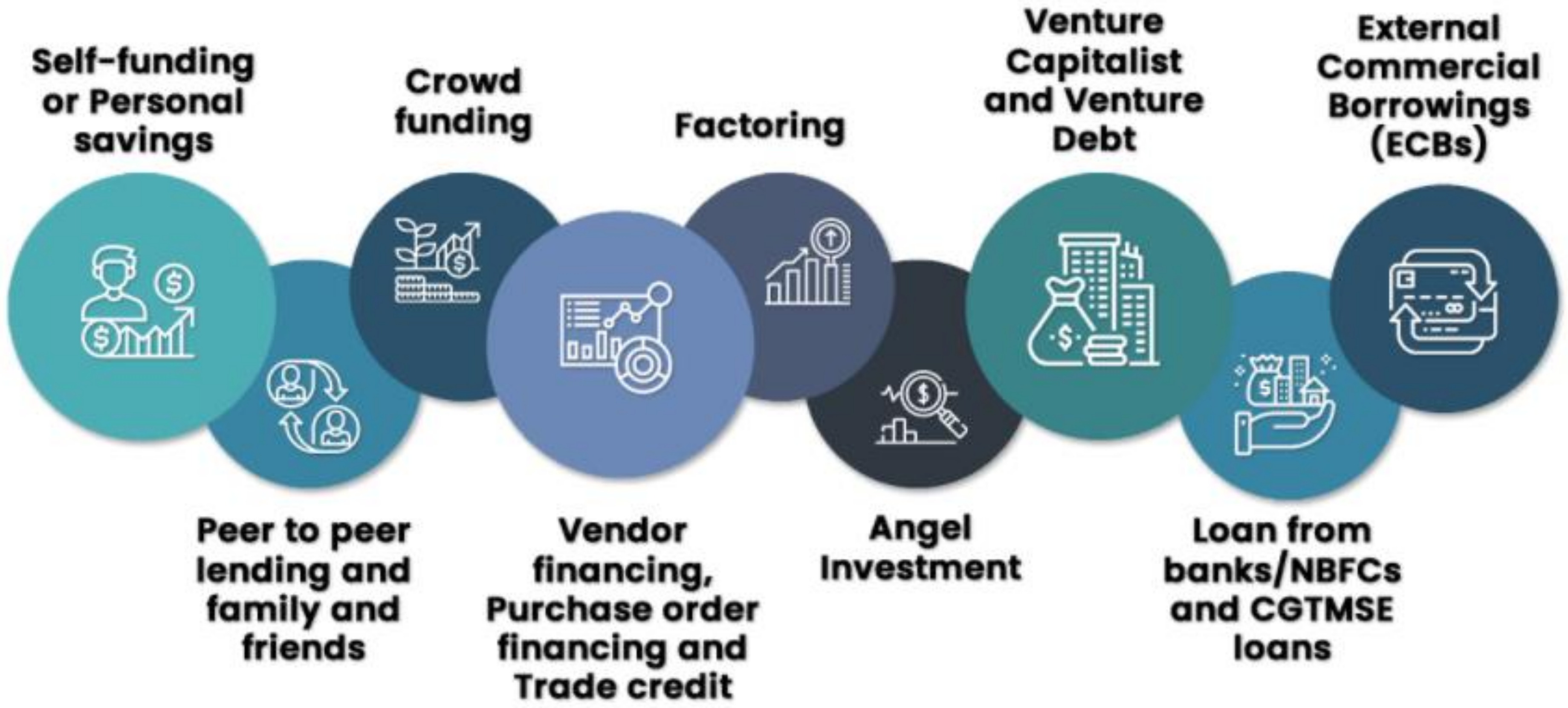
Financing choices for startups

Most common start-up finance options -1/2

- Start-up finance is needed by every newly established business to gain access to capital, whether it is for funding of product development, acquisition of machinery and raw materials, or meeting administration costs such as paying salaries to its workers.
- As banks are less likely to give loans for start-up finance, most entrepreneurs go for innovative measures to fund their business needs.
- Also, in the case where small business's capital needs do not qualify for a traditional bank loan, there are a number of alternative financing methods which can bridge the gap of funds in SMEs

