

Week 4: Raising & Managing Money

Launching New Ventures: Entrepreneurship & Strategy for Technology-Driven Startups

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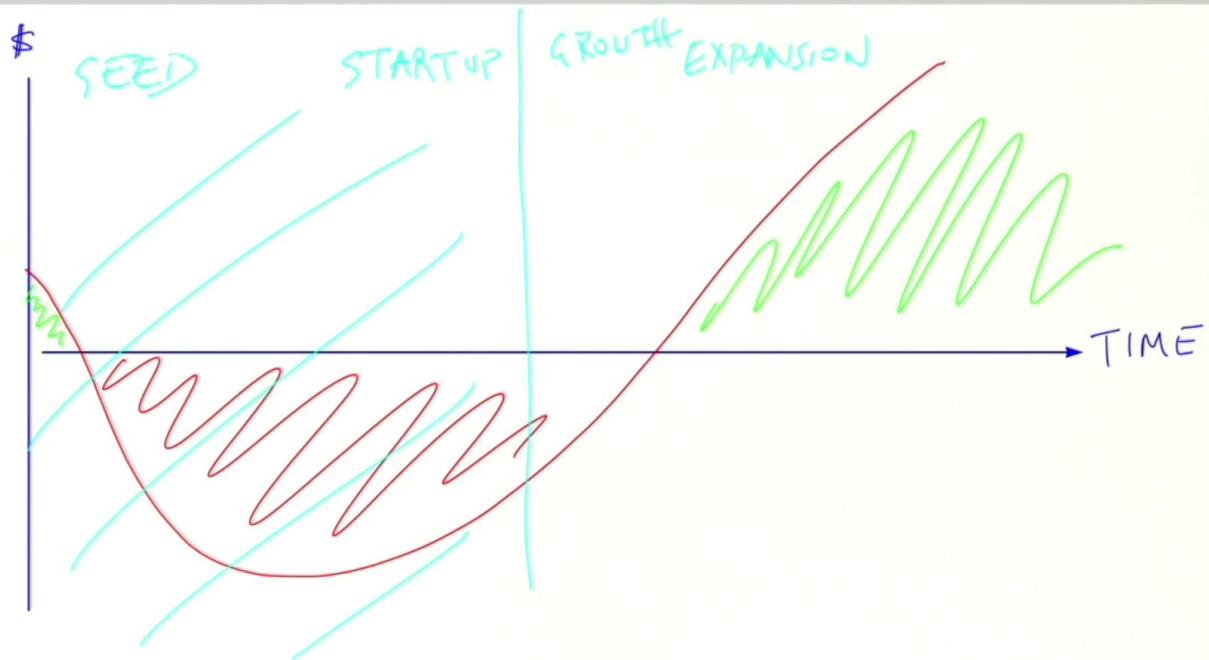
Welcome back! This is segment 4.4 on *Growth & expansion financing*. So today what we're going to do is talk a little bit, recap what we did before about the stages. We're going to give a little summary of how to analyze your options for financing, and then we're going to walk through step by step four different types of growth and expansion financing investors. So if you recall from the last several times we've discussed this staging, and we talked about sort of the early stage of financing, and then we have sort of the later stages of financing. The first ones are the seed stage, or the start up stage. Some people think about the seed stage as being earlier than the start up stage to help finance the initial cash outlays of the business. Although some people, as I mentioned before, use them interchangeably. And the same thing for growth and expansion. At some point, when the business starts taking off and making money, then usually the entrepreneurs are looking to grow the business. So they would be looking for-- a lot of people call growth financing and then eventually they are past the break-even point, and they are growing more rapidly, and they make seek to expand.

Notes

Summary



0m 00s



Launching new ventures

So some people call that the expansion financing stage. Again, a lot of people use the terms interchangeably, but after the company's already got something in the market. They're already making money, that's when you start looking for your growth and expansion financing.

Notes

Summary



1m 26s

Investors—who are they?



- Friends and Family
 - Crowdfunding
 - Banks
 - Foundations
 - Startup competitions
 - Angels and Angel Groups
 - Family Offices
 - Venture Capital
 - Strategic Partners
-
- Nobody (“bootstrapping”)

Launching new ventures

Alright, so here's our list of investors that we've seen many times at this point, and as you recall from the last segment, we were really focusing on the early stages of investors, so the first half of this list here. What we're going to do today is talk a little bit about some of the later stages, the type of people who come in at the later stage. So we mentioned before that the individual angel was often associated with seed financing and start up financing. And angel groups can too, but just to draw a little distinction between the individual angel and angel group: some of the angel groups will often come in later in the process. So we're going to include them in today's groups. If we just look here, we're going to talk mainly about this group of people. Angel groups, family offices, venture capital, and strategic partners or strategic investors or corporate venture capital investors. So those are all the same.

