



Service Science

UniMiB

F9101Q022

Funding

How to Raise Money for Start-up Activities

mirko.cesarini@unimib.it

Main Actors

- **Entrepreneurs:** people looking for funding
- Potential **investors:** they give money (or resources) in exchange of partial ownership of the company
 - If the company grows and earns profit, ...
 - ... the investor will sell the shares and will be rewarded
- Not confirmed tale
 - Google guys were short of money at the very beginning
 - They paid a physiotherapist using stocks
 - Now the physiotherapist is (very) rich
- In U.S.A. some firms accept start-up stocks as payments for basic services e.g., law firms

Funding Steps: Overview

- Steps
 - **Pre-Seed** Funding
 - Founders
 - Family & Friends
 - **Planting** the Seed
 - Business Angels
 - Incubators / Accelerators
 - **Series** Funding
 - Series A
 - Series B
 - Series C
 - **IPO** (Initial Public Offering) or Acquisition
- New ways
 - Crowdfunding, ICO, ...
- Many companies spend months/years traveling these steps
←
- Others may bypass some steps e.g.,
 - revolutionary ideas
 - individuals with a proven success track record

Pre-Seed (AKA You, Family, & Friends)

- Even the most economic start-up need some money to start
- Investors: Founders (i.e., you), Family, and Friends
- Investment range: from \$10k to \$150k
- Rationale
 - “No investor will give you money if you don’t risk something of yours”
 - Subsequent round of funding might have requirements (e.g., an existing prototype/MVP) whose accomplishment requires money

Planting the Seed

- This is the first official equity funding stage
i.e., **money for equity**
- Equity:
 - **Stocks/Shares** (also called shares, in Italian respectively “azioni” or “quote”)
 - **Reservation** of future stocks (in case they do not yet exist)
 - Stocks might not be available at company early stages ...
 - ... they might be replaced by reservation of future stocks
- Investor types (more details on next slides):
 - (again) Founders, Family, and Friends
 - **Business Angels** ← the most active at this stage
 - **Incubators**
- Prerequisites: almost none (except **team believability**)
- Purpose: collect money to get the company off the ground

Business Angels

- **Business Angels** (BA, called also angel Investors, informal investors, angel funders, private investors, seed investors)
- **High risk investment:**
 - BAs receive **equity in return** (when the shares will be marketable, the BA will sell them)
 - The **IRR** (Internal Rate of Return, more on next slide) for a BA successful portfolio ranges from **20% to 30%**
 - In case the start-up fails, the BA completely loses the investment
- Raised sums: from \$10K to \$1M
- The IRR is very high, but cheaper sources of financing (e.g., banks) are not available for funding business ventures

Numbers and investor types are provided as examples, they may change without prior notice 😊

Internal Rate of Return

- Internal Rate of Return (IRR):
 - (quick and dirty definition, although not 100% correct) the interest rate of an equivalent investment
 - Accurate definition
 - IRR, is the interest rate (r) that makes the net present value (NPV) of all cash flows equal to zero
 - $NPV = \sum_{t=1}^T \left(\frac{C_t}{(1+r)^t} \right) - C_0 = 0$
 - C_0 : the money initially given by the investor
 - C_t : the money the investor will get back at time t (e.g., when she/he will receive earnings or will sell stocks)
- IRRs can be used to **compare different investments**

How to get BA Funding

- Entrepreneurs contact a BA
- Entrepreneurs do some **prior/paper-work** e.g.,
 - Fill out a formal **application** form or write an **executive summary** of the business proposal
 - Prepare **4-5 slides ppt** explaining the business
- The BA will **screen** the applications and select people for **meeting**
 - Entrepreneurs will personally present their ppt and business proposals in few minutes (**pitch**)
 - **Question and answer session** will usually follow
 - These meetings are held on a monthly basis
- Next steps, in case the BA is interested to invest
 - People evaluation (entrepreneur **background check** and **references pursue**)
 - **Due-diligence** is performed on the start-up
 - Industry **specialists** will be asked to conduct a comprehensive **assessment** of the proposed business strategy

Important Terms

- Due Diligence.
 - Investors examine the financial statements and books and records of the company, and all aspects of its operations
 - Investors might require corrections to be performed e.g.,
 - new **employment contracts** or
 - **stock vesting** schedules for key executives
 - ...
- Stock vesting: stock bonuses ...
 - ... are valuable employee-retention tool e.g.,
 - An employee might receive 100 **restricted stock units** as part of an annual bonus
 - Restricted stocks: the stocks usually have to vest first (enter in your full possession), usually you are required to
 - work for the company for a period of time ...
 - ... or achieve some results
 - ... to stimulate managers to work on **long-term results**

Tips for approaching a Business Angel

- Every BA focuses on a **specific market/technology/...**
- BAs expect you to have done some **research before** you contact them
 - Finding basic information about their **background**
 - **What** they're looking for, **why** they **invest**
 - The value they can add beyond cash
 - BAs risk their own money
 - Often their primary goal is not profit (nevertheless, they are very sensitive about losing money)
 - Many angels have websites and blogs
- “... If founders haven't done this basic homework before calling me, I have to believe they will be just as lazy when it comes to calling prospects or customers.”