Most common start-up finance options -2/2



Most common start-up finance options

1. Self-funding or Personal savings

- Most budding entrepreneurs never thought of saving any money to start a business or to propel their small businesses in the right direction. However, personal financing can play a vital role. Some important points to note here are:
  - Self-funding is all the more important because outside investors will not put money into a deal if they see that the owner himself has not contributed any money through personal sources.
  - Personal credit lines, such as credit cards can also play a crucial role.
  - But banks are quite cautious while offering personal credit lines to entrepreneurs, and they provide this facility only when the business has enough cash flow to repay the line of credit
- **Bootstrapping:**
  - An individual is said to be bootstrapping his business when he or she attempts to find, nurture and build a company from personal finances or from the operating revenues of the new company.
  - A common mistake made by most new entrepreneurs is that they make unnecessary expenses towards marketing, offices and equipment they cannot really afford. So, it is true that more money at the inception of a new business often leads to unwise and wasteful expenditure.
  - On the other hand, investment by startups from their own savings leads to a cautious approach. It curbs wasteful expenditures and enables the promoters to follow a well-planned approach all the time.

Most common start-up finance options

2. Peer to peer lending and family and friends

People in close family and friends who generally believe in you would provide you help without even thinking that your business idea works or not. Similarly, **peer to peer lending** has also been there for many years. Some important points to note in this type of start-up finance are:

- The loan obligations to friends and close relatives must always be in writing as a promissory note or otherwise.
- Under peer to peer lending, a group of people come together and lend money to each other.
- Many small and ethnic business groups having similar faith or interest generally support each other in their start-up endeavors.
- Loans availed through peer to peer lending should also be strictly businesslike.

Most common start-up finance options

3. Crowd-funding

Lately, crowd-funding has emerged as one of the most popular start-up finance techniques through which small amounts of capital from a large number of individuals are raised to finance a new business initiative. It is a technique that makes use of the easy accessibility of vast networks of people through social media and crowd-funding websites to bring potential investors and budding entrepreneurs together. Some important points to note in this type of start-up finance are:

- Crowd-funding allows anyone with a clear vision and strong business plan, including entrepreneurs, to raise money for their project or venture.
- Crowd-funding platforms allow businesses to pool small investments from several investors instead of seeking out a single investment source.
- The entrepreneur is required to share his business plan and objectives with a large group of people hoping that enormous donations will eventually lead to the generation of desired funds.
- Some of the popular crowd-funding sites are Indiegogo, Wishberry, Ketto, Fundlined, Kickstarter, RocketHub, DreamFunded, and Catapooolt.
- Marketing benefits also reap in along with the raising of a start-up loan through crowd-funding. It provides validation of a business idea by many potential future customers for the new business


How crowdfunding for small businesses works
1
Develop your startup idea.
2
www
Pick your preferred crowdfunding website and register.
3
$
Crowdfund website will scrutinize you for eligibility.
4
Sell your idea to the masses, family, friends, and social networks.
5
Set your crowdfunding campaign rolling.
6
The crowdfunding campaign closes once its window of time ends.
7
$
The crowdfunding website subtracts its operation fee and you receive your amount.
8
Reward your supporters and contributors with services or product samples.
9
Actualize your startup idea.
FinancesOnline
REVIEWS FOR BUSINESS

What are the different crowdfunding models?

EQUITY-BASED

For financial return

Sale of registered security by mostly early-stage firms to investors.

REWARD-BASED

For non-monetary rewards

Donors have an expectation that recipients will provide a tangible (but non-financial) reward or product in exchange for their contribution.

LENDING-BASED

For financial return

Debt-based transactions between individuals. Mostly unsecured personal loans.

DONATION-BASED

For philanthropy or sponsorship

No legally binding financial obligation incurred by recipient to donor; no financial or material returns are expected by the donor.