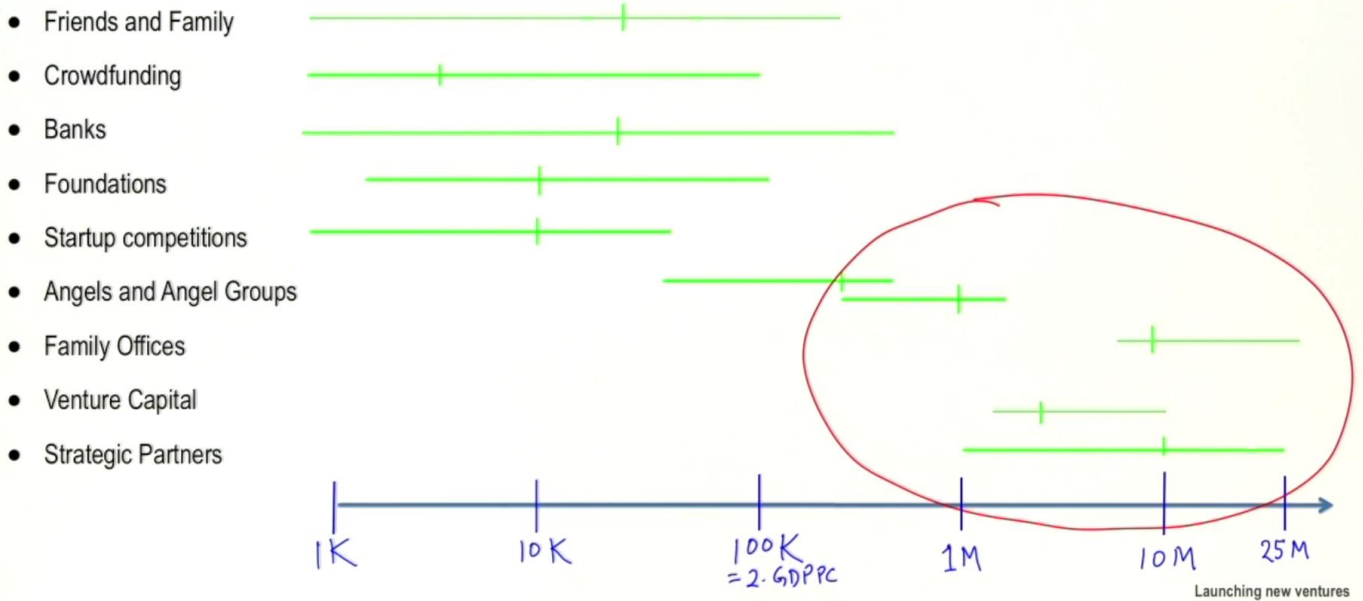
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Investors—how much to expect

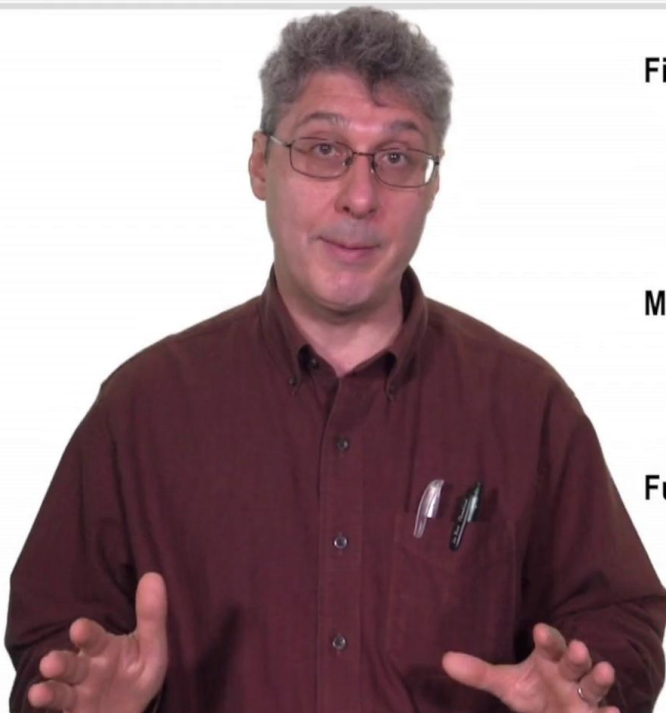


So we showed this graphic last time and time before and just to give a rough idea of the kinds of amounts that you might expect-- and again it should be calibrated to your own country's per capita GDP. So these are sort of industrialized country amounts. \$100,000 dollars or francs which is roughly two times GDP per capita. So we're going to start from that piece of it. So we're going to basically focus on this part of the spectrum now. So that's where we get into the angel groups, family offices, venture capital, and strategic partners.

Notes

Summary





Financial criteria

- How much money can you raise
- Availability (how quickly available?)
- Time horizon (short- vs. long-term)
- Cost

Management criteria

- Support in founding process
- Support in ongoing management
- Added value (e.g., reputation)

Further criteria

- Independence
- Degree of separation between source and team

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So again, just to talk about how to analyze your options. This is exactly what we talked about last time and we're going to apply the same criteria that we did last time for the seed and the start up financing to the growth and expansion financing. We're going to look at the financial criteria. How much money can you raise? How quickly can you raise it? What's the time horizon of the investor? What other costs are involved? We're going to look at management criteria. Can they give you support in the funding process? Can they give you support in running your business? Or can they add some other kind of value, such as a reputational value, credibility, etc.? And then finally, we're going to look at the independence that you gain or that you maintain depending on which investor invests, and we're going to look at the degree of separation between the source, between the investor and your team. In this particular case, there's not going to be a lot of variance there because most of these investors are going to be very distinct from your team, as opposed to your friends, and family, etc. But still, leave it on the list as something to think about when you are looking at any investment.

