Chapter 10

Getting Funding or Financing

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Chapter Objectives
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1. Explain why most entrepreneurial ventures need to raise money during their early life.
2. Identify the three sources of personal financing available to entrepreneurs.
3. Provide examples of how entrepreneurs bootstrap to raise money or cut costs.
4. Identify the three steps involved in properly preparing to raise debt or equity financing.
5. Discuss the difference between equity funding and debt financing.

Chapter Objectives
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6. Explain the role of an elevator speech in attracting financing for an entrepreneurial venture.
7. Describe the difference between a business angel and a venture capitalist.
8. Explain why an initial public offering (IPO) is an important milestone in an entrepreneurial venture.
9. Discuss the SBA Guaranteed Loan Program.
10. Explain the advantages of leasing for an entrepreneurial venture.

The Importance of Getting Financing or Funding

- The Nature of the Funding and Financing Process
  - Few people deal with the process of raising investment capital until they need to raise capital for their own firm.
    - As a result, many entrepreneurs go about the task of raising capital haphazardly because they lack experience in this area.
- Why Most New Ventures Need Funding
  - There are three reasons most new ventures need to raise money during their early life.
    - The three reasons are shown on the following slide.

Why Most New Ventures Need Financing or Funding

Alternatives for Raising Money for a New Venture

Personal Funds	Equity Capital
Debt Financing	Creative Sources

Sources of Personal Financing
1 of 2

- Personal Funds
  - The vast majority of founders contribute personal funds, along with sweat equity, to their ventures.
    - Sweat equity represents the value of the time and effort that a founder puts into a new venture.
- Friends and Family
  - Friends and family are the second source of funds for many new ventures.

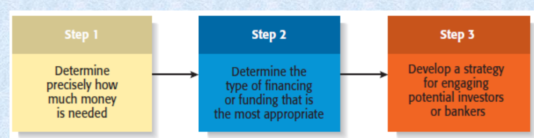
Sources of Personal Financing
2 of 2

- Bootstrapping
  - A third source of seed money for a new venture is referred to as bootstrapping.
  - Bootstrapping is finding ways to avoid the need for external financing or funding through creativity, ingenuity, thriftiness, cost cutting, or any means necessary.
  - Many entrepreneurs bootstrap out of necessity.

Examples of Bootstrapping Methods

Buying used instead of new equipment	Coordinating purchases with other businesses	Leasing equipment instead of buying
Obtaining payments in advance from customers	Minimizing personal expenses	Avoiding unnecessary expenses
Buying items cheaply but prudently via options such as eBay	Sharing office space or employees with other businesses	Hiring interns

Preparing to Raise Debt or Equity Financing
1 of 3



Preparing to Raise Debt or Equity Financing
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Two Most Common Alternatives

Equity Funding	Debt Financing
Means exchanging partial ownership in a firm, usually in the form of stock, for funding	Is getting a loan

Preparing to Raise Debt or Equity Financing
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Matching a New Venture's Characteristics with the Appropriate Form of Financing or Funding

Characteristics of the Venture	Appropriate Source of Financing or Funding
The business has high risk with an uncertain return: Weak cash flow High leverage Low-to-moderate growth Unproven management	Personal funds, friends, family, and other forms of bootstrapping
The business has low risk with a more predictable return: Strong cash flow Low leverage Audited financials Good management Healthy balance sheet	Debt financing
The business offers a high return: Unique business idea High growth Niche market Proven management	Equity

Preparing An Elevator Speech
1 of 2

Elevator Speech

Purpose

- An elevator speech is a brief, carefully constructed statement that outlines the merits of a business opportunity.
- There are many occasions when a carefully constructed elevator speech might come in handy.
- Most elevator speeches are 45 seconds to 2 minutes long.

Preparing an Elevator Speech
2 of 2

Step 1	Describe the opportunity or problem that needs to be solved.	20 seconds
Step 2	Describe how your product meets the opportunity or solves the problem.	20 seconds
Step 3	Describe your qualifications.	10 seconds
Step 4	Describe your market.	10 seconds
Total		60 seconds

Sources of Equity Funding

Venture Capital

Business Angels

Initial Public Offerings

Business Angels
1 of 2

- Business Angels
  - Are individuals who invest their personal capital directly in start-ups.
  - The prototypical business angel is about 50 years old, has high income and wealth, is well educated, has succeeded as an entrepreneur, and is interested in the start-up process.
  - The number of angel investors in the U.S. has increased dramatically over the past decade.

Business Angels
2 of 2

- Business Angels (continued)
  - Business angels are valuable because of their willingness to make relatively small investments.
    - These investors generally invest between $10,000 and $500,000 in a single company.
    - Are looking for companies that have the potential to grow between 30% to 40% per year.
  - Business angels are difficult to find.

Venture Capital
1 of 3

- Venture Capital
  - Is money that is invested by venture capital firms in start-ups and small businesses with exceptional growth potential.
  - There are about 800 venture capital firms in the U.S.
    - Venture capital firms are limited partnerships of money managers who raise money in "funds" to invest in start-ups and growing firms.
    - The funds, or pool of money, are raised from wealthy individuals, pension plans, university endowments, foreign investors, and similar sources.
    - The investors who invest in venture capital funds are called limited partners. The venture capitalists are called general partners.

Venture Capital
2 of 3

- Venture Capital (continued)
  - Venture capital firms fund very few entrepreneurial firms in comparison to business angels.
    - Many entrepreneurs get discouraged when they are repeatedly rejected for venture capital funding, even though they may have an excellent business plan.
    - Venture capitalists are looking for the "home run" and so reject the majority of the proposals they consider.
    - Venture capitalists fund between 3,000 and 4,000 companies per year, compared to about 62,000 per year for business angels.

Venture Capital
3 of 3

- Venture Capital (continued)
  - An important part of obtaining venture capital funding is going through the due diligence process.
  - Venture capitalists invest money in start-ups in "stages," meaning that not all the money that is invested is disbursed at the same time.
  - Some venture capitalists also specialize in certain "stages" of funding.

Initial Public Offering
1 of 3

- Initial Public Offering
  - An initial public offering (IPO) is a company's first sale of stock to the public. When a company goes public, its stock is traded on one of the major stock exchanges.
  - Most entrepreneurial firms that go public trade on the NASDAQ, which is weighted heavily toward technology, biotech, and small-company stocks.
  - An IPO is an important milestone for a firm. Typically, a firm is not able to go public until it has demonstrated that it is viable and has a bright future.

Initial Public Offering
2 of 3

Reasons that Motivate Firms to Go Public

Reason 1	Reason 2
Is a way to raise equity capital to fund current and future operations.	Raises a firm's public profile, making it easier to attract high-quality customers and business partners.

Initial Public Offering
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Reasons that Motivate Firms to Go Public

Reason 3	Reason 4
Is a liquidity event that provides a means for a company's investors to recoup their investments.	Creates a form of currency that can be used to grow the company via acquisitions.

Sources of Debt Financing

Commercial Banks

SBA Guaranteed Loans

Commercial Banks

- Banks
  - Historically, commercial banks have not been viewed as a practical source of financing for start-up firms.
  - This sentiment is not a knock against banks; it is just that banks are risk averse, and financing start-ups is a risky business.
    - Banks are interested in firms that have a strong cash flow, low leverage, audited financials, good management, and a healthy balance sheet.

SBA Guaranteed Loans
1 of 2

- The SBA Guaranteed Loan Program
  - Approximately 50% of the 9,000 banks in the U.S. participate in the SBA Guaranteed Loan Program.
  - The program operates through private-sector lenders who provide loans that are guaranteed by the SBA.
  - The loans are for small businesses that are not able to obtain credit elsewhere.
- The 7(A) Loan Guarantee Program
  - The most notable SBA program available to small businesses.

SBA Guaranteed Loans
2 of 2

- Size and Types of Loans
  - Almost all small businesses are eligible to apply for an SBA guaranteed loan.
  - The SBA can guarantee as much as 85% on loans up to $150,000 and 75% on loans over $150,000.
  - An SBA guaranteed loan can be used for almost any legitimate business purpose.
  - Although SBA guaranteed loans are utilized more heavily by existing small businesses than start-ups, they should not be dismissed as a possible source of financing.

Other Sources of Debt Financing
1 of 2

- Vendor Credit
  - Also known as trade credit, is when a vendor extends credit to a business in order to allow the business to buy its products and/or services up front but defer payment until later.
- Factoring
  - Is a financial transaction whereby a business sells its accounts receivable to a third party, called a factor, at a discount in exchange for cash.