Source: Colins et al. (2013)

Most common start-up finance options

4. Vendor financing, Purchase order financing and Trade credit

- Vendor financing or trade credit takes place when many manufacturers and distributors are convinced to defer payment until the time the goods are sold. It is a form of credit allowed to businesses from their vendors or material suppliers so that they can make delayed payment to them. This means extending the payment terms to a longer period for e.g. 30 days to 45 days or 60 days. Trade credit is one of the most important ways to reduce the amount of working capital one needs.
- The most common scaling problem faced by SMEs and startups is the inability to secure a large new order. The reason is that they don't have the necessary cash required to produce and deliver the product. Here, purchase order financing companies play a role and often advance the required funds directly to the supplier. This allows the transaction between the start-up and its supplier to complete and profit to flow up to the new business.
- Moreover, when a person is starting his business, suppliers are reluctant to give trade credit. They will insist on payment of their goods supplied either by cash or by credit card. However, a way out in this situation is to present a well-crafted financial plan. The owner or the financial officer has to be explained about the business and the need to get the first order on credit in order to launch the venture

Most common start-up finance options

5. Factoring

Factoring is a financing method where **accounts receivables of a business organization are sold to a commercial finance company (called the 'factor') at a discount with a view to raising capital.** The factor then gets a hold of the accounts receivables of the business organization and assumes the responsibility of collecting the receivables as well as doing the associated paperwork in receivables management. Some important points in factoring are:

- Factoring can be executed on a non-notification basis, which means that the customers may not be told that their accounts have been sold.
- The process of factoring may reduce the costs for a business organization, associated with maintaining accounts receivable such as bookkeeping, collections and credit verifications.
- In addition to reducing internal costs of a start-up business, factoring also frees up the money that would otherwise be tied in accounts receivables.
- Factoring can be used as a tool for raising money for start-ups and keeping their cash flowing.

Most common start-up finance options

6. Angel Investment

Also known as informal investors, angel funders, private investors, seed investors or business angels, **angel investors** aid in providing start-up finance. They are affluent individuals who inject capital for budding start-ups in exchange for ownership equity or convertible debt. Some of the important features of the **angel investment** are:

- Angel investors are more concerned with helping start-ups take their first steps, rather than the possible profit they may get from the business.
- Angel investors prefer to take more risks in investment for higher returns.
- Most often, angel investors are among an entrepreneur’s family and friends.
- Angel investors typically use their own money.
- They can also provide mentoring or advice alongside capital.
- They may represent individuals, a limited liability company, a business, a trust or an investment fund, among many other kinds of vehicles.

ANGEL INVESTORS

- An angel investor is typically an individual or a high worth individual investor who provides funding or financial support for start-ups in lieu of a stake in ownership in the company.
- They are usually among the family or relatives of the entrepreneur.
- Apart from investing money, angel investors share their knowledge at the critical stages.

ADVANTAGES

- Financing from angel investment is much less risky than taking loans.
- Capital needs are met by angels
- Generate large number of jobs
- Reinvests the return
- Angels bring portfolio expertise such as business acumen, vertical expertise, director service etc.
- Angel-funded firms are likely to survive at least four years
- Angels do not demand high monthly fees

IMPORTANCE

- ✓ Plays vital role in development of economy.
- ✓ More focused on commitment and passion of the founders
- ✓ They provide loans on relatively easier interest rates, unlike venture capital.
- ✓ They make a prominent difference with a startup's success and failure.
- ✓ They also look for defined exit strategy or acquisitions or initial public offerings (IPOs).

CONS

- There is a loss of complete control as an owner.
- It is quite hard to find a suitable angel investor
- They provides less structural support than an investing company.
- Angels rarely make follow on the investments
- There is a possibility of malpractices in angel investing.

Typical Sources of Angel Investment includes :

- Family and Friends,
- Wealth of Individuals,
- Groups and
- Crowd funding.

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- These angels are often a key source of early-stage investment and are very active in the first round of investment, or the seed stage
- While angels will invest at various points in time, they usually invest in the early rounds and often don't participate in future rounds
- There are specific Securities and Exchange Commission (SEC) rules around accredited investors, and you should make sure that each of your angel investors qualifies as an accredited investor or has an appropriate exemption
- As super angels make more investments, they often decide to raise capital from their friends, other entrepreneurs, or institutions. At this point the super angel raises a fund similar to a VC fund and becomes a micro VC.

