Financing Entrepreneurial Projects

Some Insights

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Sources of finance for entrepreneurs

- Founders
- 3Fs: family, friends, fools ☺
- Business Angels
- Crowdfunding
- Accelerators and Incubators
- Subsidies
- Venture Capital / private equity
- Debt financing – bank loan
- Factoring
- Leasing
- Suppliers
- Initial Coin Offering (ICO)
- Initial Public Offering (IPO)
- Revenue based financing
- Conclusions

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Founders

- investing own savings – in cash
- in-kind investment – hours spent working for the start-up
- advantage: perceived positive by the external financier. The signal is that the founder is taking risks too

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3Fs: family, friends, fools ☺ (1)

- before approaching professional investors
- ask network of family, friends and fools (close people from family or social network)
- faith in your idea or in you as a person/entrepreneur.
- are usually not professional investors
- do not expect a professional assessment of your company strategy from such an investor

3Fs: family, friends, fools ☺ (2)

When to choose this source of financing?

- it is often pursued to cover the costs of setting up a new company or to bridge the gap to a first round of (pre-) seed funding.
- Advantage: quick and cheap way of collecting cash, especially if you take into account the risk that the 3Fs take (which they are not always aware of themselves: hence, “fools”).
- usually, the amounts concerned with this type of investment are not too high
- are typically repaid as a loan (with or even without interest) or are invested in exchange for a small equity share in the company
- when the invested amounts, share percentages and level of professionalism increase, then we speak of angel investing

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Business Angels/Informal Investors

- experienced entrepreneurs who have some funds available (often from previously exited ventures) and invest those in new companies to help other entrepreneurs succeed in their business.
- angel investments start around 50,000 dollars/euros and can amount up to (or more than) a million dollars/euros, as angels sometimes invest together in groups
- go for an angel if you are looking for seed funding within the abovementioned range
- typically offer "smart capital": money, networking opportunities and knowledge within specific sectors.
- find an angel that fits with your company in terms of experience and sector knowledge.
- angels spot new investment opportunities through their network, or through platforms (AngelList, Crunchbase and f6s)

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Crowdfunding (1)

- the “crowd” finances the funding need of a company
- usually, crowdfunding is performed via an online platform where entrepreneurs offer investment opportunities on one side of the platform and on the other side of the platform, a large group of people invest small amounts to meet the entrepreneur’s investment need

There are three types of crowdfunding:

- loans
- pre-orders/donations
- convertible loans

Crowdfunding (2)

- loans: are you looking for a loan, but having trouble securing one from the bank because your risk profile is too high? Then try loan crowdfunding
- pre-orders/donations: Do you have a prototype available, and do you want to test the product/market fit, but you cannot finance the production/delivery of the first batch of actual products? Then go for pre-orders/donations
- well-known examples of platforms offering these types of crowdfunding are Kickstarter and Indiegogo. They are mainly suitable for products, projects or gadgets aimed at the consumer market and have a strong design element to them

Crowdfunding (3)

- convertible loans: Advantages:
  - no shares are being issued
  - valuation discussions are postponed until the moment the value of a company can be better determined and
  - easier, faster and cheaper process than an actual share transfer
- people that invest via crowdfunding platforms are not always professional investors
- crowdfunding is better suited for not too complex or technical propositions (e.g. consumer products), easily understood by the general public (that's why it's called "crowd" funding)
- there are crowdfunding platforms with a specific focus:
  - Netherlands - **Oneplanetcrowd** - sustainable projects with a positive impact
  - Romania - **SeedBlink** - medical service providers selling preventive medical packages to firms

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Accelerators and Incubators

- both are a good opportunity for start-ups to take advantage of the office infrastructure, consulting services, qualification offers, capital services and community offers
- in addition to office space, coaching, mentoring sessions and events, it is above all the new contacts from the networks and the exchange of experience that start-up teams can benefit from
- can be government or private institutions
- Example: Polish entrepreneurs launch in Romania Mill Games, the first accelerator to invest in independent gaming studios

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Subsidies/Schemes

- aim is typically to stimulate entrepreneurship, innovation/R&D or economic growth within a certain geographical area or a specific sector focus. That is why every region, every country and even, for instance, the entire European Union has its own subsidies
- it is important to look for a subsidy that fits with your company
- When to choose this source of financing: ALWAYS
- subsidies are relevant during almost every company stage, from startup to corporate, from freelancer to publicly traded company
- administrative and reporting requirements often apply to subsidy applications and grants. You need to be able to justify the costs for which you request a subsidy and, sometimes, it is mandatory to have this justification audited as well.

