

Startup fundraising

How startup funding works

Options for funding a startup:

- Crowdfunding
 - equity based
 - reward based
 - debt based
- Venture capitals
- Angel investors
- Small business loan and credit cards

Quiz

Different stages of startup fundraising

- Seed round
- Series A
- Series B
- Series C

Quiz

Case study: Google

How startup funding works

First thing to keep in mind about startup fundraising is to recognize that fundraising isn't your only option, as the bootstrapping (starting a business without external help or capital) approach might better suit your startup.

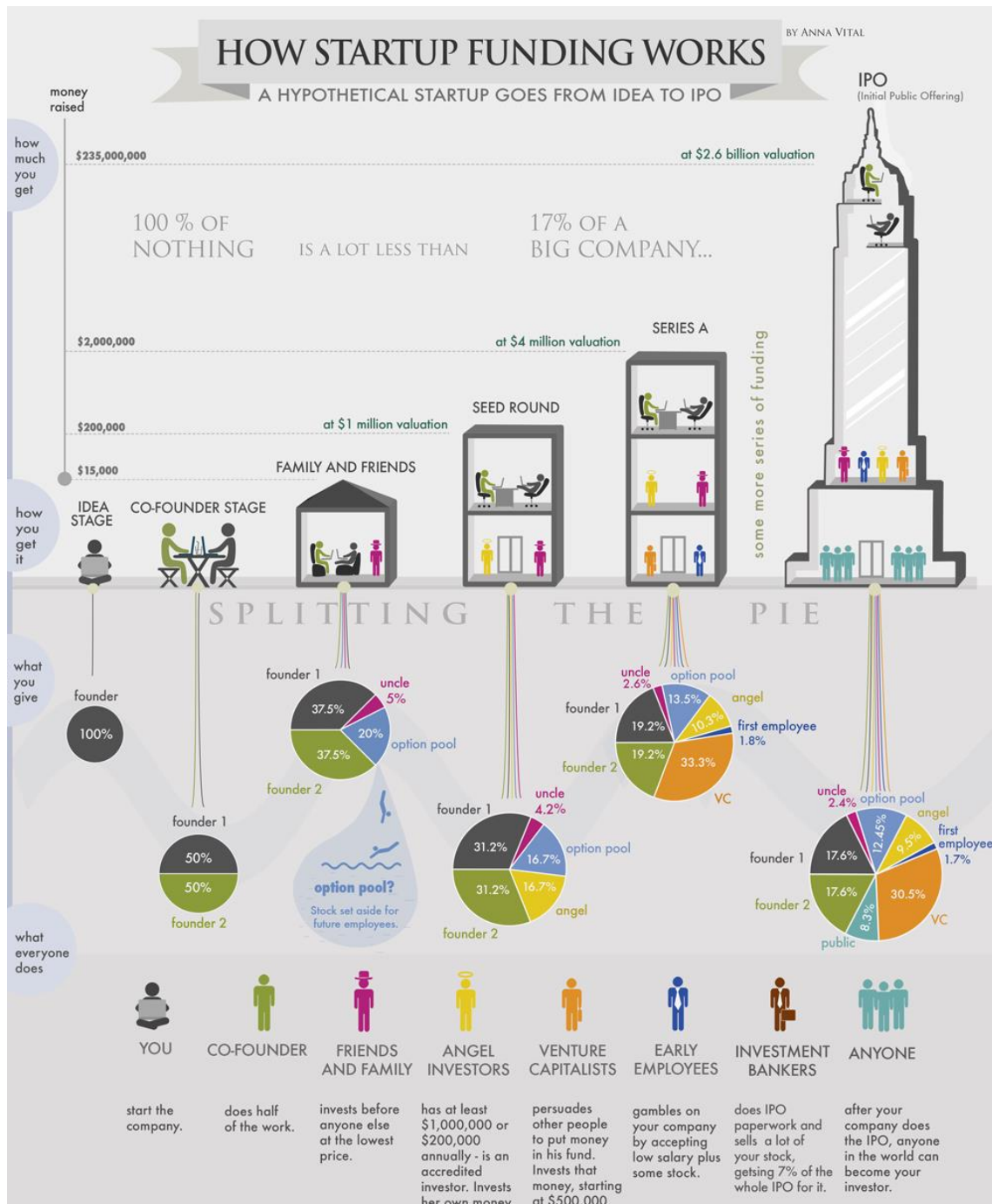
But if you decide that fundraising is the route you want to take, it's crucial to understand how, as you take more investment, **your slice of the company pie decreases**. On the other side, your **company is growing**, so you will have a **small piece of a much larger pie**. For example, when Google went public, Larry Page and Sergey Brin had about 15% of the pie, each. But that 15% was a small slice of a really big pie.

That's a brief description of how startup funding works. You will get much better idea of how this process works if you look into the info graphic below which shows the story of the hypothetical startup (it will be detailed in the chapters below).



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How Startup funding works



<http://fundersandfounders.com/how-funding-works-splitting-equity/>



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Options for funding a startup

For many, the decision about whether or not now is the right time to start a business comes down to funding.

You can have brilliant idea, but it won't mean much if you don't have enough money to actually start a business. Luckily, there are quite a few different ways that you can go about funding a startup. Some of them are listed below.

Some of the options for funding a startup:

- angel investors (this type of funding generally occurs in a company's early stages of growth, with investor expecting a 20 to 25 percent return of their investment)
- venture capitalists (can be appropriate for small businesses that already have revenues coming in; can grow up to tens of millions of dollars that can be used to invest, network and grow their company)
- crowdfunding (Crowdfunding on websites like Kickstarter and Indiegogo can give a big boost to the financing aspirations of small businesses)
- small business loan (many specialized options available; obstacle - finding a way through such tough lending period)
- credit cards (one of the most readily available ways to finance a startup, can be a quick way to get your business up and running)
- EU funds (for example, if your business focuses on a scientific or research oriented field, EU funds can be very useful; government also gives grants for many other fields, helping startups and young people in generally to set up or expand a company)
- online lending (popular alternative to traditional business loans; advantage of speed - application up to an hour, issued within days; popular services: OnDeck and Kabbage)
- product presales (selling products before they launch)
- friends and family (alternative to traditional forms of funding, advantage - avoiding the hassles of bank contract)
- side business ("double-dipping")
- selling assets
- winning contests (sometimes business can benefit from a bit of luck)

It's important to analyze all angles of your business and your future goals and then analyze each type of funding opportunity so that you make sure you're starting your business off on the right foot. Five best and most popular options for funding a Startup are described below.

Best/most popular options for funding a Startup

1. Crowdfunding



<http://businessfundingshow.com/wp-content/uploads/2015/05/crowdfunding2.jpg>

Crowdfunding is one of the newer ways of funding a startup that has just recently taken the world by storm. In crowdfunding anyone can contribute money toward helping a business that they really believe in. A startup owner, an entrepreneur puts a detailed description of his business on some of the online crowdfunding platforms and then consumers can read about business and choose whether they believe in that idea and want to give money to that business or not.

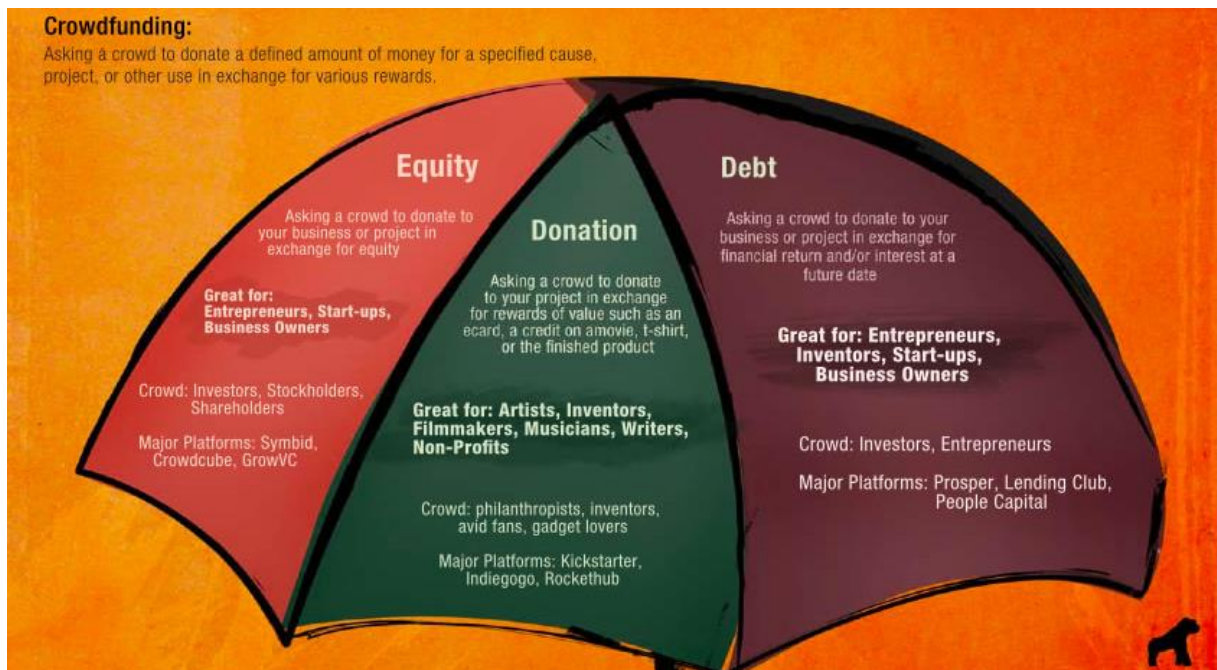
There are 3 general categories crowdfunding can fall under:

- Equity,
- Donation/Revard and
- Debt.



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Crowdfunding categories



<http://podeeum.com/index.php/trends/crowdfund>

The most popular websites for crowdfunding divided by crowdfunding category are listed below.

- **Equity based**

Equity based crowdfunding is asking a crowd to donate to your business or project in exchange for equity. This funding option is great for entrepreneurs, startups and business owners. The backers at these websites are accredited investors and not yet "crowds" of everyday people, so these platforms might not fit the typical definition of crowdfunding. However, these websites do permit accredited investors to back projects at lower investment thresholds (e.g., \$1,000, \$5,000 per investor) online elements of crowdfunding.

- Grow Venture Community - www.group.growvc.com



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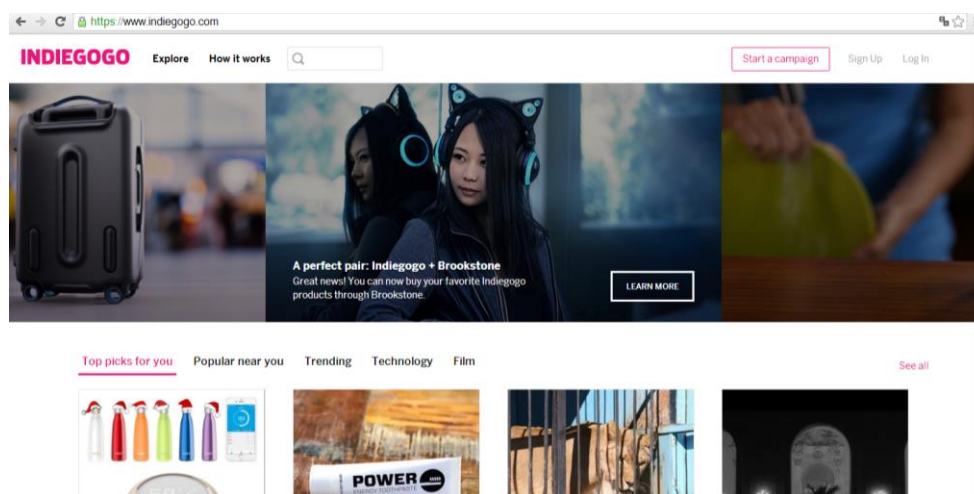


Grow VC started as the world first equity crowdfunding service, and since then has introduced many new digital finance services for investing, lending market places, hedging and portfolio management, it represents an ecosystem where entrepreneurs can connect with experts, funders, team members, new customers and partners to realize their ideas. The Group focuses especially to offer crowd based market place and community technology and investment products that can work with or used by 3rd parties. Grow VC Group has grown to have globally 5 companies for new investment models.

- **Donation/Reward based**

Donation/Reward - based crowdfunding is asking a crowd to donate to your project in exchange for tangible, non-monetary rewards such as an ecard, t-shirt, pre-released CD, or the finished product.

- Indiegogo - www.indiegogo.com

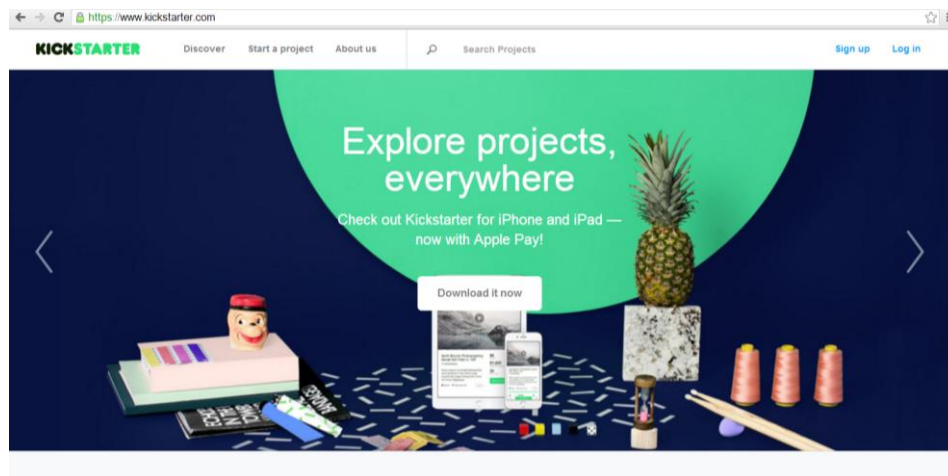




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Originally launched with a focus on film, Indiegogo pivoted to include funding for literally anything and is becoming known for financing personal and cause-related campaigns such as that for the bullied bus monitor, which raised over \$700,000. It accepts all projects without review. As Indiegogo says on its website, "Our platform is available to anyone, anywhere, to raise money for anything." While its success fee at 4 percent is 1 percent lower than most websites (which charge 5 percent), it does charge one of the highest fees in the industry - 9 percent - if you don't meet your goal.

- Kickstarter - www.kickstarter.com



The most well-known of the crowdfunding websites, Kickstarter focuses on creative endeavours including design, the arts (film, publishing, music), gaming and technology. While Kickstarter can't be used to fund businesses per se, it does accept products and has had some remarkably successful campaigns, including about 50 that have generated over a million dollars in funding. Kickstarter "curates" its projects, meaning it has a rigorous submission process, and if you aren't approved to post, it can be quite disappointing.

NOTE: Indiegogo is open to project creators around the world. Kickstarter only accepts project creators from the U.S., U.K. and Canada.

- **Debt based**

Donation/Reward - based crowdfunding is asking a crowd to donate to your project in exchange for financial return and/or interest at a future date.

- Endurance Lending Network - <https://www.fundingcircle.com/us/>



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Endurance Lending Network is a web based lending platform that connects small businesses looking for up to \$500,000 debt capital with non traditional lending sources (accredited individuals, family offices, wealth management platforms, debt funds, etc.). It aggregates and filters the opportunities into investment pools using web based on-boarding and a sophisticated credit algorithm that is much different and more effective for entrepreneurs than those banks use.

Keep in mind, however, that although crowdfunding campaigns may be trendy, there are hundreds of campaigns that go unfunded each year through this method. This is a competitive place to earn funding, so unless your business is absolutely rock solid and can gain the attention of the average consumers through just a description and some images online, you may not find crowdfunding to work for you in the end. According to startup veteran Drew Hendricks, "The most successful campaigns seem to come with a good story. While most Entrepreneurs are inclined to highlight the product and hide in the background, on crowdfunding sites, the entrepreneur is the story."

2. Venture Capital

Venture capital investing is one of the most well-known ways of raising money for your startup.

Venture capital is money that is provided by investors to startups with perceived long-term growth potential in early stage. Venture capitalists (investors) are very important source of funding for startups. They finance high and new technology based enterprises as oppose to banks that generally support proven technology with established markets.

Venture capitalists bring much more than money to the company: value added investors, productive board members, portfolio benefits, follow on capital, guidance, access to experts, and media exposure. They bring a wealth of experience and a particular expertise. Many of them know the pitfalls that entrepreneurs deal with when trying to start a company from their own experience.

Venture Capitalists typically reserve additional capital for follow-on investment rounds. This is helpful for companies that have a long runway, or need more time to build out their businesses.





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Another huge value that VCs provide is access to their networks for employees or clients to use the products or services you are building.

Of course, there are some dangers in taking venture capital (for example, taking VC early; there is the potential that you could overvalue your company).

Investing in those kind of Startups usually entails high risk for the investors , but it has the potential for above average returns.

What criteria do Venture capitalists use?



"I call my invention 'The Wheel,' but so far I've been unable to attract any venture capital."

VCs use **investment criteria** to evaluate the proposals and decide which startup they should invest in. They look for a strong management team, a large potential market and a unique product with a strong competitive advantage. They want to own a large percentage of the company so they can influence its direction thus they usually look for opportunities in industries that they are familiar with.

Venture capitalists should have in mind that failure rate in venture investment can be up to 50%, therefore they should follow some of the basic VC capital investment criteria before making investment. Some significant venture capital investment criteria are listed below:

- **#1** - More risk more returns

Investment in risky ventures can get higher returns (if ventures are selected carefully). Investor should know for which stage of the development the investment is needed (it will provide a basic idea of the risk factor involved and time period of investment).

- **#2** - Company's profile



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The VC investment criteria are mostly based on company's profile. Investors will mostly invest in fast growing company which has a huge market presence and intellectual property that is able to put barrier to its competitor growth. The company should also be into a promising business field.

- **#3 - Company development stage**

When investing, venture capitalist must know the stage of growth of the company and the risk involved. Venture capital investment is needed for 4 stages of company's development: idea generation (getting the "seed money" - introducing new idea in the market, start up (funds for marketing and development), ramp up (first round, early sales and manufacturing, working capital) and exit (expansion or going public).

- **#4 - The business model**

Venture capital investment criteria are about secure and high returns and the business model of the company enables it to grow fast (business model should have the potential to attract customers, make customers repeat customers, stay ahead of competitors and enable company to create more revenues with limited resources).

- **#5 - Management team**

One of the most important VC investment criteria, with no strong management, company will not be able to deliver its plans. Both management and marketing team should be strong, professional and expert at its job.

- **#6 - Company's valuation**

The market evaluation of the company should be attractive - good evaluation reduces the risk.

- **#7 - The Exit plan**

Venture capitals mostly hold the stocks for three to seven years and they should have an "exit plan" to cash out its investment. Ideally they sell their equity in initial public offering of the company.

Every startup has its own unique needs, and some of those will be better suited for crowdfunding, and some of those will be better suited for venture capital, and some of those may be better suited for angels.

3. Angel Investor

Angel investor is an affluent, wealthy individual who provides a capital for startups in exchange for equity. Angel investors work similarly to venture.

Angels typically fund a startup at the seed stage of a company. There is a higher risk associated with angel investments as they are dealing with an unproven business model. It's also probable that the company doesn't have a product and, if they have customers, they might not have significant revenue. However, they are more forgiving on the types of metrics that VCs use to measure a potential investment.





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“When you bring an angel on board, you want to make sure you have the right one, because it's like getting married, except you can't get divorced easily.” (Schy) Angel becomes your business partner and hopefully, in addition to capital, brings a rolodex that they can tap into and/or relevant business experience that they advise you in.

Angels are huge opportunity for companies that are just getting started and haven't been able to completely think through all of the aspects of building a business. It also works well for companies that need quick access to capital.

Time needed to take an investment from an angel is usually significantly shorter than from a traditional VC firm.

Still, you should be aware of some hazards. While there are individual angels that have tremendous insight into building a company, there are also young founders fresh from an IPO who might not have the knowledge that can help your company.

Some of the angel investors invest online through equity crowdfunding or organize themselves into angel networks to share research and pool their investment capital, as well as to provide advice to their portfolio companies. These group invests are sometimes referred to as crowdfunding. A business angel network is defined as a conglomerate of angel investors whose prime concern is to facilitate the investment of seed enterprises and business startups for investors.

There are several types of angel networks:

1. Non profit Business angel associations - associations of angels facilitating angel's investment in local companies for a stake in the company
2. Incubators - group of angels hosting companies in exchange for a stake in the company
3. For profit Angel networks - networks enabling entrepreneurs to meet business angels (often work on a success fee and entrance fee basis)

Types of fees:

1. Equity fee - proportional stake of the amount invested in the company concerned
2. Registration fee - fee paid by entrepreneurs in order to have access to the Angel network
3. Success fee - percentage of the investment paid to the Network.

4. Small Business Loans and Credit Cards.

Sometimes, the first place that entrepreneurs go when thinking about funding is the bank. There are many specialized options available for situations like small business ownership (for example microloans), but an obstacle to entrepreneurs is finding their way through such a tough lending period. Startup owners may seem too risky to the bank since they are starting a business for the first time.



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Beside business loans, credit cards are also available for the startup owners (they have to have an excellent credit history if they want to get credit card for their business). There are specific credit cards designed for entrepreneurs. This is definitely the riskiest option on the list but it gives full control and full ownership of company to the entrepreneur.

Quiz

1. When starting a startup funding rounds, owner usually has:
 - a) 100% of the company
 - b) 15% of the company

2. Kickstarter and Indiegogo are one of the most known web sites for:
 - a) credits and microloans
 - b) registering your business
 - c) crowdfunding
 - d) entering business plan contest

3. When starting a business, new entrepreneurs are more like to receive initial funding from:
 - a) donors
 - b) corporations
 - c) foundations
 - d) family and friends

4. Your friend has an idea for a new product that he strongly believes in and he needs a startup capital. He and his family and friend don't have the money for the development of the product. Which of following options should he pursue?
 - a) crowdfunding
 - b) bank loan
 - c) venture capitals
 - d) angel investors
 - c) incubators
 - d) micro-credit loans





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e) all of the above

5. Venture capitalists and angel investors usually invest in:

- a) high and new technology based enterprises
- b) proven technology with established markets

6. Crowdfunding categories are:

- a) _____
- b) _____
- c) _____

7. Venture capital and angel investing is usually:

- a) risky
- b) safe and predictable

8. What are the benefits that venture capitalists and angel investors can bring to the startup beside money?

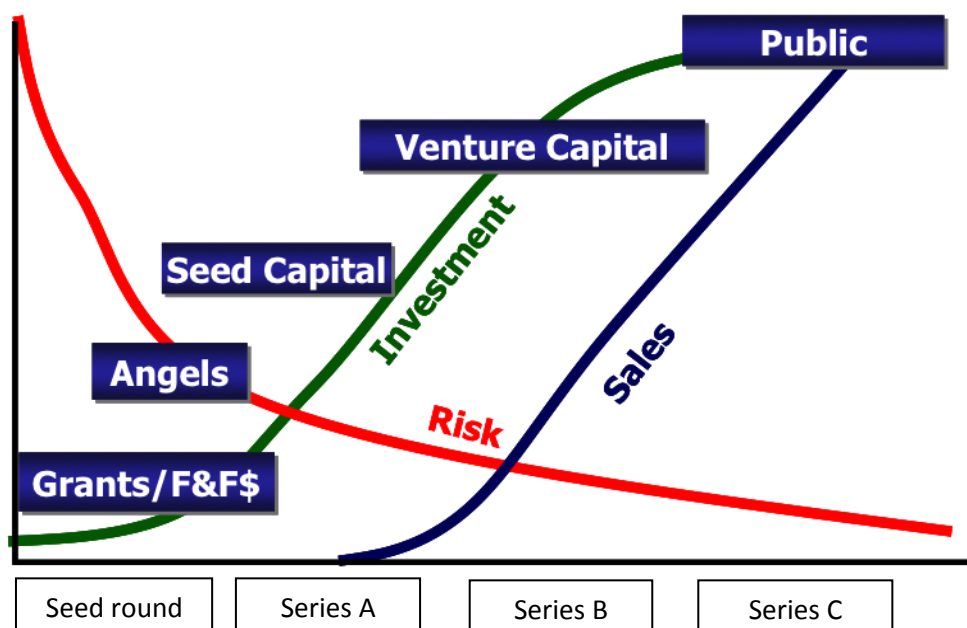
9. What investment criteria do venture capitalists use to evaluate a company before they invest in it? (Name at least three)



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Different stages of Startup fundraising

- Seed round
- Series A
- Series B
- Series C



Typically, startup's funding rounds can be divided in the next four stages:

- **Seed Round:**

Usually, in seed round a small amount of money is given to a company to give it the momentum it needs to produce its initial product. In this stage, the start-up has a concept and an idea about how it can be viable on the market, but doesn't have a working prototype yet. Money that the company receives in this stage is what it needs to move from this early conceptual phase toward a product.

- **Series A:**

In this stage, company already has a prototype and usually seeks founding from VCs so it could bring its product to the market. Series A is larger than the seed round (usually between 3 - 7 million dollars) and offers a portion of the company for the funding. Startups typically use series A funding to figure out the best business model for their company and for moving the product toward market.

- **Series B:**



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In this stage, startups usually have a product and a business model and they need funding to bring the product to the broader market. A significant increase in the funding occurs in series B (from 7 up to 50 million dollars).

- **Series C:**

Series C all about fast growth. Companies might move the work they've been doing in series B toward international markets or focus on diversifying their product for multiple different platforms.

How long do you spend fundraising rounds?

If the startup wants, fundraising rounds can go forever, although that's not very practical since in each round of funding startup owners offer a piece of its company to the investors. That actually works great in first few rounds (the company's valuation grows as people invest), but since you give up about 25% of your company each time someone invests, after a couple of rounds of funding, you don't have much left to offer to an investor. At this point, it's the best option for the company to either sell (as Instagram) or start trading publicly (Facebook).

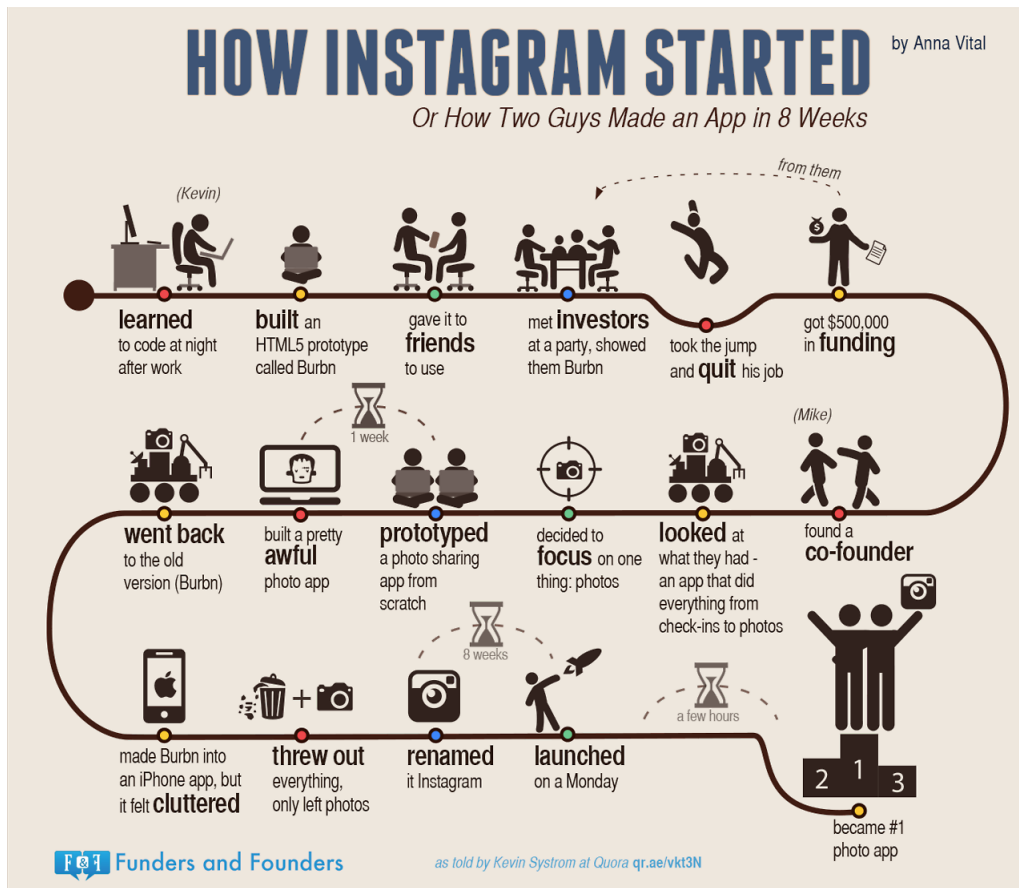
Instagram model is a very good model for thinking how this form of growth works. They started with a \$500,000 seed round, and then within two years of that raised a \$7 million series A and a \$50 million series B, before they were finally bought out by Facebook. (<http://techcrunch.com/2012/04/09/instagram-story-facebook-acquisition/>) Instagram's story is very encouraging for startup owners, since it went from 0 to 1 billion dollars in just two years. (Look the story of the Instagram startup creators below)





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Instagram startup story



Generally, a startup can expect between a hundred thousand and a million dollars in their seed round. With each round of funding, the startup gives up a portion of the company (usually about 25%) to their funders. Sometimes startups skip the seed round and raise a few million dollars of series A funding right out of the gate, but the Instagram model above is much more typical.

Quiz

- Typically, startup's funding rounds can be divided in
 - two
 - four
 - fivestages.
- After a couple rounds of funding the best option for the company is to:
 - sell it or start IPO



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- b) find new investors
- c) recreate business plan

3. In series A of founding rounds company seeks for a:

- a) funding from friends and family to design a prototype
- b) funding from VCs so it could figure out the best business model and bring its product to the market
- c) funding from VCs to enable growth

4. As funding rounds grow:

- a) investment, sales and risk grow
- b) sales grows and investment and risk reduce
- c) investment and sales grow and risk reduces