Most common start-up finance options

7. Venture Capitalists

Venture capital means professionally managed funds made available for startup firms and small businesses with exceptional growth potential. Venture capital is money provided by professionals who alongside management, invest in young, rapidly growing companies that have the potential to develop into significant economic contributors. Some of the important features of venture capital are:

- Venture capitalists usually finance new and rapidly growing companies, purchase equity securities, assist in the development of new products or services, and add value to the company through active participation.
- The relationship one establishes with a VC can provide an abundance of knowledge, industry connections and a clear direction for the business.
- Venture capitalists take care of pooled money from many other investors and place them in a strategically managed fund.
- Venture capitalists are experienced in the process of preparing a company for an initial public offering (IPO) of its shares onto the stock exchanges or overseas stock exchange such as NASDAQ


What is venture capital?
Super Idea!!
Sam
Asks bank for loan
BANK
Rejected
Sees venture capitalist
Sue
$
Sue likes Sam´s idea and invests $1m.
Sam Inc. created
Sue owns 60%
Sam owns 40%
Sams's Product
Sams's Product
Sam's products sell super well.
Sue decides Sam's products have peaked.
Sam Inc. sold
For $25m


Venture Capitalist
Somebody who invests in a business venture
IDEA
Sam
Sam asks his bank for a loan
BANK
Rejected
"Here's $1m, but I want 50% of the firm."
Auntie May is rich
He asks Auntie May for a loan
$
$
Auntie May has become a venture capitalist

What Is Venture Capital?

- Venture capitalists:
  - **Raise** pools of capital from institutional and individual investors
  - **Finance** new and rapidly growing companies;
  - **Purchase** preferred equity securities and **take board positions**;
  - **Add value** to the company through active participation;
  - **Take** higher ***risks*** with the expectation of higher rewards;
  - Have a **long-term** orientation
  - **Make $$$** by via M&A or IPO liquidity events

What is Venture capital?

- Money provided by investors to start-up firms and small businesses with perceived long-term growth potential.

- It is a very important source of funding for start-ups that do not have access to capital markets.

- It typically entails high risk for the investor, but it has the potential for above-average returns. Most venture capital comes from a group of wealthy investors, investment banks and other financial institutions that pool such investments or partnerships.

- This form of raising capital is popular among new companies or ventures which cannot raise funds by issuing debt.

VENTURE CAPITAL

Venture Capital is a mechanism wherein investors support entrepreneurial talent by providing finance and business skills in order to obtain long – term capital gains by exploiting market opportunities.

ADVANTAGES

- Opportunity for Expansion of Company
- Valuable Guidance and Expertise
- Helpful in building networks and connections
- No obligation for repayment
- Venture Capitalists are trustworthy
- Easy to locate

DISADVANATAGES

- Dilution of Ownership and Control
- Early Redemption by VC's
- VC's take a long time to decide
- Approaching a VC can be tedious
- May require high Return on Original Investment
- May release the funds from time to time
- May lead to under-valuation

Venture Funding

Venture funding is a funding process in which the venture funding companies manage the funds of the investors who want to invest in new businesses which have the potential for high growth in future.

Venture Funding Stages

Stage 1: Seed Capital

Stage 2: Startup Capital

Stage 3: Early Stage/ Second Stage Capital

Stage 4: Expansion Stage

Stage 5: Bridge / Pre IPO Stage

Venture Funding Round

1. Seed Funding
2. Series A
3. Series B
4. Series C

The Syndicate

- While some VCs invest alone, many invest with other VCs. A collection of investors is called a syndicate
- The syndicate includes any investor, whether a VC, angel, super angel, strategic investor, corporation, law firm, or anyone else that ends up purchasing equity in a finance
- Most syndicates have a lead investor . Usually, but not always, this is one of the VC investors. Two VCs will often co-lead a syndicate, and occasionally you'll see three co-leads.
- Be careful of too many cooks in the kitchen. In the past few years, the idea of a party round, where many investors make relatively small investments at the early stage, has become popular.

Innovation: The Path to Wealth Creation and What Venture Capital Is All About

- Major innovation based on new technology and new product development that address new needs or meet existing needs help organization to create wealth continuously.
- Wall Street darlings—companies like Microsoft, Alphabet (the parent of Google), and Facebook—were yesterday's venture capital– funded startups. These companies understand that major innovation must never stop.
- Look at the publicized innovation efforts of Alphabet (now pursuing self-driving cars), Tesla owner Elon Musk (racing to commercialize space travel), and the major pharmaceutical and biotech firms creating new cures for diseases that won't go away
- Automotive companies such as Volvo and BMW have established formal venture capital arms
- The biggest wealth creation opportunity—for both entrepreneurs and the investors who back them—is through market changing innovation commercialized by new ventures