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Venture Capital / Private Equity (1)

- Private equity (PE) is the collective name for professional investment firms that invest in not publicly listed companies
- Venture capital (VC) is a type of private equity that focuses specifically on (from the investor's perspective) risky investments in early-stage companies.
- People often speak of PE when investing in larger organizations that have existed for some time already
- VC, on the other hand, involves investing in growth capital of young companies
- VC firms have a fund available of a specific size (e.g., 100 million dollars/euros) that has to be invested within a certain period of time (e.g., 10 years) in a number of companies with different risk profiles to spread the risk across the portfolio. The aim is to sell the shares after a couple of years for a certain return/profit

Venture Capital / Private Equity (2)

- When to choose this source of financing: Venture capital is mainly suitable for companies that have already passed the “seed stage” and are looking for series A or series B funding. This type of funding is therefore meant to help companies grow faster than they would if growing organically, for instance if a firm wants to internationalize.
- VC firms typically invest in the range of about 500,000 to 20 million dollars/euros. To raise funding from a VC, a company’s product/market fit has to be already proven, and steadily growing revenue streams have to exist for several years. However, there are also venture capitalists with seed funds (starting with rounds of about 200,000 dollars/euros) that offer seed capital to companies that have not met the abovementioned criteria yet.

Venture Capital / Private Equity (3)

- advantage of VC firms: can fund multiple rounds for the same company, where an angel or other seed investor is not always capable of doing so. Venture capitalists often also have a specific sector focus and good knowledge/network within this sector.
- Examples of VC Funds in Romania:
  - Catalyst (the first private equity fund designed for Romania),
  - GapMinder (targeting IT Software and Services start-ups in RO and CEE)
  - Early Game Ventures (an early-stage venture capital firm in Romania investing in startups that create new industries in Europe's emerging markets)
  - ROCA X (investment fund focused on early-stage tech startups)
  - Cleverage Venture Capital
  - Founders Bridge
  - Gradient Ventures
  - Techstars Ventures
  - Next Capital (for telemedicine)
  - Sparking Capital (for circular economy, waste recycling).

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Debt financing – bank loan (1)

- even though there are banks around that have started VC funds, they are generally more risk averse than, for example, angels, seed investors and normal VC investors. This does not mean that banks do not finance entrepreneurs – on the contrary!
- more likely to invest in SMEs, in companies with lower risk profiles (than startups, for instance) and when companies can offer collateral
- early-stage startup does not fit in the focus of the VC funds, it can thus be difficult to secure funding from a bank.

Debt financing – bank loan (2)

When to choose this source of financing:

- banks generally take less risk than, for example, VC investors and angels
- a bank is a very good option:
  - if you can provide collateral,
  - if you are looking for working capital financing, stock financing or financing to cover investments in buildings/machines
  - If the company is generating stable income streams and has been growing organically for a number of years (is less risky)
- advantage of debt financing: you do not have to give away a part of your company in terms of equity, which means that in the long term, it can turn out to be a much cheaper way of financing than, for example, securing funding from an angel investor or VC investor.

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Factoring (1)

- is a way of financing working capital by lowering the size of accounts receivable
- Example: if you send an invoice to a customer, but it takes the client 60 days to pay, then you can decide to “sell” this invoice to a factoring company (against a certain payment, of course).
- The factoring company will pay for the invoice (or provides you with a loan) so that you do not have to wait 60 days before the invoice is paid by the client. A factoring company can also take over the risk that the client does not pay at all.

