Capital and Capital Sources

THE CAPITAL MANAGEMENT PLAN

- Capital formation in the context of the co-venturing paradigm : raising capital from external sources comes with a cost, That cost can be a percentage of equity ownership or in the form of an inflexible obligation to make payments to service debt.

- It is imperative that the technology entrepreneur, (the founder of a venture) develop a plan to minimize the impact of raising capital on retained ownership and control, and the ability to manage cash flow in the venture.

- This capital management plan should address four basic issues:

✓ Whether to **self-fund or seek capital from external sources;**

✓ If external capital is sought, what type of capital (e.g., debt or equity) to seek;

✓ When to seek capital; and

✓ How much capital to seek.

SELF-FUNDING

- Self-funding, permits to avoid the cost of external capital, as well as various potential securities laws considerations.
- However self funding does not determine whether or not sufficient funds can be amassed.
- Even if self-funding is a viable option, the various reasons for the principals of the venture to use external capital are:
- ✓ to share the risk entailed in capitalizing the venture;
- ✓ to leverage their funds to permit them to pursue other opportunities; or
- ✓ to take advantage of particularly advantageous valuations of the venture .

- Self-funding thus is simply not a realistic options , in many options.

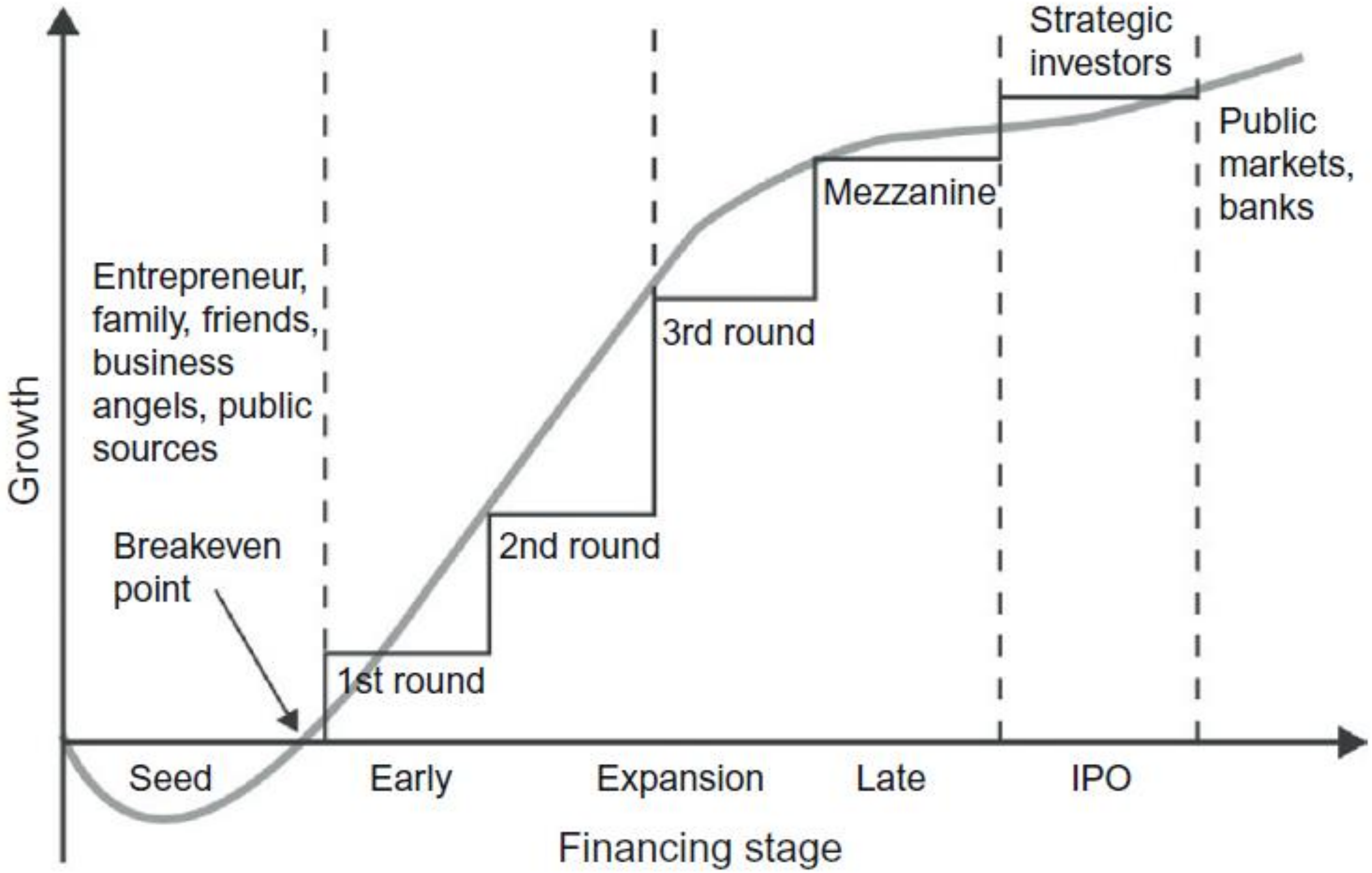
EXTERNAL CAPITAL

- Capital is categorized into two basic types :

  Equity or Debt.
- **Equity financing entails “selling” an ownership interest** in the venture. A capital contribution is made by an equity investor in return for a percentage of ownership.
- **Debt financing involves taking out a loan** or selling “bonds” to raise capital; the venture gets the use of the lender’s money in return for a relatively inflexible obligation to repay the money plus an additional fee (interest).