Huge opportunity areas for future innovation and new wealth creation

1. Advanced materials
2. Artificial intelligence
3. Big data and predictive analytics
4. Biological computers
5. Biomedical
6. The conquest of aging
7. The genome
8. Immunology
9. The Internet of Things and of Everything
10. Nanotechnology
11. Robotics
12. Virtual reality

Firm Selection by Venture Stage Focus-1/4

- Let’s start with the stage in a venture’s growth and maturation.
- **Seed Stage**:
  - In this stage, a relatively small amount of capital is provided, usually to prove a marketplace/product concept.
  - This stage usually involves market research and product development and then, assuming going-in hypotheses are borne out, beginning to build a management team and business plan
  - The funding for this stage, which typically comes after the entrepreneur has maxed out his or her credit cards and contributions from family and friends, is often sourced from individual angels and angel groups.
  - However, it is also sometimes pursued by professionally managed venture capital firms, particularly firms that may be interested in investing in subsequent financing rounds if venture progress justifies that.
  - This is what we meant when we said the line between venture capital firms and angel groups isn’t always clear.
  - Why would someone invest at such an early stage? Perhaps because it is the ultimate bargain; the venture’s share price is inevitably lowest at this stage, so potential gain is greatest.
  - But this stage is really not for the faint-hearted, as less is known about the venture so early in its development and so uncertainties are greatest at this initial stage

Firm Selection by Venture Stage Focus-2/4

- **Early Stage (Post-Seed):**
  - Think about the process of venture maturation as being like a funnel
  - The majority of the seed stage ventures will never even reach this post-seed early stage
  - For those ventures that pass this screening stage, their share prices will be higher than at the seed stage.
  - Risks and uncertainties, while still great, will have diminished some. The probability of a positive return, while still pretty low, will be greater than before
  - Financing needs at this stage are usually greater than at the seed stage, typically in the $0.5–$5 million range.
  - This is where venture capital firms usually take over from the angels. At this stage, the venture generally is approaching product development completion and is focused on market testing or pilot production, with product refinement often still ongoing

Firm Selection by Venture Stage Focus-3/4

- **Expansion Stage:**
  - At this stage, the venture usually is being actively sold in the marketplace.
  - The venture may already be profitable, but require substantial funds for rapidly growing receivables, inventories, and perhaps increased production capacity as well.
  - Alternatively, the venture may still be operating at a loss while investing aggressively in envisioned substantial long-term growth.
  - Risks are likely still great enough that a conventional lender like a bank is generally not viable.
  - The dollar magnitude of financing rounds continues to increase at this stage, typically to the \$5–\$25 million range.
  - Some venture capital firms focus most of their dollars on this or even later financing stages. The larger the financing round, the more likely the money will come primarily from institutional investors and the less access individuals will have.
  - Firms still working primarily with individual investors may, however, participate as well at this stage, sometimes in support of ventures they funded earlier and that still hold attractive promise

Firm Selection by Venture Stage Focus-4/4

- **Late Stage:**
  - At this point, the likelihood of marketplace sustainability is greater, even if ultimate growth potential is still uncertain.
  - This is where the dollars sought for investment get really large, sometimes even in the hundreds of millions of dollars, as the business may need substantial investment capital for rapid growth and timely market domination.
  - At this stage, the venture may already be large and sometimes even well known, but its owners believe its value will be still greater as it more closely approaches longer term potential.
  - Think about companies like Uber, Airbnb, and others that have already become household names but that still seek further investment to realize their full potential. Share price is usually considerably higher at this point, as the risk of total failure and total loss is considerably less.
  - Participation at this stage is generally limited to the major institutional venture capital firms catering primarily to institutional investors with the capacity to meet the much greater investment need.
  - Historically ventures had exited from the venture capital realm by this stage and pursued an initial public offering (IPO)