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Factoring (2)

When to choose this source of financing:

- you must have clients in order to be eligible for factoring. If you do not have any paying customers, factoring is not an option. If you do have customers, factoring can be very useful if you have to deal with long payment terms.
- Do you have large corporates as your customers? If so, it can take a while for invoices to be paid, and there is often not much you can do about it. In order to keep your working capital position healthy, factoring can be a good solution. Is accounts receivable management costing you a lot of time and effort? Do you often suffer from bad debtors? Then factoring could also be an outcome

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Leasing

- Do you have to make large investments in assets such as computers and/or machines? Why don't you lease instead of purchasing them? By leasing assets companies can spread payments over a longer period of time instead of having to fulfill the full payment of an investment the moment they decide to purchase an asset.

- When to choose this source of financing: When a company is capital-intensive, meaning it is dependent on the use of (sometimes expensive) assets, such as machinery, leasing may be the way to go.

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Suppliers

- is your business heavily reliant on its supply chain? Then try to negotiate favorable payment terms with suppliers. If your customers have long payment terms, for instance, you can try to agree to longer payment terms with your suppliers as well so that you do not run into any problems concerning your working capital. On the other hand, you could also try to discuss discounts in the event you pay your suppliers very quickly.
- when to choose this source of financing: Choose this form of financing if you have good relationships with your suppliers or if you have a good negotiating position with them (for example, if you are a large/important customer).

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Initial Coin Offering (ICO) (1)

- for an ICO, a company typically writes a whitepaper to pitch a certain business idea and asks the general public to finance the idea using bitcoin and/or altcoins (other cryptocurrencies than bitcoin). In return, the investor receives an altcoin newly generated by the company during the ICO.
- Usually, this newly generated altcoin is at the center of the company's business activities and thus leveraged in a way that increases its value. As soon as this altcoin becomes tradable, investors can resell it (and hopefully make a profit). An ICO is therefore very similar to an IPO (see the section below) but uses cryptocurrency instead of shares that can be converted into "normal cash".

Initial Coin Offering (ICO) (2)

When to choose this source of financing:

- It is possible to do an ICO as a non-crypto company, but currently, the majority of the companies that do an ICO are blockchain/cryptocurrency companies. This is due to the fact that the new altcoin generated by an ICO often has a function within the company which increases its value. The speculation on the fact that the value of the new altcoin will indeed increase is what attracts investors.

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Initial Public Offering (IPO) (1)

- The IPO is the holy grail of financing!
- An IPO is the public listing of a company: the first time a company offers its shares to the general public (instead of to private individuals, investors or companies). This means that practically anyone in the world (individuals or institutional investors) can invest in the company by buying shares at a certain value.
- Before an IPO, a company is private, i.e. it often only has a limited number of investors that have invested early stage or growth capital. Think of the founders, angels and VC firms for instance.

Initial Public Offering (IPO) (2)

When to choose this source of financing:

- Successful IPO: a company must be able to demonstrate years of strong growth, and its proposition typically includes a certain network effect/scalability.
- Growth can be defined in several ways
  - turnover
  - profit
  - number of customers/active users (e.g. Spotify has been a loss-making company for years, but has been growing enormously in terms of turnover and users)

Initial Public Offering (IPO) (3)

- A company also has to demonstrate transparency and confidence that growth will continue in future years because it has to win the trust of the general public that the value of the shares (which are bought by the public during the IPO) will rise in the future so that they can make a profit on their investment.

- For the investors that owned a share in the company already before the IPO, a public listing can turn out to be very attractive (financially). An IPO should not be underestimated though: it is a very costly process and results in many reporting requirements toward the public, imposed by strict government regulations

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Revenue-based financing (1)

- revenue sharing or royalty-based financing
- for emerging and high growth companies
- investors inject growth capital in exchange for a percentage of monthly revenues

- is a funding mechanism in which an investor provides financing to a startup and in return the investor will receive a percentage (e.g. between 2% - 5%) of the (future) revenues generated by the startup. The future revenue-based interest payments are typically capped at two to three times the size of the initial funding amount.

Revenue-based financing (2)

- When to choose this source of financing?
- This type of funding is typically offered at (pre-) seed stage. The benefits of this type of funding for startups are the following:
- The founders do not have to give away any equity meaning they will not dilute their equity shares.
- As opposed to a normal bank loan the interest payments for revenue-based financing are linked to the generated revenues, which means that if revenues decline required payments also decline. This reduces the chance of cash flow issues and potential illiquidity.

