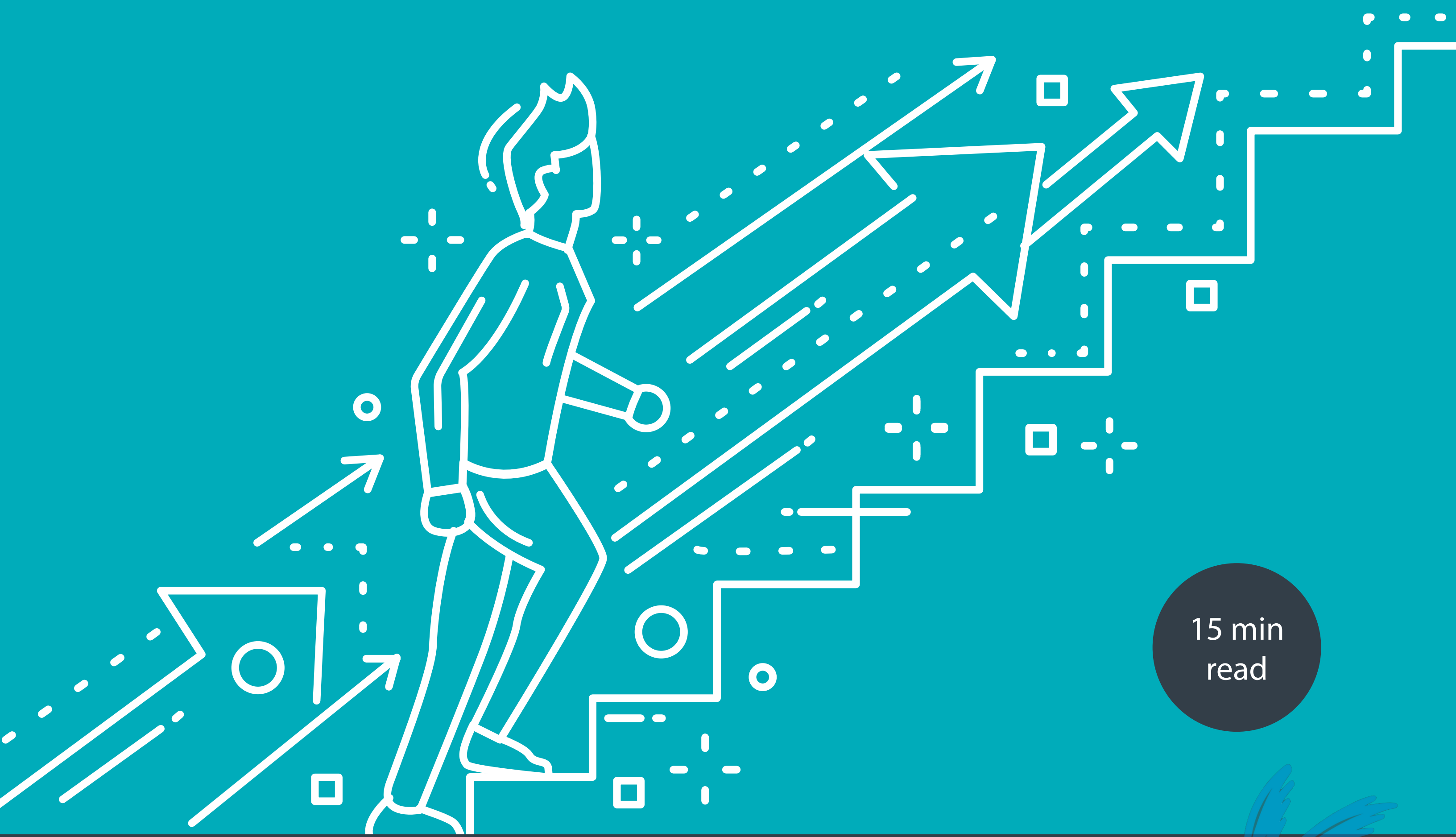
Standard Ledger

STARTUP TO STAYUP

THE STARTUP
FOUNDER'S GUIDE TO

Startup funding



15 min read

Prepared by Standard Ledger - dedicated startup accountants in Australia and the UK.

HOW THIS EBOOK CAN HELP YOU

FACT	FICTION
Startups need funding to survive.	Funding grows on trees.

Really, we know you knew that, and we also know you're busy so we'll get to the point.

This ebook is a funding guide for earlier stage startups. You've most likely already put your own money in and maybe you've also done a friends and family round, but now you're planning how to scale up and fund your next stage of growth.