Most common start-up finance options

8. Loan from banks/NBFCs and CGTMSE loans

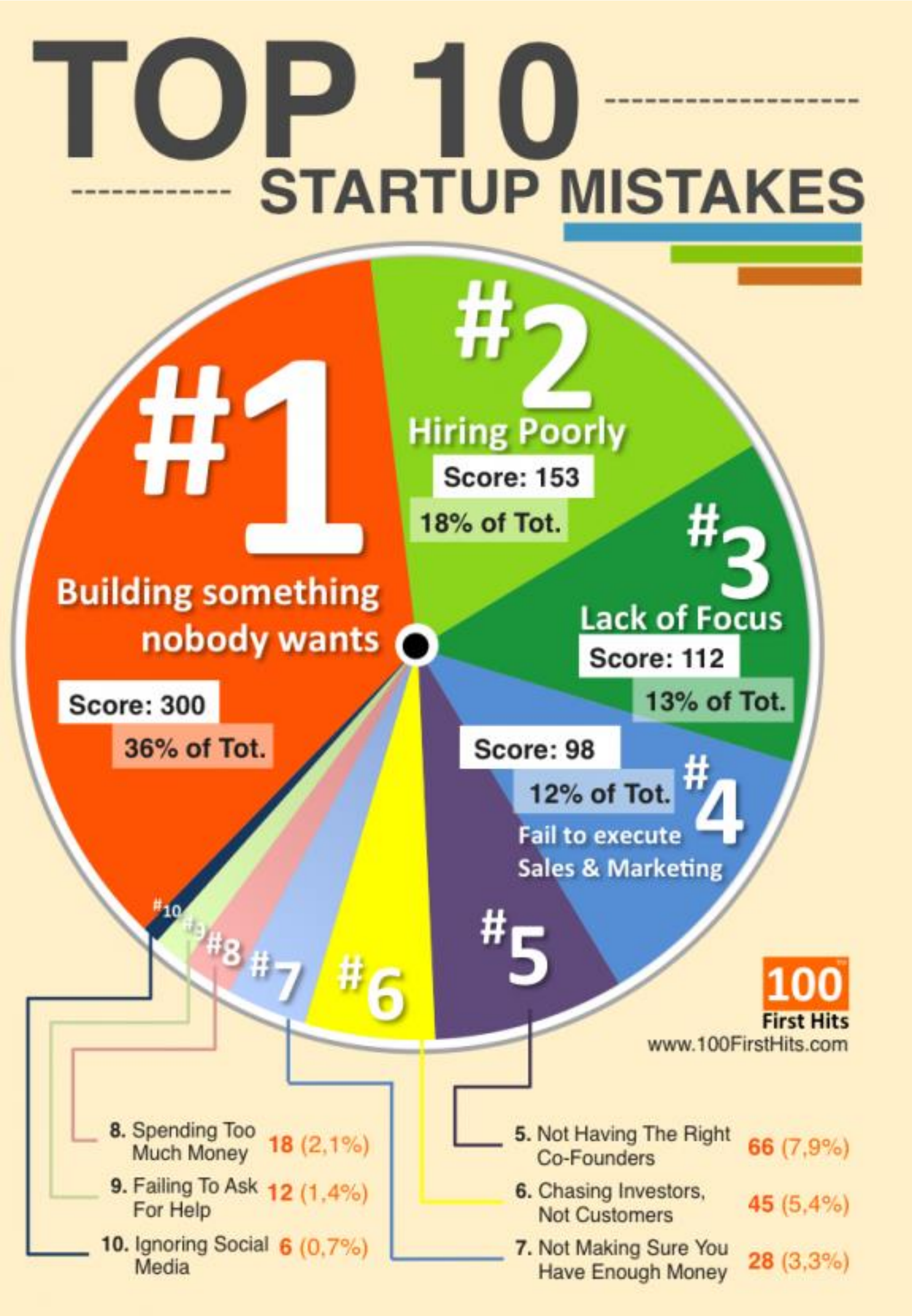
Some common loans available specifically for start-up finance include Growth Capital and Equity Assistance Scheme by SIDBI, microloans, equipment financing, **MUDRA loan scheme**, Bank Credit Facilitation Scheme, etc. Banks and Non-Banking Finance Companies (NBFCs} are different from angel investment and venture capital. They do not become the owner after granting the loan. They provide loans to fulfil various business needs, such as:

