Stages of Financing

- Early-stage financing (highest risk)
  - Seed capital – to prove the concept is viable
  - Startup capital – to make the business operational

- Expansion financing (lower risk)
  - Second-stage financing – first commercial sales
  - Third-stage financing – rapid expansion
  - Fourth-stage financing – to go public
Seed Capital

- Highest risk (no assurance of success, long time before revenues are achieved)
- Sources typically include relatives and entrepreneur’s own capital
- Needed typically for R&D
  - To prove the concept
  - To develop a working prototype
- VCs won’t invest at this stage
  - Biotech companies were an exception
Startup Capital

- Typically funded by venture capitalists or angel investors
  - They require ROIs of 40-200%
  - High ROI required in part to offset an average 80% failure rate

- Proceeds typically used for
  - Marketing (expansion)
  - Operations or production (expansion)
  - Continued R&D
  - Staffing
Subsequent-Stage Financing

- Typically provided by venture capitalists, investors, investment banks, corporations
- Multiple investors common (to share risk when investment required is too large)
- Required ROIs in the 25-100% range
- Proceeds typically used for marketing, systems, new product development, expansion, and brand development
Equity Financing

- Company must be valued first (value is often estimated) so a value can be placed on the shares owned by the investor

- The investor gets
  - An equity stake in the company (percentage is negotiated)
  - A seat on the board of directors

- Investment does not have to be paid back

- Risk is borne by the investor(s)

- Investment is for a limited time (about four years)
Investment-Deal Terms

- Capital requested
- Percentage of the company given in exchange
- Uses of the proceeds
- Exit strategy (how would the investment be recouped and when?)
- Other conditions
  - For example, stock buybacks based on achieving agreed upon performance milestones
Will an Investor Invest?

- Depends on how attractive the deal is
- Depends on how strong the business model is
- Depends on the level of trust the entrepreneur can command (usually more with more experience) (chemistry)
- Depends on how seductively the business plan is written
Loan Terms from Banks

- Loan amount
- For how long? When will it be repaid?
- At what monthly payment? What interest rate?
- What is offered as collateral?
- When is the money needed and when will the first payment begin?
- Other conditions
Loan Terms (cont.)

- Investors or relatives – not just banks – can also lend you money
- Offer an interest rate that would induce them to lend (double the bank’s?)
- Negotiate the term of the loan and how it would be repaid
  - No collateral is typically required
- Make sure the terms of the loan are put in writing and agreed upon (both parties sign)
Non-Collateral Loans from Banks

Conditions that must be met

- Company must have been in business three years
  - Two of those years must have shown a profit
- Principal must have good character, credit rating, and no criminal record
Exit Strategy

- This is when everyone “cashes out”
  - Often at an IPO (initial public offering)
    - Company goes public
    - Equity financing received from the public offering pays off the owners and investors of record
  - Could be acquired by another company
- Business plan must indicate when this might happen
- Proceeds go to the owners in proportion to the number of shares they own