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Financing Stages

- Seed: your very first financing
- Startup: just *after* the seed phase
- Growth or expansion financing

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- How to analyze your options
- Four different types of growth & expansion financing investors

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Alright, let's talk about angel groups. An angel group is a group of individual angels who are wealthy individuals, mostly former entrepreneurs, who've already made money and who want to give back in some way. And they form a group, an official organized group, that meets on a regular basis. Sometimes once a month, or once every couple months to screen ideas from entrepreneurs. So what you're doing here is you're making a pitch in front of an angel group. They might schedule four to five different entrepreneurs to come in and make pitches and then, at the end of the presentation, they would have a question and answer period, they would have a discussion amongst themselves, and then, they would have some kind of vote or tally to see if any of the members of the group are willing to make an investment in the entrepreneur's company. And so that would go to the next level, you would actually do due diligence and then, they would basically make a proposal to sell some of the equity of your company to this group. So the ranges of this is going to be typically \$250,000 to \$1.5 million, which represents 30 times GDP per capita with a typical amount on the order of \$500,000, or say ten times GDP per capita.

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0m 06s



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The time frame can be relatively quick. A lot of angel groups advertise their existence and have a process for applying. Although it is recommended that you do homework on the group, find out what their specialities are, find out what they like before just sending out applications to every single angel group. It could be done in a month or two. The time horizon of these angel groups is often relatively patient. It's on the order of five to ten years. Sometimes, they would like to get it out in a subsequent round or before a real exit event. But in many cases, that's not possible, and they realize that. Many times they are willing to wait a little bit longer, and they do tend to come in earlier in the growth financing or the late start up financing phase. Let's talk about the advantages of having an angel group as your investor. One of the biggest advantages is that you can get input or advice from some of these angels. You're going to have a broad talent base. So you're going to have a large number of people. You get exposure and some of them are probably going to be experts in the same sector in which you are already operating or proposing to operate.

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So these people are going to be very, very good people for advice on running your company. Beyond that, for the exposure, imagine how long it would take if you had to hit up, solicit, one angel investor at a time. It would take months. Whereas you might be able to walk into a room of 10 to 50 angels all at once; and some of them might be interested in your idea. And then, in addition to all these, once you get the investment this can also be considered a positive signal for your reputation. So it does have reputational benefits. It gives you some credibility to say, "I've received an investment from an angel group," which tend to be more well known than any individual angel. Disadvantages: of course, here you are --just like when we talked about in the last segment-- you are going to give up a little bit of control of your company. And you're going to have to give up sort of the decision rights depending on your negotiation with the group. They'll be probably one lead investor, one lead angel investor, and that person will be the primary point of contact but you are going to have to deal with several people and the second disadvantage is they may or may not all agree with each other all the time.

Notes

Summary



0m 10s



- You sell a share of your company to a group of wealthy individuals
 - Equity-based
- Amount range: \$250K-\$1.5M (30 x GDPpc), typical \$500K
- Time frame: 1-2 months
- Time horizon: 5-10 years

Advantages:

- You can receive advice / input
- Broad talent base
- Bigger exposure (many angels at once)
- Positive signal for reputation

Disadvantages:

- You relinquish (relatively) more control
- They may have different opinions

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Of course at the beginning they're going to be very enthusiastic, that's why they chose to invest in your company but over time, they may not always agree with each other and since they're independent individuals you're going to have to negotiate with multiple people at the same time for the direction of your company, management decisions, etc.

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8m 33s



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A family office is an investor that invests the fortune of a single family. And so they're usually looking for a portfolio investment to diversify their own financial risk. In many cases, the family office would not be interested in talking to an individual entrepreneur. They may be more likely to be a partner in a venture capital fund. We'll talk about that in a minute. But occasionally, family offices do make investments in individual businesses, and it's becoming more common lately. So this would be, again, you're going to sell a share of your company to a private investor who represents a family fortune and this is going to be an equity based investment. So they're going to take a share of your company. The amount range is relatively high. That's because these investors don't want to deal with a bunch of small investments, lots of companies, lots of stakeholders, etc. So in general, these are going to be on the higher side, probably a more capital intensive business. \$5 million, which is a 100 times GDP per capita I would say would be on the low end of that range, and it can go up from there. Hard to say what the typical investment is here, really. Because these are not public events.

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0m 13s



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Most people don't talk about them. They're relatively private transactions. So they are on the higher end of the scale here. Usually, it might take one to three months to find and negotiate a deal with a family office. The time horizon, on the other hand, could be quite patient on the five to ten year frame. So the advantages here are, of course, they are larger amounts of money, which is really nice especially if you have some major capital needs for your growth or expansion phase. So what are the advantages of receiving investment from a family office? The first big one is: these are relatively large amounts of money. If you have a large capital need, you need to buy equipment or make an investment in a plant, or maybe you just have a big marketing campaign which requires a lot of capital then you can raise larger amounts of money from them. They probably are more patient than other late stage investors, such as venture capitalists. The disadvantages though is very difficult to gain entry to find the family office business and to talk to somebody, to actually pitch to them. I think it's actually a very tricky thing. You have to work through a network; usually.

Notes

Summary



0m 15s



- You sell a share of your company to a private investor representing a family fortune
 - Equity-based
- Amount range: \$5M+ (100 x GDPpc), typical \$???
- Time frame: 1-3 months+
- Time horizon: 5-10 years

Advantages

- Larger amounts
- Probably more patient relative to VC

Disadvantages:

- Very difficult to gain "entry"
- You relinquish (relatively) more control
- Less likely to get advice / input

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They almost always work on professional referrals. So it's tricky to get into a family office. That's why ordinarily, we don't much consider it to be a very credible source, but on the other hand, if you happen to run into one or get access to one, then you get all the advantages we've just discussed. You're going to relinquish some control of your business. These are going to be equity investors, so they are going to have a say in your management decisions. On the other hand, they're probably not going to give you any kind of advice or input but rather be on the more passive side of the investing advice spectrum.