- Inventory and equipment purchase
- Arrange opening capital (working capital) to carry out functions smoothly
- Fulfil fund requirement for the expansion purpose
- On the flip side, there are some drawbacks of the funding option also like there is a requirement of making payment of interest on loan periodically irrespective of the growth of your business venture. Apart from this, bankers may also ask for substantial collateral money and good credit rating along with the fulfilment of prescribed terms & conditions.
- **CGTMSE Loans**: In order to encourage entrepreneurs and start-ups, the Ministry of Micro, Small & Medium Enterprises (MSME), Government of India has launched the Credit Guarantee Trust for Micro & Small Enterprises.
- Without collateral or surety, the loan can be availed up to Rs. 1 crore. Fresh as well as existing MSMEs can obtain a loan from all scheduled commercial banks and specified Regional Rural Banks and those authorities which entered into an agreement with the Credit Guarantee Trust. For choosing this option, you have to check the eligibility criteria first, however, under this scheme, both new and existing micro and small enterprises including service enterprises are eligible for a maximum credit cap of Rs. 200 lacs.

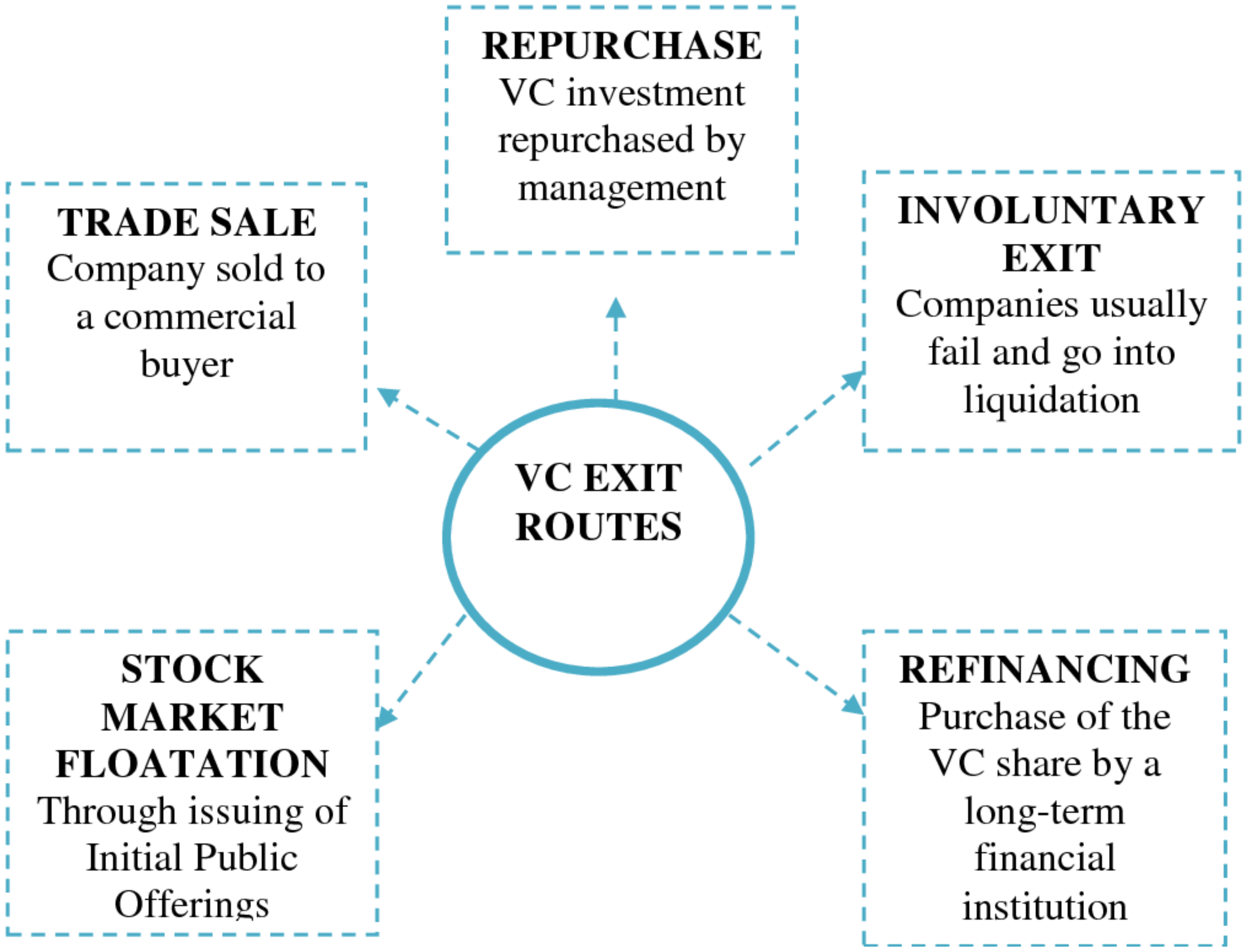
Most common start-up finance options

9. External Commercial Borrowings (ECBs)

- The other main option for funding of start-up is External Commercial Borrowings (ECB). Under this, funds can also be raised from non-resident lenders in the form of **External Commercial Borrowings.** The minimum average maturity period for the ECBs raised by start-ups shall be 3 years. External Commercial Borrowings can be procured in the below-mentioned forms:
- Bank loans
- Buyers'/Suppliers' credit
- Financial Lease
- Foreign Currency Convertible Bonds (FCCBs)
- Securitized instruments such as non-convertible, optionally convertible or partially convertible preference shares, floating rate notes and fixed rate bonds, etc.
- In India, External Commercial Borrowings can be done from two routes, namely, Automatic Route and Approval Route. It may be noted that except FCEBs (permitted only under the approval route) all other forms of ECB can be availed of both under the automatic and approval routes. The ECB framework depends on factors like eligibility of borrower and recognized lender, amount of ECB availed, average maturity period, etc.



TOP 10
STARTUP MISTAKES