Incubators

- **Incubators** typically accept startups at the **idea-stage**
- Goal: to help start-ups **growth** till they can apply for further funding (e.g., Series A) or to join an accelerator (see next slide)
- Service provided
 - Desk / room **spaces** (e.g., like co-working places)
 - **Mentorship**, access to the Incubator community and (people) network
- Payment
 - Incubators usually neither provide funds nor accept equity in return of their services
 - A **monthly fee** is usually required

Accelerators

- Accelerators are **cohort-based programs for companies**
 - Only start-up that are **beyond the idea stage** can join e.g.,
 - The company has traction on the market
 - The company need to further develop/grow its business
 - The company has a proof of concept (e.g., a product or an MVP)
 - Access to the program is upon **selection** (a contest is performed)
 - The program usually takes **3 to 6 months**
- Accelerators
 - provide funds in return of about **10% of equity**
 - each **accelerator focuses** on a specific industry/sector/...
 - E.g., InMotion ventures, part of Jaguar Land Rover, invests in startups working in transport and logistics
- Goal: to prepare companies to raise another round of funding (e.g., Series A)

Series A

- Series A round of financing is generally done by **companies**
 - generating some **revenues**
 - although **not yet profitable**
- Companies look for Series A funding to
 - cover up salaries of people involved
 - perform additional research activities
 - finalize products/services to be introduced into the market
- Investors obtain Series A stockings in exchange of funds
- Series A Stocks etymology: the first series of stock issued by a company after common stock offered to founders, family, and employees
- Investor type: **Venture Capitalists (VCs)**
 - Investors target
 - companies with great ideas and
 - strong strategy for turning that idea into a money-making business
 - The **company is evaluated** on the basis of
 - Proof of concept
 - Progress made with seed capital
 - Quality of the executive team
 - Market size
 - Risks involved
 - Investment range (in U.S.A.): “... you generally pitch to Business Angels when you are raising under **\$1 million**, Venture Capitalists when you want to raise more”

Business Angels often receive only stock reservations, not actual stocks

VC

- Venture Capitalist (VC)
 - Provides capital to startup ventures or supports small companies that do not have access to equities markets
 - Makes investments / Administer money on behalf of other people
- They invest
 - High risk business ...
 - ... that have high potential for growth

Series B

- Companies looking for Series B funding are **well established** i.e., they ...
 - ... have gone **through Seed** and **Series A** funding rounds
 - ... have already developed substantial **user bases**
 - ... have **proven to investors** that they are **prepared for success** on a larger scale
 - ... already have evaluations between \$30M and \$60M (in U.S.A.)
- A company looks for Series B funding to scale up i.e.,
 - To stimulate **customer growth** and **business development** (sales, advertising, ...)
 - To **grow a team** with talent acquisition
- Investor types: Venture Capitalists
 - The VCs from Series A e.g., the **key anchor investor(s)** that helps to draw in other investors
 - New **VCs** specialized in **later stage investing** (i.e., less risky investors)
- Investor's expectation
 - To see growth in revenue, users, or product success
 - Company is required not only to **break even** but to also **have a net profit**
- Investment range (in U.S.A.): > \$10M

Series C

- Companies looking for Series C funding
 - have **proven to be successful** in the market
 - want to scale up and or become business leaders as quick as possible
 - **acquisitions** of other companies,
 - earn **greater market share**
 - develop **new products** and **services**
 - E.g., extend from the U.S. to the European Market
- Investor types: VCs, hedge funds, investment banks, private equity firms ...
 - The company has already proven itself to have a successful business model
 - These new investors expect to invest money into profitable investments
- Investment range (in U.S.A.) much larger than previous Series (> \$30 million)
- In U.S.A. is the **last stage** in a company's growth cycle **before** an Initial Public offer (**IPO**)