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11m 48s



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Alright let's talk about venture capital. Venture capital lumes large in the minds of most entrepreneurs, even though most entrepreneurs don't get it or don't even need it in most cases. However, it's so talked about that I figured it would be good for us to get the basics of how venture capitalists works and what are some of the plus and minuses of it for this segment here. The idea behind venture capital is you are going to sell a share of your company to a professional growth investor. These are going to be equity in based investments and so you are in fact going to relinquish some part of the ownership of your company. And the amounts range on the higher side. So usually on the order of two to ten million dollars, or let's just say 200 times GDP per capita, and it's hard to say what a typical amount is, but it could be on the relative on the lower end of that \$2 million area. These are often staged investments so that means even if you raise two million from the venture capitalist, they may not give it to you all at once. In fact, they're almost never going to give it to you all at once. They're going to tie it to milestones and deadlines.

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They're going to check up on you, and they are going to see if you are following the plan that you originally had or if you have some ideas for how to modify the plan. In terms of the time frame here, usually two to three months. Could be more, depending on how long the negotiation takes, and how long it takes you to find some. The time horizon here is going to be relatively shorter. Usually on the order of five to seven years. That's because they are looking to get a return on their investment in a relatively short period of time. We'll talk about that next. So what are the advantages here? They're definitely going to give you advice or input, and they can help you make decisions on managing your business; and what to do, strategy decisions. They have a great network. So they are able to hire people for you or find people for you to hire, bring people in from their other former portfolio companies or portfolio companies, or other connections that they have. Generally, have a lot of good connections. The amount of money raised is also favorable for companies that really have a capital need. Usually, we say a venture capital business is funding really high growth or high expansion phase for capital intensive businesses.

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It's not for every kind of company. The disadvantages here it's the same as the advantage: they're going to give you advice and input. In this case, you may not like all the advice and input that you receive, but they're going to definitely give it to you, and really, really keep track of what you're doing. They're going to follow what you're doing carefully. You're going to relinquish some control, you're going to give up some ownership of the company, but you're also going to give up some decision rights. They're going to have, usually, some kind of veto power over major strategic decisions that you're making. So they're going to really, really look into what you're doing. Typically, they're never going to sign a non-disclosure agreement or other sorts of things for secrecy purposes because of legal reasons. So technically, your ideas could be diffused. They could legally talk to one of their other portfolio companies or talk to someone else and maybe inspired by something that you said, give the idea away to someone else. Although, again, once they've made the decision to invest in you, they want you to grow, and to do well, and be successful.

Notes

Summary



0m 22s



- You sell a share of your company to a professional growth investor
 - Equity-based
- Amount range: \$2M-\$10M (200 x GDPpc), typical ~\$2M
- Time frame: 2-3 months+
- Time horizon: 5-7 years

Advantages:

- They will give you advice / input
- Great network for hiring
- Amounts are higher

Disadvantages:

- They will give you advice / input
- You relinquish more control / decision rights
- Your ideas could be diffused
- Investments staged

They're not just going to try and give your ideas away to anybody but your ideas could leak, let's put it that way. And as I mentioned earlier, the investments are going to be staged. They're not going to give you all the money at once, and they're going to have milestone planning and they're going to give you the pieces of the investment, a small piece at a time, every time you hit a milestone.

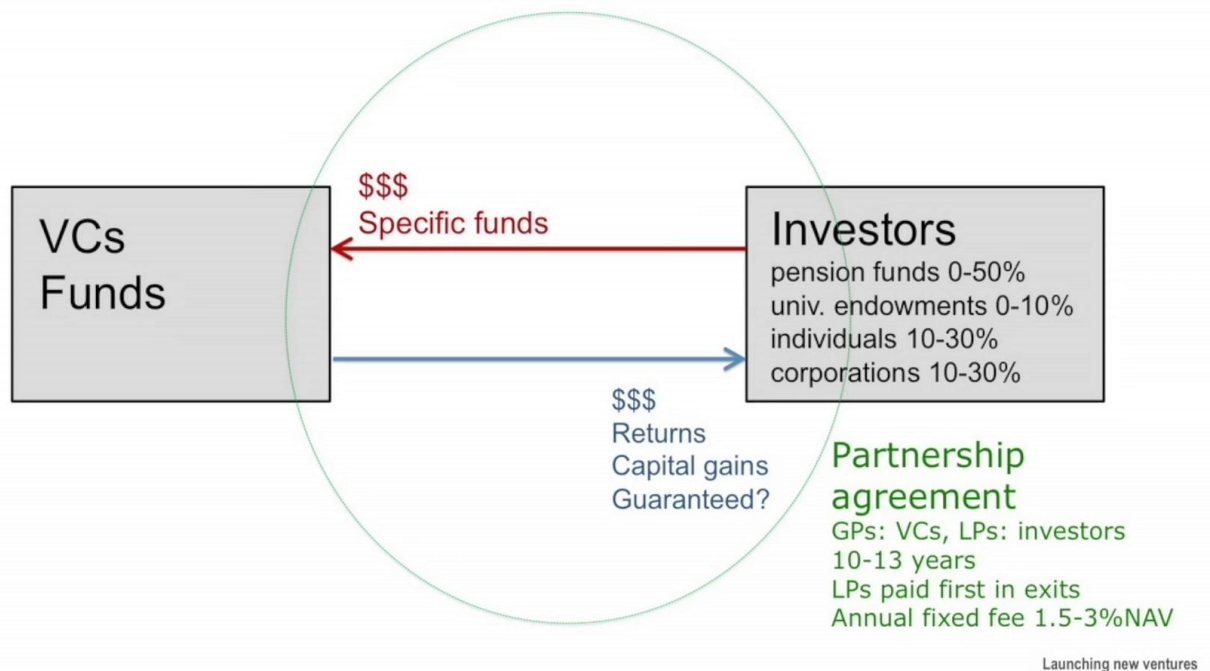
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16m 37s