#1
Building something nobody wants
Score: 300
36% of Tot.
#2
Hiring Poorly
Score: 153
18% of Tot.
#3
Lack of Focus
Score: 112
13% of Tot.
Score: 98
12% of Tot.
#4
Fail to execute Sales & Marketing
#5
#6
#7
#8
#9
#10
100
First Hits
www.100FirstHits.com
8. Spending Too Much Money 18 (2,1%)
9. Failing To Ask For Help 12 (1,4%)
10. Ignoring Social Media 6 (0,7%)
5. Not Having The Right Co-Founders 66 (7,9%)
6. Chasing Investors, Not Customers 45 (5,4%)
7. Not Making Sure You Have Enough Money 28 (3,3%)


REPURCHASE
VC investment repurchased by management
TRADE SALE
Company sold to a commercial buyer
INVOLUNTARY EXIT
Companies usually fail and go into liquidation
VC EXIT ROUTES
STOCK MARKET FLOATATION
Through issuing of Initial Public Offerings
REFINANCING
Purchase of the VC share by a long-term financial institution

What is Venture Lending?

- **Venture Lending** could be any form of debt financing provided to a company which is venture backed financing.
- **Venture Lending** is provided by specialized banks or non-bank funds and used to fund working capital or equipment purchases.
- **Venture Lending** providers combine their loans with warrants, or rights to purchase equity, to compensate for the higher risk of default.
- Venture loans can provide a young company the extra time and resources needed to reach major product or customer milestones.

SVB presentation: Venture Debt – Maximizing Its Value in the Current Environment, February 23, 2004

VD VS VC

VENTURE DEBT

- Keep Full Control
- Less Advice
- Must have Over £1m Turnover
- More Profit Share

VENTURE CAPITAL

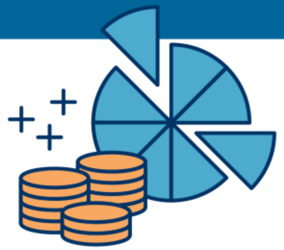
- Loss of Equity
- More Advice
- Must have Big Earning Potential
- Less Profit Share

FUSE CAPITAL

Why Venture Debt?

Less Equity Dilution

Venture debt doesn’t require giving away much equity, meaning founders can retain more of their company while still raising capital.



Extends Cash Runway

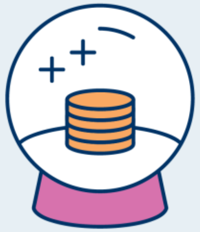
Startups sometimes use venture debt to quickly raise cash to help hit milestones between raising equity rounds.

More Adaptability

Venture debt can support startups facing short-term challenges or unexpected market conditions.

Helps Avoid Down Rounds

Some companies use venture debt to put off raising additional equity rounds until they’re in a position to gain more favorable terms (like a bigger valuation).



TYPES OF VENTURE DEBT

There are three main types of venture debt structures: