broke”** – Usually if you set a goal you must raise the full amount or you get nothing

Closer look: Crowdfunding - Strategies

	Key points
Reward or Equity?	**Rewards** – good if your offering inspires the masses; set wide range so pledges can rage from few to hundreds of dollars or more **Equity** – might give you access to more funds (i.e. Fundable.com), but you're giving up shares
Start Early	**Get backers** before you sign up your project so that you can make sure you're offering things that people want. Avoid being the '**empty restaurant**'
Don't be greedy	**Set modest goals** so that you get what you need but don't end up with nothing
Be Ubiquitous (everywhere)	**Good campaigns generate buzz** – need a strong listing which means you are really putting in the effort especially for the first month to two months

Closer look: Angel investors

Angel Investing

- "Angels" - **people with money** that invest in small businesses; usually wealthy or successful entrepreneurs
- How it works:
  - angel **invests** an agreed amount and the angel **gets a share** of your business
- Angels' Objectives:
  - Sell stake for a **significant profit**, looking for '**home runs**' of about **10x**
- Realities:
  - Angels **invest for high growth in young, unproven** companies
  - Angels (nowadays) often invest in tech, but also in other fields like healthcare, energy, etc. Angels take risks - if business fails, they losing their money
- Where they are:
  - Angels are all over the country (and outside the U.S. too)

Closer look: Angel investors

	Key points
Pros	• **Availability -** Angels often step when others don't – they want to get in early • **Flexibility –** Angel investors are usually more flexible with investment amounts • **Network –** Angels use own experience and contacts to help companies they invest in
Cons	• **Expectations -** Angels look for (usually) 10x investment; your business needs to drive high growth (and you must deliver that growth, otherwise you can expect to come under a lot of pressure) • **Loss of Control -** Angel investor co-own the business; he / she will have a say in how to run it • **Limited Funds -** investments are usually small

Closer look: Angel investors - Strategies

	Key points
Finding an Angel	• Check out **web platforms** (i.e. AngelList, FundersClub, and others) • **Angels invest locally** - they want to know the company they invest in • Most **cities have local angel networks** (the Angel Capital Association has a lot of info) • Look for local business people and network with people that might want to invest
Pitching	• Know what Angels are looking for in a deal • **Show strong growth prospects**, but don't overdo it; things need to be realistic (investors see hundreds of business plans) • Show **how you think you can make money** and show best / worst cases • Show **compelling idea** (or problem solved) and **competent team** • show an **exit strategy** - angels don't look for lifetime commitment
Working With Angels	• **Need to know how to work with your angel** - some are "hands off", but others aren't • **Read agreement carefully** - see how much power you giving up, and discuss with to get an idea of how they plan to be involved

Closer look: VC funding

What is Venture Capital?

- Venture capital (VC) is similar to Angel investing with a few significant twists - mainly in that a VC is usually a company and not an individual person
- Amounts: funding amounts are much higher - average VC investment can range from ~$2mn to ~$10mn (depends on type and stage of company)
- VC's look for ~10x return over a time period of about five to eight years
  - Typical fund raises money for a specific time period; it invests in a 'portfolio' of companies, and try to grow them; later selling them for a profit. The fund later repays the initial investors
- Popular areas for VC Money:
  - Software is the most popular by far given it's ability to scale fast
  - Biotech, Energy and Medical devices are also large areas of investment
- There are VC firms all over the country / world (with a heavy presence in California)

Closer look: VC funding

	Key points
Pros	• **Growth** – the average VC deal is ~5 to 10x larger than angel investments • **Not a 1 time investment** - Can raise large amounts of money from VC's multiple times • **Not a loan** - There is no repayment to VC's and there are no personal guarantees • **Capabilites** - Very useful to have experienced investors, as they bring both money and strategic thinking, as well as proven tactics and reliable networks
Cons	• **Difficult to raise funds** – must meet VC criteria of driving spectacular growth in a specific time period • **Controlling spending –** VC's can write some very big checks, making sure money isn't spent on low-value-add activities / people / equipment is a real challenge for some • **Loss of Control** – The agreement signs over a share of your company and usually gives VC's a place on the management team / board of directors – you're not the sole decision maker anymore • **Conflict of Interest – VC's** are on a strict timetable and want to exit the business with a particular return by a particular date

Closer look: VC funding - Strategies

	Key points
Finding a VC	• Approach a list of several funds • Ask google for "Venture capital firms in <YOUR LOCATION>"; or check out this list
Making the pitch	• **VC's** get thousands of pitches • Need to work hard to get a meeting as the numbers are huge; ideally use your network or get an introduction • Successful pitches don't get you money, but they do get you further discussions which might lead to money • Successful pitches show your company has a good team, a clear plan, and strong growth potential; get the point across quickly and clearly
Working with a VC	• If successful in making them interested; need to agree on amount and terms • Important to set valuation (determines VC's share) • Once agreed, a "term sheet" is created, this lists the agreement's key points • VC will also do "due diligence" – they will investigate your company in detail to check that all the information you've provided is accurate. • Money might be divided into "tranches" – aka portions of money that are gradually given to you depending on whether your company meets its targets

Financing Pathways – two other options relevant for larger firms

- **Private Equity –** PE firms focus on more mature firms
  - PE deals are typically large (e.g. $500 mn to $5 bn)
  - This option is for larger companies and the deal structures are different
  - PE firms expect a large stake in the business and they definitely expect board and management seats

- **IPO –** is the process when a private company changes to a public company.
  - Public meaning that anyone (people or companies) can now buy shares via public means (i.e. brokerage accounts)
  - IPO's also allow companies to raise money, but this time from a larger audience

Summary

Key points:

- There are many different financing pathways:
  - Self-funding
  - Relying on debt
  - Crowdfunding
  - Angel investors
  - Venture capitalists
- It’s important to think about which might be the best “match”
  - Consider how you’ll find the type of financing you’ve chosen, the strategy for managing this type of financing, and how you’ll use it going forward

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