How venture capital works



Let's talk about how venture capital works. Venture capitalists make investments for other investors. They usually raise funds for a specific fund, and they go and they talk to different people, pension funds, family offices, other wealthy investors, and they take the money from them, and they create a small limited partnership with those funds, and then they take that money, and they invest it in start up companies, in a portfolio of start up companies. Usually, the way the deal works with the limited partners is that there is a time horizon at which the fund must be liquidated and all remaining amounts of money in the fund has to be returned to limited partners. So that's why there's some kind of pressure here to make an exit event happen. So as we discussed a few segments ago, the exit event, which could be a trade sale, or an initial public offering, or some other follow-on investment is a way for the investors to exit the business. Not necessarily the entrepreneurs.

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16m 57s



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And so what they're doing is they are making investments in a portfolio of companies with a specific relatively short time horizon on the order of five to ten years, they don't make all the investments at once, at the very beginning. Time goes on; and then they are building their portfolio, but they know that within seven years, finally by the time they make all their investments they're going to need to liquidate that fund. So therefore, they really, really want to see an exit event for some of the portfolio companies in their portfolio. And if a company isn't performing, it doesn't look as if it's going to actually make a good exit event, they may cut back on the effort and attention they want to give to it, and focus on one that they think it's a very, very good chance of recouping their investments and all other portfolio companies. Because an IPO can more than pay-- one IPO can more than pay for all the investments that they made and a trade sale would probably break even on the investments themselves. So they go for a couple big hit home runs. They look for a couple big exit events.

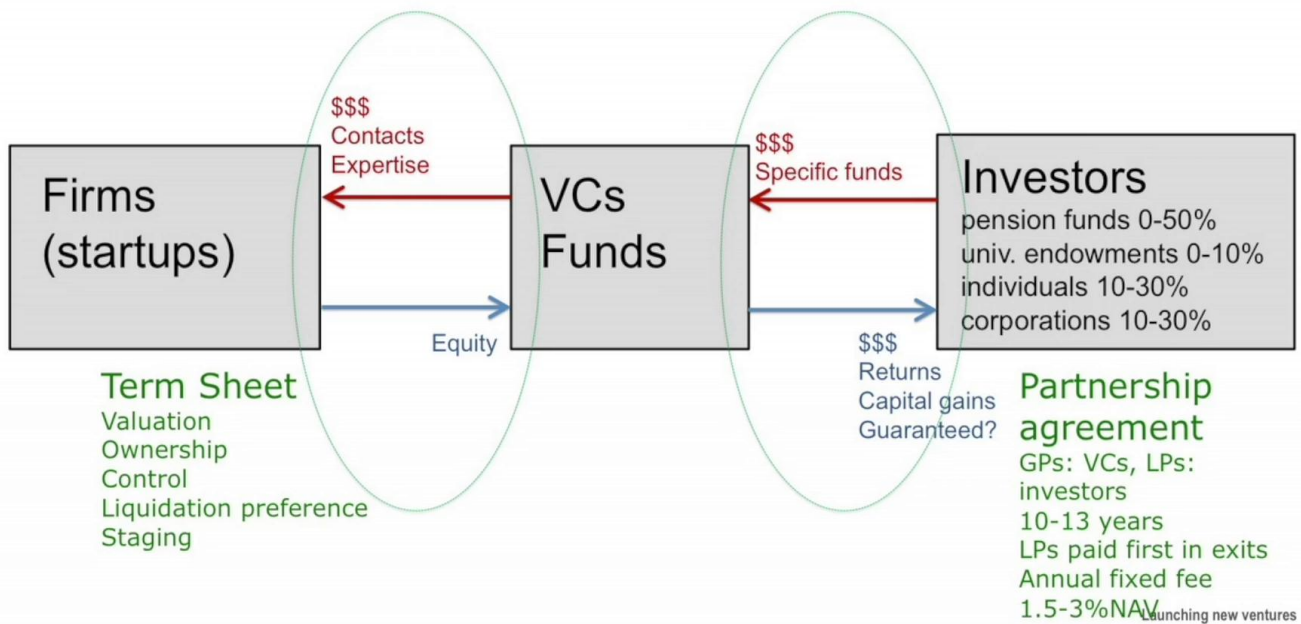
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How venture capital works



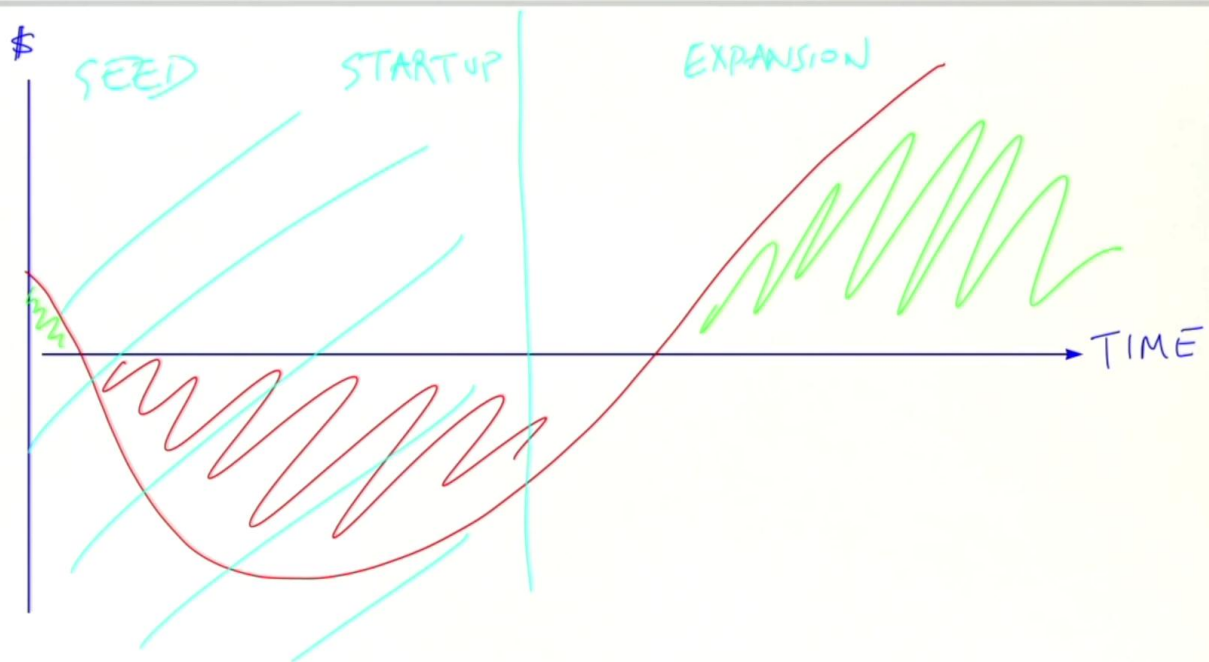
They look for a couple trade sales, which breaks even on perhaps that particular investment, and overall, they have a very nice return which then they give back to the limited partners in the end. So that's why venture capitalists typically are looking for growth, and they are looking for exit at a certain point in time on a finite time horizon.

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19m 33s



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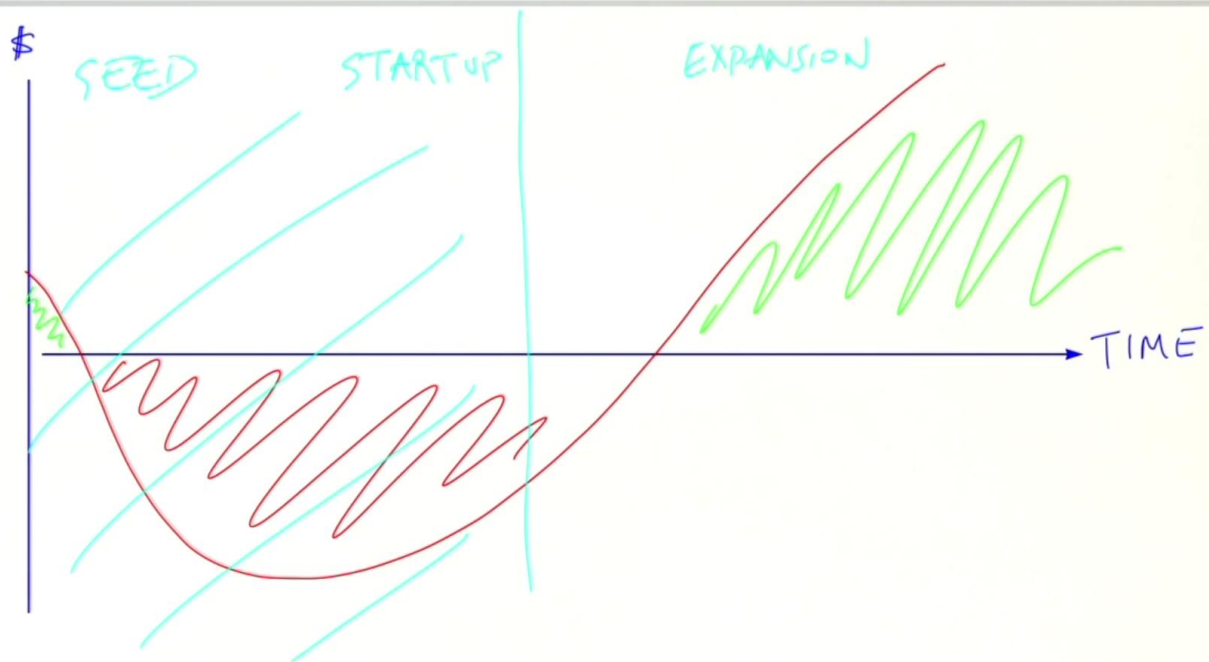
OK, let's talk about strategic investors. Some people call them strategic partners and some people call them corporate venture capital investors. And it's basically all the same. It's when a large company makes an investment in a start up. And so therefore you as the entrepreneur are going to sell a share of your company to a larger company. This is also an equity based investment. Now the amounts are usually relatively large for these kinds of transactions. So let's say \$1 million to \$25 million. That's 500 times GDP per capita. Quite a large amount. Typically, hard to say because it's very very big variance, but let's say on the order of \$10 million. The time frame is a little bit longer. Let's say two to five months because you have to find the investor. You have to get into the right person inside the big company, and then you have to negotiate the deal. Some companies set up their own units for making corporate venture capital investments. But other companies don't have such a official organized program, they're more ad-hoc in the way that they make investments, and those companies take even longer to decide what to do. On the other hand, for a time horizon depends on the motivation of the big company.