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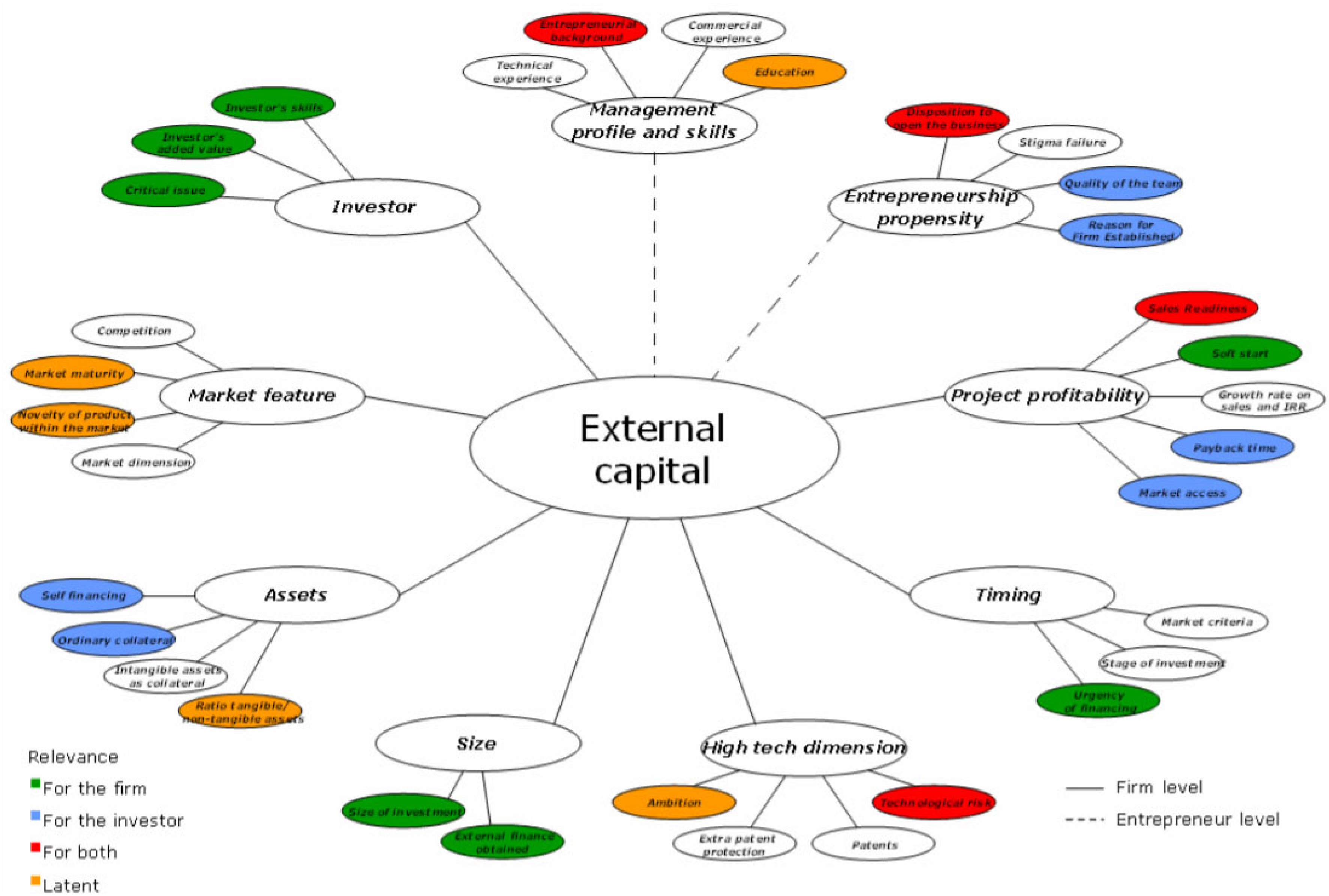
(Instead of) Conclusions



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