Which is really what startup funding is all about - stages. This ebook covers the full startup funding life cycle from seed to exit, detailing the different funding sources available. Here's a chapter breakdown:

1. The startup funding life cycle
2. Funding sources
3. Real life stories - funding experiences from startups
4. How to prepare for fundraising

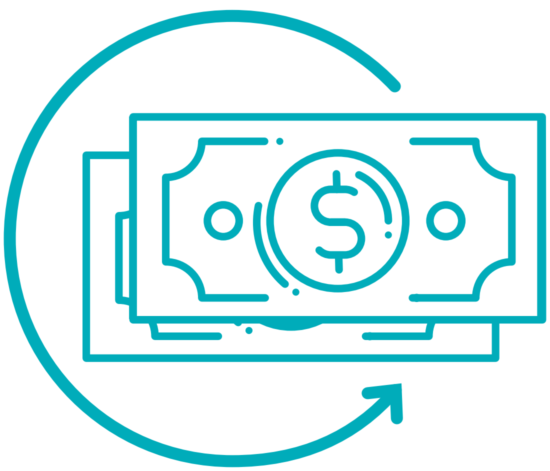
Hang on a minute, why listen to us?

Because we're not typical accountants. Sure, our directors have big accounting firm experience but they've also worked in venture capital firms and at the coal face inside startups (which we love - that's why we're dedicated to them). We get startups, and we believe it's our job to help you understand and access your best funding options.

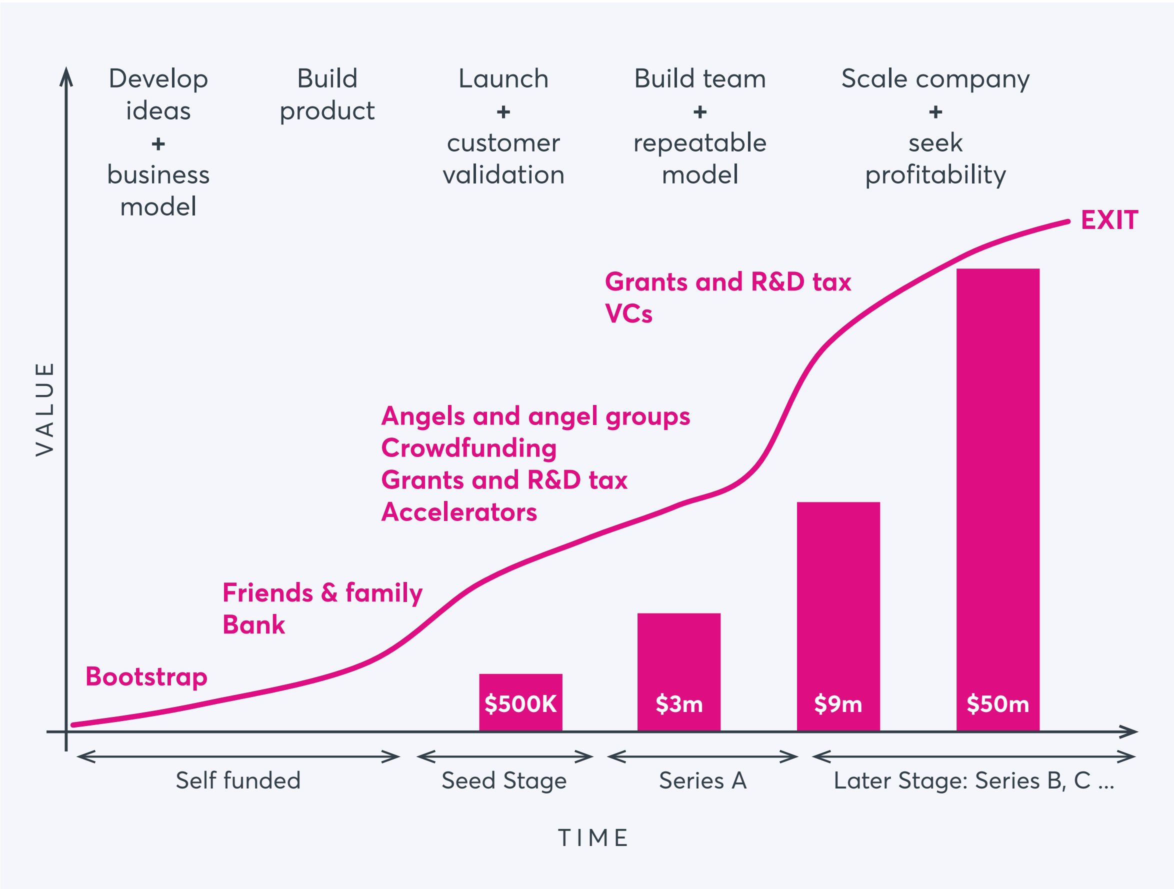
CHAPTER 1

The startup funding life cycle

Understanding the journey



You need funding to survive, so where can you get it? The answer to that often depends on what stage your startup is at. Let's look at a typical funding life cycle for a startup company.



In the next chapter, you'll find a detailed breakdown on each of the startup funding sources shown in the life cycle.

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STARTUP TO STAYUP

To succeed, you need the right people including an accountant who can:

- Help you DIY in the beginning
- Take over when you're ready to scale up
- Help you prepare for and access funding
- Be your virtual CFO
- Help you go from startup to stayup!

Find out how we work with startups or book a call to get started.

standardledger.co

CHAPTER 2

Show me the money

Startup funding sources

In this chapter, we zoom in on the different funding sources available to startups, looking at how they work and what they mean for you as a founder.

Flick back to CHAPTER 1 if you want to see where each funding source sits within the startup life cycle.

Bootstrapping

We won't dwell on this funding source since you're probably already doing it, but just to clarify - bootstrapping is when you use your personal finances and/or operating revenue to fund your startup.

Friends and family

You might have already done a friends and family round too - it is a really common source of funding when you're starting a business. But here are some words of wisdom about this funding source that might help you now or down the track.

Early-stage startup companies often offer friends and family equity based on an inflated valuation that angel and venture capital (VC) investors would not accept. This makes it difficult for an angel or VC investor to come in at a fair value (for everyone) later on.

To avoid this, aim for a fair value from day one. What does that mean? Well, a typical pre-money startup valuation for angels is between $1 million and $3 million. That means a pre-money valuation for friends and family needs to be less than that - usually between $250,000 and $1 million.

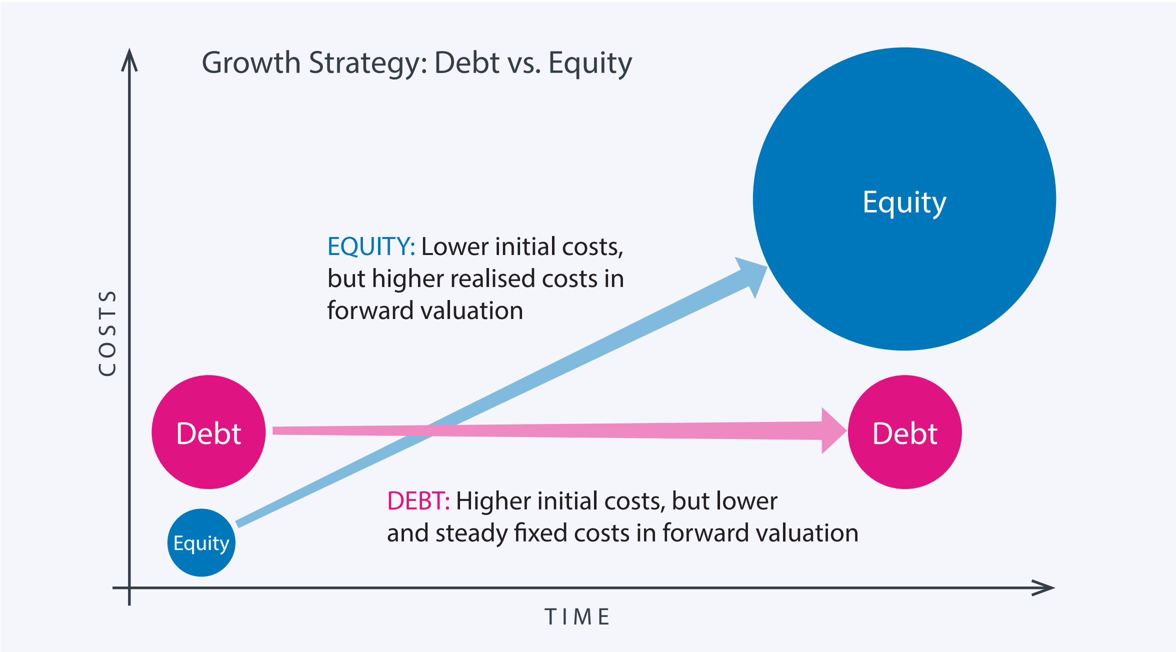
Or, if it's too late for that, you can restructure your startup company when an angel or VC investor comes in. This means reallocating equity among friends and family so that everyone ends up with the number of shares they would have owned if the friends and family investors came in at a fair valuation. This can be quite fraught but hopefully your friends and family will understand that a smaller share of an angel or VC-backed company is usually worth more than a larger share of a startup that doesn't have outside support.

Bank loans

Banks and startups might seem at odds - one is conservative while the other is risky by nature. Some people also have an outright aversion to debt.

Having said that, many banks do offer small business startup loans and they are worth considering for two main reasons:

1. You know exactly how much to budget for since debt is a fixed cost
2. You don't need to give up equity in your company in exchange for it - in that sense, debt is cheap, as this graph illustrates



But in reality, most startup founders aren't in a position to borrow from the bank, because they usually require one or all of the below:

Collateral (such as a mortgage) with a bank

Someone to guarantee your loan (we've often seen parents in this role)

You to demonstrate your ability to repay the loan if your startup fails

Crowdfunding and equity crowdfunding

Reward-based crowdfunding has been around for a while now, with the likes of Pozible, Kickstarter and Indiegogo among the most successful platforms.

Crowdfunding typically suits raising money for a fixed outcome, such as creative projects like films or albums, or not-for-profit community ventures. It's also often used for hardware 'gadgets', such as the Pebble watch and Occulus Rift.

It can be a great way to see if you can get traction before you invest in full manufacturing and distribution. And if you are successful with crowdfunding, it ticks a big box that venture capital investors will want to see further down the track.

Startups can now also use crowdfunding to raise money from the general public in exchange for equity in their venture. This is called equity crowdfunding, and it's legal under certain conditions, including using approved platforms such as Birchal (spun out of Pozible) and Equitise.

Government grants

The great thing about government grants is that they are non-dilutive - you don't have to give up any equity in your company.

Some of the not-so-great things about grants are:

- Application processes can be lengthy and even difficult (and you are not guaranteed to receive the grant)
- You often need to match 25-50% of the funds granted, which means you still have to raise at least that portion of the money before the government will match it
- Some grants give up-front funding but others require you to spend the money and then claim it back

In Australia, there are various options available ranging from grants for small business startups to those launching internationally. They change from time to time depending on government priorities but check out the following, which are particularly suited to startups:

- Accelerating Commercialisation grants
(for when you're bringing products to market)
- Export Market Development Grant
(for when you start to launch internationally)
- Minimum Viable Product grants (New South Wales only)
- Business Development Fund (Queensland only)
- South Australian Early Commercialisation Fund (South Australia only)

It's also worth visiting business.gov.au, which has a lot of information including search tools to find any grant currently available in Australia.

R&D tax incentives for startups (and forward funding)

The Australian Federal Government's R&D tax incentive program is the largest source of funding for startups, probably because it's relatively easy to access.

Unlike grants, the R&D tax incentive is not competitive. If you meet the eligibility criteria, your business is entitled to receive 43.5% of your research and development (R&D) expenses back, as cash.[1]

You don't need to be making a profit but you do need to meet the below criteria:

1. You must have spent at least $20,000 on R&D during the financial year. This can include paying employees and Australian contractors and their costs
2. You must be undertaking R&D activities that fit into either 'core activities' (e.g. a new product, process or service, or a unique adaptation of one) or 'supporting activities' (e.g. manufacturing, testing or marketing the result of the core activity)
3. You must provide activity-based records about your R&D activities (such as plans, meeting notes and research), as well as expenditure-based records (such as timesheets, ledgers and invoices)

It's all tied into your annual tax return so you need to lodge that as well as your R&D claim application. Or have your accountant do it all for you. And don't forget, you can claim the R&D tax incentive every year (as long as you're eligible).

[1] If you're an early stage startup and not yet profitable, you will receive a 43.5% cash refund from the ATO, typically six to eight weeks after lodging the R&D claim and associated tax return. If you're already profitable, your R&D claim can reduce the tax that you'd otherwise be paying.

R&D tax incentive example

You:

- Raise funds to start with
- Spend $100k (for example) on:
  - R&D salaries & on costs
  - Australian R&D contractors
  - R&D "overheads"
- Make a loss
- Submit R&D claim and have it approved by AusIndustry
- Lodge your tax return including R&D schedule
  - Receive $43.5k cash

R&D forward financing

There is an emerging group of financiers who provide forward funding against a future R&D tax incentive claim.

If they believe you're likely to receive your R&D tax refund in the coming year (especially if you've received one previously), they will loan you the money in advance. You then pay it back, once your R&D tax incentive comes in. Some lenders will even lend this quarterly throughout the year, as you spend on R&D.

Clever use of this funding source means you can either accelerate your R&D work or reduce the amount of capital you would otherwise have needed to raise. For founders, this means you get to keep more equity in your startup.

Accelerators

The best thing about this funding source is that you usually get access to some great mentors, with priceless knowledge and invaluable contacts.

The worst thing about accelerators is that they can be very difficult to get into with short application windows, which might not suit the stage your startup is at. And many of them involve giving up equity in your company in exchange for funding. But this is not necessarily a bad thing, as we'll explain below under 'equity investing'.

In balance, they are definitely worth checking out, especially for tech startups. There are government and private accelerators, and this list is a pretty good place to start researching them.

Equity investment (angels and VCs)

This is where funding gets exciting. Really exciting.

But it can also be nerve-wracking because you're now having to answer to outside investors. Expectations are raised and the pressure is on you, the founders, to deliver on them. All while you're selling off portions of your own startup - you can expect to give up anywhere from 10-30% with each equity round.

This can be off putting but would you rather own 100% of something that's worth nothing, or 60%, 40% or even 20% of something really successful?