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0m 29s



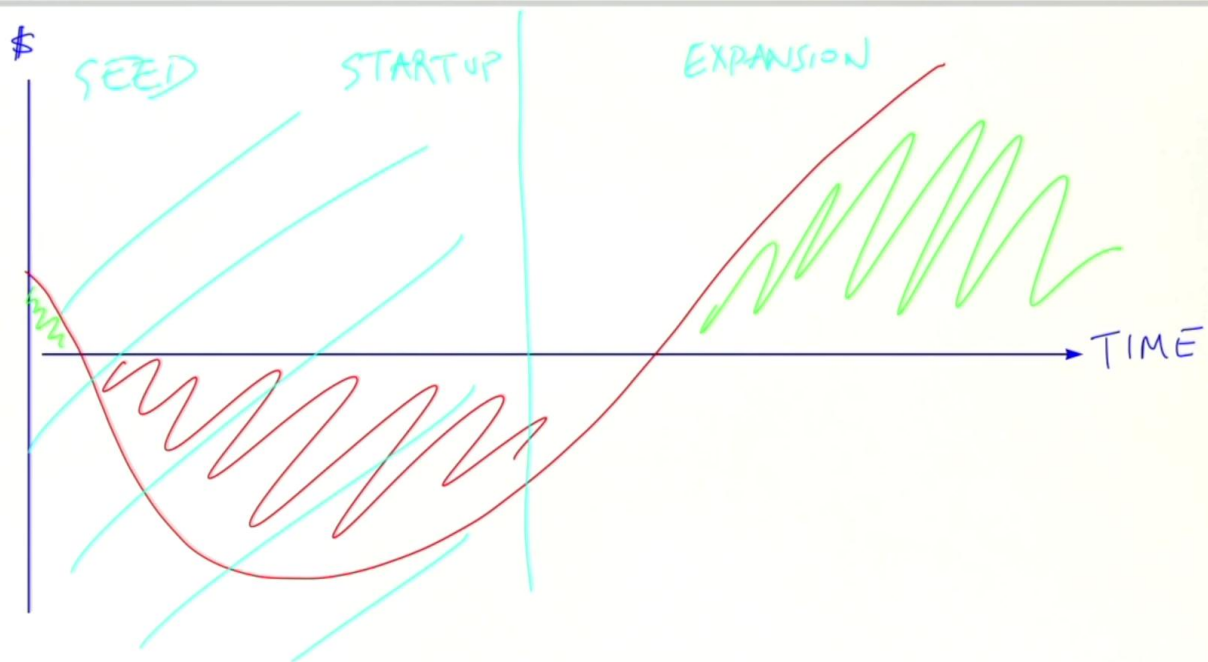
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It could be eight to ten years relatively patient, very patient in general. It also depends on what the purpose of this investment is from the company's point of view. If they're looking for a financial return. So they really want to see an exit, they'll have a similar time horizon to a venture capitalist. On the other hand, if they're looking for more of a strategic return. In other words, is your company going to stimulate compliments that are going to stimulate demand for their product. They may be willing to wait a long time before trying to cash out of your business. The time horizon could be a relatively long and patient ten year period before they would even think very much about trying to exit the business as an investor. So what are the advantages here? There are lots of advantages. They might be your biggest customer or supplier. So if they're your customer, then they might think that if you sell a lot, then they're going to sell a lot to you. So that could be a big advantage. Your incentives are nice and aligned in such a situation or a supplier could be the same.

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They usually don't have the exit pressure, usually, as I say here unless they're really, really focusing on financial return to your company which most research has shown is not a very good idea and usually not very successful from the big company's point of view either. You're better off looking for a company that's interested in the strategic investment as opposed to a financial investment, and that will also help on the time horizon side because there will be less pressure to try and get you spruced up to sell. Disadvantages. You do need to relinquish some control. They are going to have some influence on your decision making and compounding their influence on your decision making is the speed of their decision making. Some people are attracted to start ups because they want to make quick decisions and many big companies, especially the kinds that can make these kinds of \$10 million investments in small companies have very slow decision making processes. You have to factor that in because when you want to do something very, very quick, they may not be ready for it. It may take them a very long time to build consensus inside their big company. Final disadvantage here is-- I put strategic conflict.

Notes

Summary



0m 33s



- You sell a share of your company to a larger company
 - Equity-based
- Amount range: \$1M-\$25M (500 x GDPpc), typical ~\$10M
- Time frame: 2-5 months
- Time horizon: 8-10 years

Advantages:

- They might be your biggest customer, or supplier
- They do not have exit pressures (usually)

Disadvantages:

- You relinquish some control
- S L O W decision making
- Strategic conflict?