Recap of previous Steps

Steps	Nickname	Amounts	Goal
Pre-Seeds	Take-off	\$10K - \$150K	Get the company off the ground
BA	Planting the seed	\$10K - \$1M	Planting the Seed
Series A	Anchor	>\$1M	Secure 1 st (Big) Investor (Anchor)
Series B	Build	>\$10M	Develop the Business
Series C	Consolidate	>30M	Become the dominant Player, prepare the company for IPO

- Facebook funding steps

- Feb 2004. Few thousand dollars from its co-founders
- Jun 2004. PayPal co-founder Peter Thiel invested \$500K
- Apr 2005. Facebook raises a \$12.7M Series A round of funding from *Accel Partners*
- Apr 2006. Facebook raises \$25M as Series B round of funding.
 - The round is led by *Greylock Partners*, contributions from Meritech Capital Partners
 - The prior investors Accel Partners and Peter Thiel are also in
- Oct 2007, Microsoft purchased a 1.6% share of Facebook for \$240 million, (total implied value of around \$15 billion)
- May 2012. Initial Public Offering (IPO)

It acted as Business Angel

IPO

- **Initial Public Offering (IPO)**
 - A company **sells stocks** to the **general public** for the first time (in the U.S.A. this is referred as: “going public”)
 - Equity offered on a **public stock exchange** (short name in U.S.A.: Wall Street)
 - New York Stock Exchange (NYSE)
 - NASDAQ
- Goal: to **raise money** for further boosting the company activities
- The company is introduced to **thousands of new shareholders** (everyone can invest money and buy company stocks)
 - There is no control over who invests in the company
- **Public companies** (i.e., the companies after the IPO) must
 - follow strict rules and regulations (e.g., legislation protecting people savings)
 - give **quarterly financial reports** (general idea: to make the market informed about the company results and financial situation)
- An IPO can be done selling debt instead of equity (we won't go deeper)

Crowdfunding

- Crowdfunding.
 - A project is funded ...
 - ... by raising small amounts of money ...
 - ... from a large number of people.
 - Frequently by means of an internet based platform
- Actors
 - Project initiator(s) i.e., the entrepreneur(s)
 - Individuals who financially support the idea
 - The platform that brings the parties together

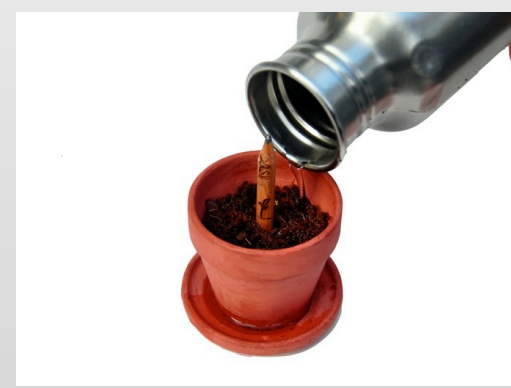
Kickstarter

- Kickstarter is a Crowdfunding platform <https://www.kickstarter.com/>
- Entrepreneurs, people looking for funds are called “Project creators”
- To start a fund-raising project
 - Project creators choose a deadline and a minimum funding goal (monetary goal)
 - Once the project is public, people (the crowd) can financially contribute
 - If the goal is not met by the deadline, no fund is actually collected
 - The investor may get back (in case of the goal is met and the project started)
 - Equity
 - First version of the product / service (Kickstarter acts as a preselling agent)
 - Nothing (e.g., philanthropic projects)
 - ...
- No guarantee that the project will start, complete, succeed, ...
- Revenue model: Kickstarter applies a 5% fee on the funds raised

One Kickstarter Successful Project Example

- (Pencil) Sprout. Once finished, the remaining can be planted
 - Seeds on the end
 - It will grow into a plant
- Kickstarter campaign
 - People can reserve a pencil
 - \$10 for each pen reservation

<https://www.kickstarter.com/projects/democratech/sprout-a-pencil-with-a-seed>
- Kickstarter target rule was used i.e., a minimal number of reservations was required to start the project
- Does this remind you anything? 😊
- The project can be viewed as an MVP



Initial Coin Offer

- **Initial Currency Offering (ICO)**. It is a type of funding using **cryptocurrencies** (e.g., Bitcoin, Ethereum, ...)
- The company offers to investors some **units of a new cryptocurrency (or crypto-token)** in exchange of money (including existing cryptocurrency)
- E.g., File coin
 - Unused data storage in data centers
 - Data centers can earn Filecoins by making unused resources available
 - Filecoins can be exchanged with existing money (including other crypto-currency)
 - Customers pay in Filecoins for storage services
- The company has got funding by selling the first created Filecoins
- More information <https://filecoin.io/>