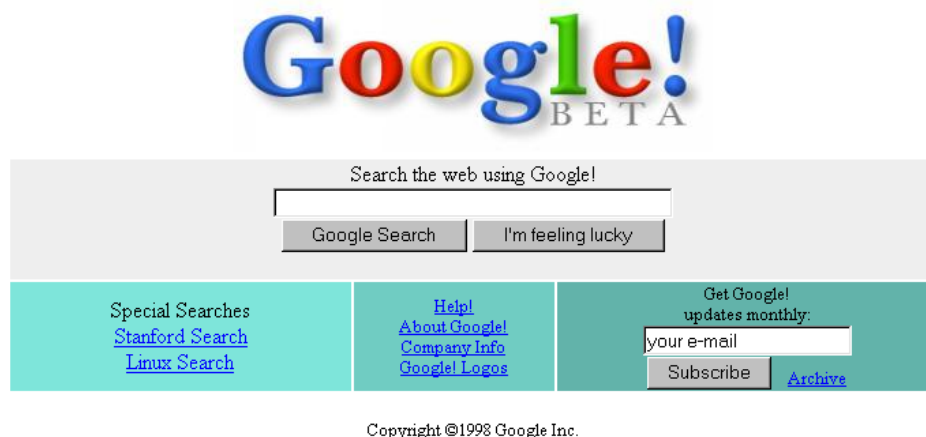


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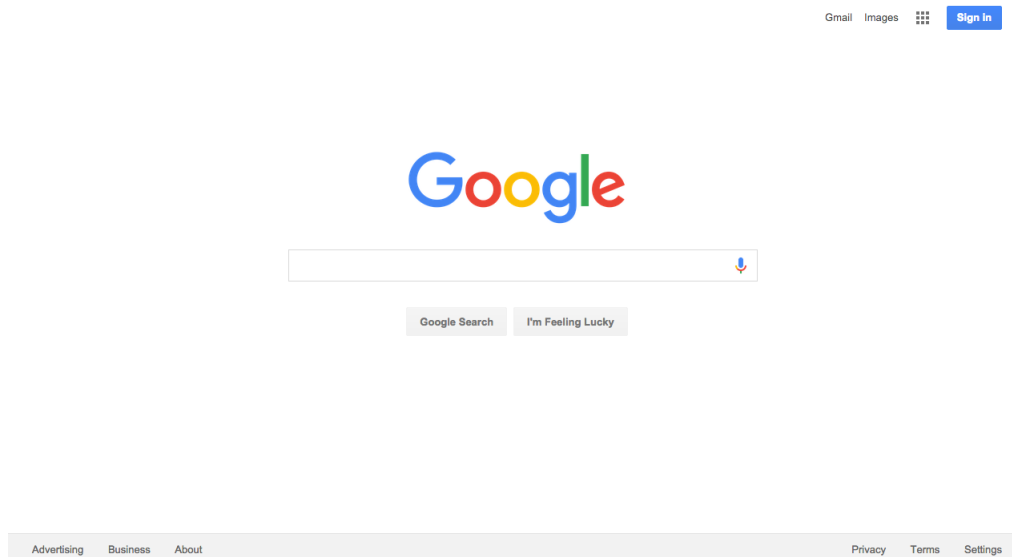
Case study: Google

Google started in January 1996 as a research project by Larry Page and Sergey Brin when they were students at Stanford University and had grown to the level that we can't even imagine life without it.

Google's original homepage



Today, the name “Google” has found its way into everyday language - it’s added to Oxford English Dictionary denoted as “to use Google search engine to obtain information on the Internet.” Google also has fans which call themselves “Googlists as they follow the “new religion” called “Googlism”. The New York Times had discussed the topic “Is Google God?” (<http://www.nytimes.com/2003/06/29/opinion/is-google-god.html>)



Short funding history: financing, 1998 and initial public offering, 2004

The **first funding** for Google was on **August 1998** - contribution of **\$100,000** from Andy Bechtolsheim, co-founder of Sun Microsystems.

Early in 1999, while graduate students, Brin and Page decided that the search engine they had developed was taking up too much time and distracting their academic pursuits. They went to George Bell (Excite) and offered to sell it to him for \$1 million. He rejected the offer and later criticized Vinod Khosla, one of Excite's venture capitalists, after he negotiated Brin and Page down to \$750,000. On **June 7, 1999**, a **\$25 million round of funding** was announced, with major investors including the venture capital firms Kleiner Perkins Caufield & Byers and Sequoia Capital.

Google's initial public offering (IPO) took place five years later on **August 19, 2004**. At that time Larry Page, Sergey Brin, and Eric Schmidt agreed to work together at Google for 20 years, until the year 2024. The company offered 19,605,052 shares at a price of \$85 per share. Shares were sold in an online auction format using a system built by Morgan Stanley and Credit Suisse, underwriters for the deal. The **sale of \$1.67 bn (billion)** gave Google a **market capitalization of more than \$23bn**. By January 2014, its **market capitalization** had grown to **\$397bn**. The vast majority of the 271 million shares remained under the control of Google, and many Google employees became instant paper millionaires. Yahoo!, a competitor of Google, also benefited because it owned 8.4 million shares of Google before the IPO took place.

The stock performed well after the IPO, with shares hitting **\$350** for the first time on **October 31, 2007**, primarily because of strong sales and earnings in the online advertising market. The surge in stock price was fuelled mainly by individual investors, as opposed to large institutional investors and mutual funds. GOOG shares split into GOOG Class C shares and GOOGL class A shares. The company is listed on the NASDAQ stock exchange under the ticker symbols GOOGL and GOOG, and



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on the Frankfurt Stock Exchange under the ticker symbol GGQ1. These ticker symbols now refer to Alphabet Inc., Google's holding company, since the fourth quarter of 2015.

Gamification

The infographic below shows how to raise money for your startup. Look it over and try to recreate some of the steps on your fiction startup. Explore the crowdfunding sites; try to find VCs and angel investor sites. For the steps you can't create use your imagination and describe how would you make it work.



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