VENTURE FINANCING STAGES

Including Initial public offering (**IPO**) or **stock market launch**



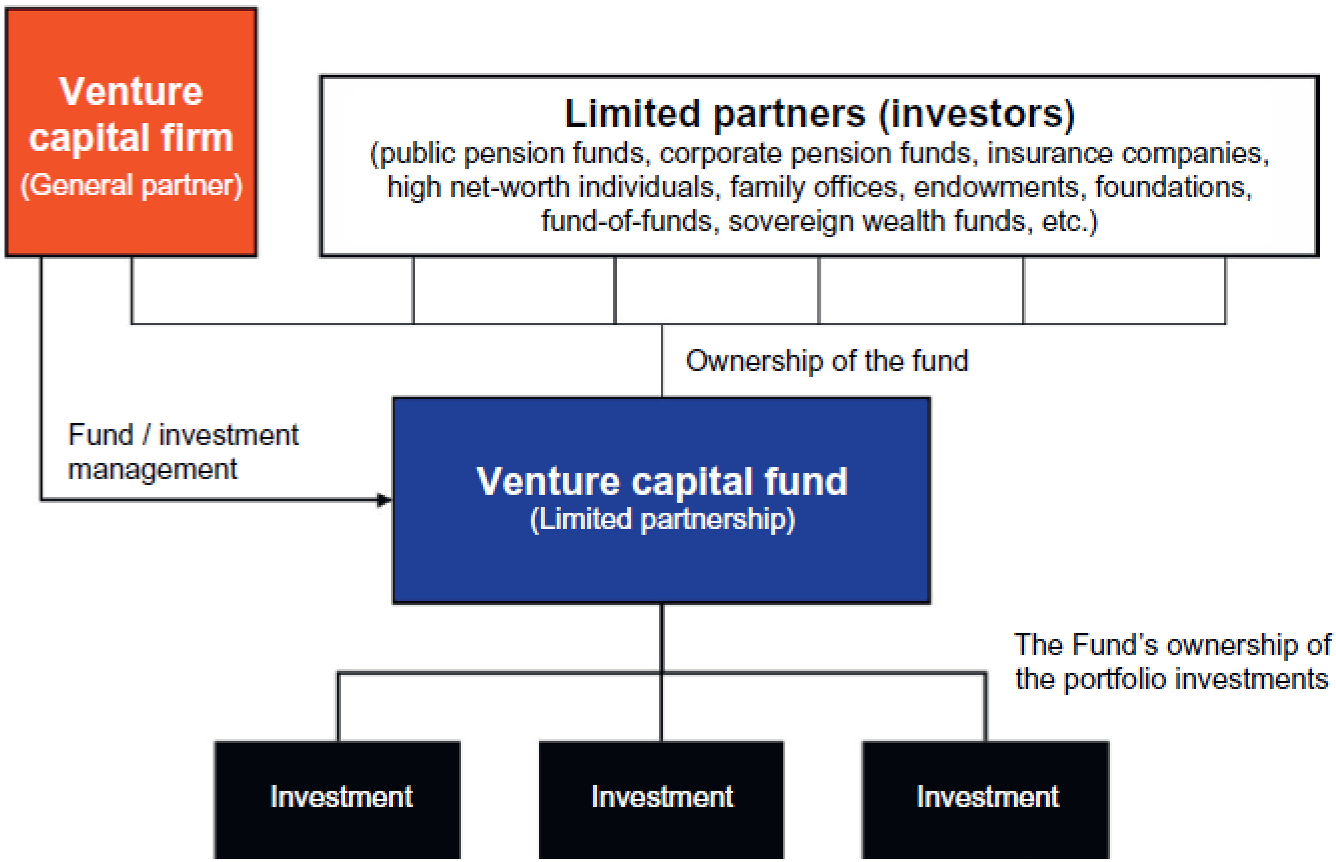
- **Angel Financing**

  An investor who provides financial backing for small startups or entrepreneurs is termed generally as angel financing. Angel investors are usually found among an entrepreneur's family and friends. The capital they provide can be a one-time injection of seed money or ongoing support to carry the company through difficult times.

- **Venture Capital**

  Start up companies with a potential to grow need a certain amount of investment. Wealthy investors like to invest their capital in such businesses with a long-term growth perspective. This capital is known as venture capital and the investors are called venture capitalists.

VENTURE CAPITAL FIRM STRUCTURE



FUNDRAISING TOOLS AND TECHNIQUES

- **Private Placement Memorandum**
- **Subscription Agreement**
- **Elevator Pitch**

Private Placement Memorandum(PPM)

- It is a legal document that specifies all the risks associated with investing in the venture, including the potential for complete loss of all invested capital.

- The PPM also specifies the amount of capital that is to be raised, the type of security being offered, and the rights and privileges associated with investing. Most early stage fundraising will divide the amount to be raised into investment **units.**

- The PPM will often specify the minimum amount that needs to be raised in order for the venture to be able to use the funds.

SUBSCRIPTION AGREEMENT

- The final document to include in equity fundraising is the **subscription agreement.**

- A subscription agreement is a document that a potential investor signs, indicating an intent to invest at a certain amount. Even though a subscription document is not considered to be binding on the potential investor, it creates a psychological commitment on the part of the investor.

ELEVATOR PITCH

- Elevator Pitch, the term is used to conjure what it would be like to meet a potential investor in an elevator and, in the limited time available, describe the business in a manner that captures the investor’s attention.

- An elevator pitch should articulate the venture’s offering (product and/or service), its business model (how it will make money) and the size of the opportunity.

ALTERNATIVES TO DEBT AND EQUITY FINANCING

- **Innovation Challenge/Research Competition**

- **Bootstrap Financing**

- **Licensing**

Innovation Challenge/Research Competition

- The above is a competitive program that encourages small businesses to explore their technological potential and provides the incentive to profit from its commercialization.
- Small businesses must meet certain eligibility criteria to participate in the program:

Bootstrap Financing

- The company uses its own sales and cash flows to invest in its growth. This type of internal growth is also referred to as organic growth. That is, the company grows only by virtue of its own ability to sell, control costs, and reinvest profits.

- Bootstrap financing has the advantage of helping the firm steer clear of the dilutive effects of equity financing and the debt burden effects of debt financing.

- The primary disadvantage of this type of financing is that it limits the venture's ability to grow rapidly.

Licensing

- This tool is available to technology-based companies to self-finance their growth is licensing third parties to use their technology in return for some consideration.

- That consideration typically takes the form of money (although it can be other things such as, e.g., access to needed resources, or a cross license to use the third party's technology).