Think of 'poor' Jack Dorsey who co-founded Twitter and only had 4% of it when it listed. Don't cry though ... it was worth US$400 million.

And that's what equity investing is all about - keeping a smaller piece of a bigger pie. With that in mind, there are two main types of equity investors - Angels and venture capitalists (VCs) - as explained below.

Angels

Angel investors are high net worth people who are already successful in their own right.

They are a common source of early stage funding for startups and because they invest their own money, they are usually personally involved in their investments. If you can find an angel with experience and connections in your space, it's hugely beneficial because of the sales and opportunities they can open up for you.

However, angels are typically private people who can be difficult to find. Your best approach is to use your own personal contacts and get a 'warm' introduction to an angel from someone they respect. If this isn't an option, look to lawyers, bankers and accountants who have these networks. Failing that, you can also try:

- Matching services, like Business Angels, Melbourne Angels, Sydney Angels and Innovation Bay
- Sophisticated investor[2] platforms like VentureCrowd or Equitise
- Investor networks, such as the female focused Scale Investors
- Startup accelerators like Startmate, Bluechilli or industry specific versions like SproutX for agriculture and The Actuator for medtech startups. You'll find there's a healthy network of angel investors who are giving back as mentors behind these accelerators.

Angels typically invest between $25,000-$250,000 as individuals, or $100,000-$1 million when they come together on syndicated deals. Angels might invest via equity or often via a convertible note, which is a short-term loan arrangement that is intended to convert to shares.

[2] A sophisticated investor is a defined term under the Corporations Act for private individuals who are deemed to be "sophisticated enough" to make their own risky investment decisions (as opposed to a general "retail" investor) and who may be approached for raising capital. Sophisticated investors need to have net assets of more than $2.5 million or a gross income of more than $250,000 for each of the last two financial years.

Venture capitalists

This is where things start to get really serious, and when you're typically looking to raise $500K+ for your startup.

Venture capital firms (VCs) are professional managers who run a fund on behalf of their investors. Unlike angels, they're not investing their own funds. In fact, the investment funds behind VCs are mostly from a very small allocation by superannuation funds.

While they sometimes invest in seed rounds for early stage startups, VCs mostly prefer to invest larger sums of money after the seed stage to justify their effort involved.

You might already be familiar with some of the leading names in the VC world, such as Blackbird Ventures, Bluesky Funds and SquarePeg Capital, and you can find a full list of VCs on the industry group - AVCAL's - website.

When looking for VCs, take time to understand the sectors they invest in and the stage at which they usually invest.

Also try to find out if their fund is already fully committed and therefore unlikely to listen to you, or if they have money to spend. This means you need to track them, bearing in mind that they typically operate within a 10 year cycle involving:

Years 1-4: investing in startups

Years 4-10: working with their portfolio companies towards exit

Year 10: returning funds to their own investors and doing their own fundraising for the next cycle

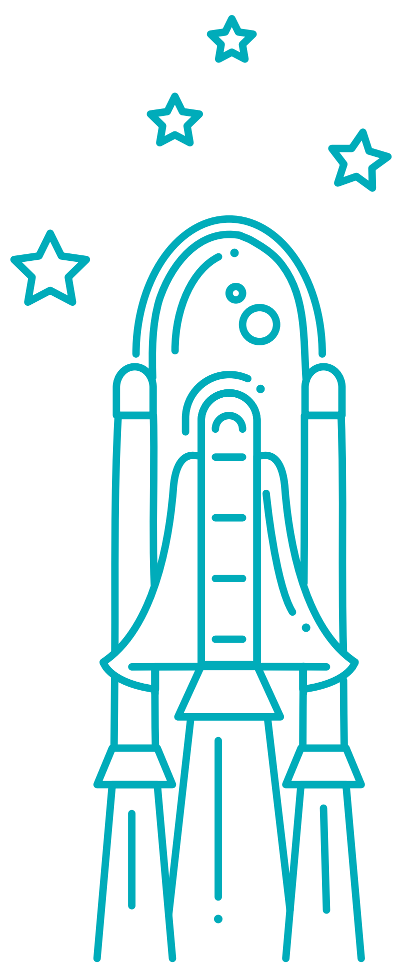
It's also worth knowing that if your startup is going well, they will often want to top up their investment to follow through to exit. Their shareholder agreement will usually give them first right of refusal for follow on fundraising rounds.

Like angels, VCs are much more receptive to being contacted through someone they know. So, get your network on and find someone who knows the VC you want to contact, including other startup founders they have invested in. If you can't do that, you can contact them 'cold', and you will really need to impress them with your pitch.

CHAPTER 3

Real life stories

Fundraising experiences from startups



Talking about capital raising and startups can be sensitive, so we're sharing some stories from real companies we have worked with but withholding their real names for privacy reasons.

VR company gets R&D tax refund

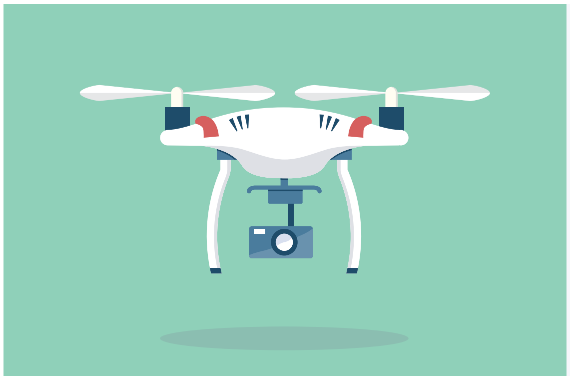
'Frank' and 'Joe' quit their day jobs to focus on their startup, which is developing virtual reality (VR) systems for businesses.

For most of their first year, they survived by drawing down on their mortgages to bootstrap their startup company. While this is the kind of commitment that goes a long way with investors, it means money is tight. They were working in their shed but the cost of equipment and a couple of contractors meant what they did have was dwindling. Fast. They knew they'd be able to demonstrate their tech to some investors interested in the area soon, but they had to survive long enough to reach that goal.

They didn't know that this sort of innovative development in leading edge technology is exactly what the Australian Government wants to encourage through the R&D tax incentive.

Luckily they talked to us, and just in time too. We showed them how the R&D tax incentive works and just before the annual deadline (30 April for the previous financial year), AusIndustry approved their R&D claim. A month later, they received a cash refund of $135,000 via their tax return.

And while they were on a roll, we quickly finished their R&D claim and tax return for the current year so it was submitted as soon as that year ended. Frank and Joe received their second R&D tax incentive refund that September, the same time they received their first customer order. Now they're ready to talk to investors.



Drone company uses R&D forward financing

'Drone Systems' wanted to develop a new product line - drones that could stay in the air longer to monitor long pipelines for leaks or long shorelines for sharks, for example.

CEO 'John' was betting the farm on the opportunity by using cash from the commercial side of the business to fund the new development. It was taking longer and costing more than expected so John was considering seeking outside investment, but he didn't really want to give up equity before the product was further developed so he'd have a better story to tell investors and a better position to negotiate from.

Three months into the financial year, John had already spent $200,000 and was probably going to spend $500,000 more.

His business had received the R&D tax incentive the previous year so it was pretty clear he'd get it again this year. You could almost say it was government guaranteed. Knowing that the $700,000 he was expecting to spend on R&D this year would be eligible for a 43.5% refund through the R&D tax incentive, we talked to John about forward financing this.

We built a cashflow system for his business and worked with one of our financier partners so John was able to receive a loan that paid him cash based on the R&D he'd already done and a facility that he could draw down on quarterly through the remainder of the year.

At the end of the financial year, we submitted the final R&D tax incentive claim, the financiers got paid back and John had built the drone that was suited to long distance flights. Now, he was ready to talk to investors and he hadn't given up any equity to get to that point.

Organic food startup finds a local angel

'Organiks' was an online organic food delivery service in Melbourne's north that had been growing steadily through its passionate followers. Founder 'Mary' was ready to take it to the next stage with marketing, a new ordering system and expansion.

We helped her turn her ideas into a plan, with a financial model showing her how much it would cost. And then as luck would have it, she found out that one of her loyal customers, 'Adrian' wanted to invest in her business, using his retail background to help her grow it.

But neither Mary or Adrian (or his traditional accountant) were experienced in business sales or investing, so we provided them with an independent valuation of the business. From there, they agreed on what share Adrian would have and what that was worth.

As we love to say - 'plan drives numbers' - and from her original idea, Mary has now grown her sales significantly and is talking about expanding further. So … watch this space.

SaaS startup on investor roadshow

'EventX' are an events management platform. Not ticketing - that's the easy part. The platform helps event organisers manage the practical side of putting on large events, especially those with awards, judges and prizes where there are lots of moving parts and people to corrall.

Husband and wife team, 'Tim' and 'Toni', started this Software as a Service (SaaS) platform. Traditionally event management companies charge on a quote and deliver basis, so EventX was trying something new in their space. Tim and Toni also had no experience in SaaS startups making it difficult for them to prepare their investor pitch and startup valuation.