Other Sources of Debt Financing
2 of 2

- Peer-to-Peer Lending
  - Is a financial transaction that occurs directly between individuals or peers.
  - Prosper is the best know peer-to-peer lending network.
- Crowdfunding
  - A form of raising money that takes place, usually via the Internet, where people pool their money to support a start-up or other initiative, usually in return for some sort of amenity rather than loan.
  - Kickstarter is a popular online crowdfunding platform.

Creative Sources of Financing or Funding

Leasing	SBIR and STTR Grant Programs
Other Grant Programs	Strategic Partners

Leasing
1 of 2

- Leasing
  - A lease is a written agreement in which the owner of a piece of property allows an individual or business to use the property for a specified period of time in exchange for payments.
  - The major advantage of leasing is that it enables a company to acquire the use of assets with very little or no down payment.

Leasing
2 of 2

- Leasing (continued)
  - Most leases involve a modest down payment and monthly payments during the duration of the lease.
  - At the end of an equipment lease, the new venture typically has the option to stop using the equipment, purchase it for fair market value, or renew the lease.
  - Leasing is almost always more expensive than paying cash for an item, so most entrepreneurs think of leasing as an alternative to equity or debt financing.

SBIR and STTR Grants
1 of 4

- SBIR and STTR Programs
  - The Small Business Innovation Research (SBIR) and the Small Business Technology Transfer (STTR) programs are two important sources of early-stage funding for technology firms.
  - These programs provide cash grants to entrepreneurs who are working on projects in specific areas.
    - The main difference between the SBIR and the STTR programs is that the STTR program requires the participation of researchers working at universities or other research institutions.

SBIR and STTR Grants
2 of 4

- SBIR Program
  - The SBIR Program is a competitive grant program that provides over $1 billion per year to small businesses in early-stage and development projects.
  - Each year, 11 federal departments and agencies are required by the SBIR to reserve a portion of their R&D funds for awards to small businesses.
  - Guidelines for how to apply for the grants are provided on each agency's Web site.

SBIR and STTR Grants
3 of 4

- SBIR Program (continued)
  - The SBIR is a three-phase program, meaning that firms that qualify have the potential to receive more than one grant to fund a particular proposal.
  - Historically, less than 15% of all Phase I proposals are funded. The payoff for successful proposals, however, is high.
    - The money is essentially free. It is a grant, meaning that it doesn't have to be paid back and no equity in the firm is at stake.
    - The small business receiving the grant also retains the rights to any intellectual property generated as the result of the grant initiative.

SBIR and STTR Grants
4 of 4

SBIR Three-Phase Grant Program

Phase	Purpose of Phase	Duration	Funding Available (Varies by Agency)
Phase I	To demonstrate the proposed innovation's technical feasibility.	Up to 6 months	Up to $100,000
Phase II	Available to successful Phase I companies. The purpose of a Phase II grant is to develop and test a prototype of the innovation validated in Phase I.*	Up to 2 years	Up to $750,000
Phase III	Period in which Phase II innovations move from the research and development lab to the marketplace.	Open	No SBIR funding available, however, federal agencies may award non-SBIR-funded follow-on grants or contracts for products or processes that meet the mission needs of those agencies, or for further R&D.

Other Grant Programs

- Private Grants
  - There are a limited number of grant programs available.
  - Getting grants takes a little detective work.
  - Granting agencies are low key, and must be sought out.
- Other Government Grants
  - The federal government has grant programs beyond the SBIR and STTR programs.
  - The full spectrum of grants available is listed at www.grants.gov.
  - Be careful of grant-related scams.

Strategic Partners

- Strategic Partners
  - Strategic partners are another source of capital for new ventures.
  - Many partnerships are formed to share the costs of product or service development, to gain access to particular resources, or to facilitate speed to market.
  - Older established firms benefit by partnering with young entrepreneurial firms by gaining access to their creative ideas and entrepreneurial spirit.

Strategic Partners

- Biotech firms often partner with large drug companies to conduct clinical trials and bring new products to market.
- The biotech firms benefit by obtaining funding from their partners, and the partners benefit by having additional products to sell.