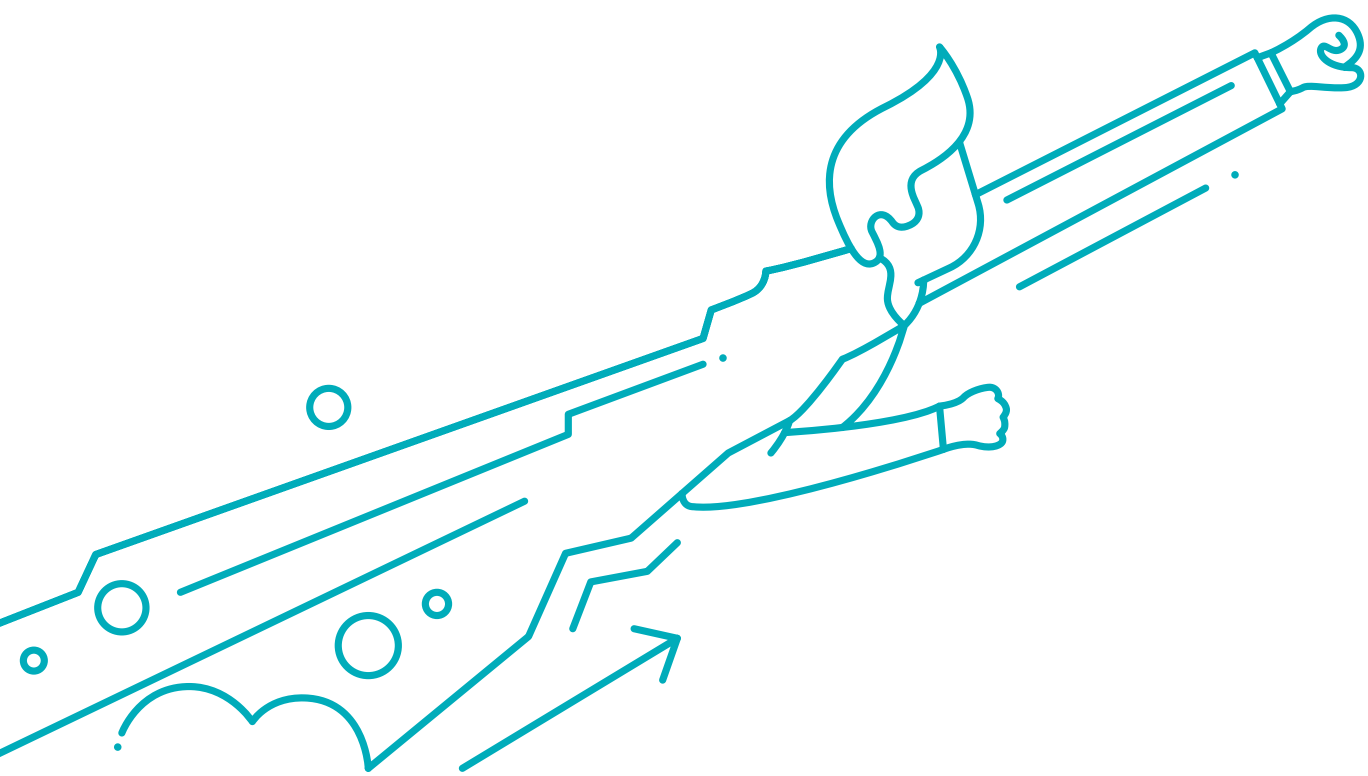
So they asked us to help. We built an investor ready financial model, which has been used as part of a virtual CFO service for a few months now helping Tim and Toni get really comfortable with the financials.

At the time of writing, EventX are on their roadshow with the usual mixed response of "it's not for us", "you're too early" but also a couple of interested seed stage VC investors. It's a marathon not a race, as they say, and we're sure EventX will raise the funds they need to keep growing. And after investment, we'll continue to deliver virtual CFO services to the new Board.

CHAPTER 4

Are you ready for this?

How to prepare for fundraising



Your PRE preparation checklist

You know the figures: Nine out of 10 startups fail. So even before you start preparing for fundraising, take a step back and ask if your business has what it takes. Here are the questions you need to answer.

VALIDATION	What pain do you solve? Do you have an effective solution that customers are willing to pay for? Have you talked to potential customers?
MARKET	What is the market size and scope? Why is now the right time for your startup to succeed? Who are your competitors (there is always competition, even if it's 'do nothing' where users won't change behaviour) Why are you better/different? What is your competitive advantage?
TRACTION	What have you built? What have you sold? What proof do you have that someone wants your product/service?
STRUCTURE	Is your startup's structure simple and easy for investors to buy into? Have you protected your intellectual property? Have you talked to a startup lawyer? (we can vouch for these guys)
PLAN	Do you have a one-page business plan? (e.g. Business Model Canvas) Do you have an operational plan, detailing what you're going to do, when and how?
TEAM	What makes your team the right one to deliver on the plan?
FINANCES	Does your business model show how you're going to charge and make money? Do you have a financial model that shows your operational plan, in numbers?

"Diligence is the mother of good luck."
Benjamin Franklin

Now that you've asked yourself the hard questions (thanks page 21), how do you actually prepare for capital raising?

Very thoroughly. You might even want to put activewear on to make it through this list but it's worth it because without proper prep, you'll be wasting everyone's time.

KEEP IT REAL - Above all, investors want to see real figures and real customers. Use real numbers wherever possible throughout your pitch and grant applications. And if you don't yet have customers, talk to potential ones before you pitch. Don't be so afraid of sharing your idea that you never get it off the proverbial napkin.

COMPANY STRUCTURE - Complicated structures and messy founder relationships turn equity investors off, big time. Keep it simple - we usually recommend a company plus a trust to hold shares in it because it gives you more options at exit time. And yes, there is sense in planning for exit - you just want to make sure it doesn't prevent you raising funds.

PROTECT IP - It makes sense to put confidentiality provisions in your employer and contractor agreements. However, most investors won't sign a non-disclosure agreement (NDA). While most startups are building software products that are not generally otherwise protectable, medtech or biotech startups should talk to specialist IP lawyers about patents where appropriate.

THE RIGHT PLAN - Sure you'll probably use the Business Model Canvas or its cousin, the Lean Canvas, for your initial startup business plan. But sooner or later the rubber hits the road and you need a specific operational plan. Not a 50-page business plan that no one will ever read. It should be 10 pages tops, written in plain language and setting out where you are right now as well as what you need to do, when and how, including numbers. This is what you send to investors if they want more info. You'll also be able to cut and paste a lot of this info for grant applications.

BE DIRECT - You've watched Shark Tank, you know how quick to judge angel investors are. Venture capitalists (VCs) are the same, but worse. And grant assessors aren't ones to wade through reams of writing either. So while it might seem obvious: be flexible, efficient and to the point in all your communications.

PREPARE YOUR PITCH - You never know when one of your networking efforts might pay off and you get a chance to speak to a potential investor, so make sure you have your elevator pitch down pat. That's your spiel about what your business does, covering the two or three unique things about it, all within one minute. You'll also need a standalone 1-2 page version ready to send, and a pitch deck ready to run through face to face.

If you're pitching to VCs, also check out what Square Peg Capital, Fred Wilson, Rocketspace and David Rose have to say.

TEAM - You'll cover this in your pitch deck, just make sure you're clear on why you're kick ass enough to make this opportunity real. Make sure you also know what your team doesn't currently have because investors can often help out with that.

FINANCE - You need to be able to clearly articulate how (and why) customers are going to pay you. What are the unit economics of your offering - how are you charging and what are your corresponding costs, including your cost of customer acquisition.

You'll need a financial model that backs up your operational plan and clearly shows how much money you're looking to raise and what you'll do with it.

And you need to show you're on top of your day-to-day finances and are meeting your tax and legal obligations. Pull out those spreadsheets.

KNOW YOUR ANSWERS - Be ready to give concise answers when asked about your team, the technology, the market, your competitors and your financials. Be aware that investors often ask questions they know the answers to so they can test your knowledge and your ability to answer correctly and concisely. And make sure you do have the answers because saying "I'll get back to you" will likely lose you the opportunity.

KNOW YOUR NUMBERS - Even if numbers aren't your thing, you need to be all over them. You need to know how much you're looking for and be able to explain why you want that much (in other words, how it will be used).

And, the $64 million question … you need to know your startup's valuation. Equity investors will ask: "What valuation are you looking for?" Early stage startup valuation is ultimately a negotiation and not something traditional business valuers or accountants are experienced in. But it is possible to prepare well for this question with the right advice from a startup savvy accountant so that you're not laughed out of the room ...

PRACTICE - You know you need to. In front of the mirror is best. Seriously. Despite any nerves, you have to appear knowledgeable, articulate and passionate.

GET HELP - If you get a chance to pitch to angel or VC investors, you'll only get one shot. Make sure you have some startup savvy legal and accounting advisors around you ready to help with your valuation and the term sheet, which will lay out the basis of the deal.

This ebook was written by ...

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Remco is not your typical accountant, which is why he founded Standard Ledger. His career combines multinational experience in firms like Accenture and PricewaterhouseCoopers, with experience at the coalface as CFO for his own startups and as virtual CFO to others. He has been doing the latter for 10 years, following four years in venture capital. During that time, he has helped raise and invest more than $40 million. Remco also teaches entrepreneurial finance topics at General Assembly and for Swinburne and Adelaide universities.

Standard Ledger

Standard Ledger is as passionate about startups as you are. We know entrepreneurs need accounting services that scale as they grow. We know you need an accountant who does more than ticking boxes at tax time, like help with valuations, capital raising, financial modelling and other virtual CFO services. And we know you can't stand hidden fees or locked-in contracts. That's why we are committed to fixed, open and transparent pricing. Along with our sister legal firm, General Standards, we are exclusively focused on startups - together, we can look after all your accounting and legal needs.

Are you thinking of fundraising soon?
We're happy to chat.

Email us with a question
or book a meeting online.

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