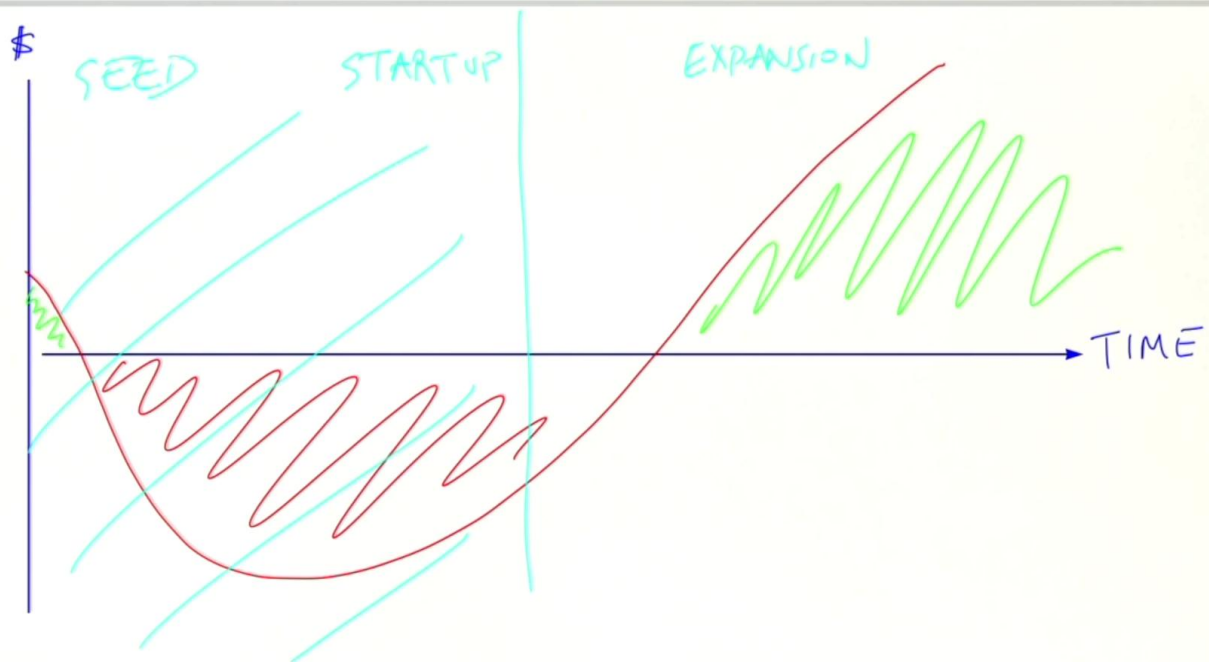
What does that mean? Basically what that means is at the beginning it looks very good. It looks very complimentary. It's perfect. But over time, you may find that your business interests and the big company's business interests are not exactly aligned perfectly. In which case, it can create a lot of distraction for the entrepreneurs and it creates a kind of a conflict between the two companies. And since they are part owner, you're going to be involved with them quite a bit, and so if the conflict escalates, it can be a big distraction.

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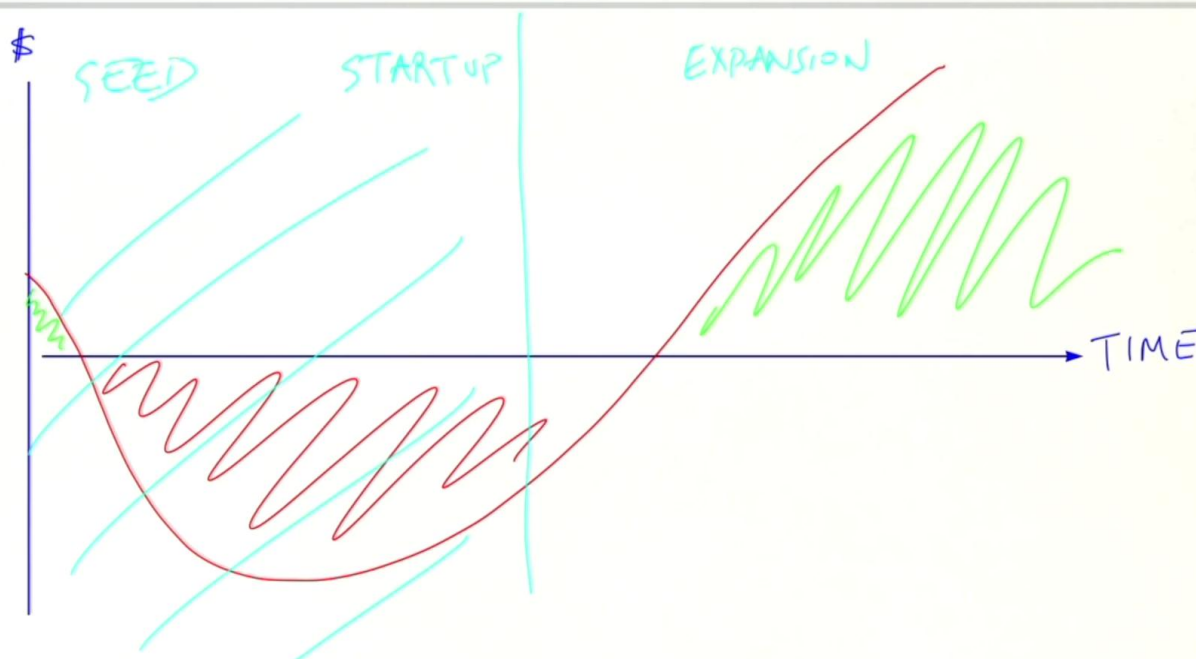
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OK, so here's the last slide. It's the overview of the sources of funding and the process. And basically just summarizes everything that we just discussed. So just to point out a couple things. On the left here we have the various sources. How much money you would typically raise and how quickly this would happen. I could have put this one here in red too just because it can take a lot longer. And we could probably put this one in green because they're more patient perhaps, a strategic investor. They do take a lot of time. They may take a lot of time to make the initial investment decision, and they may take a lot of time to make on-going strategic decisions for you. They will give you input. In fact, all of these sources are going to give you input in managing your company. And as I point out here, that can be good because you can get good input from a venture capital but on the other hand, you can also get a lot of input, maybe too much input, from a venture capitalist. With a venture capitalist, you do relinquish more control, and they're going to be more involved. On the other hand, the reputational benefit of receiving venture capital is very very good.

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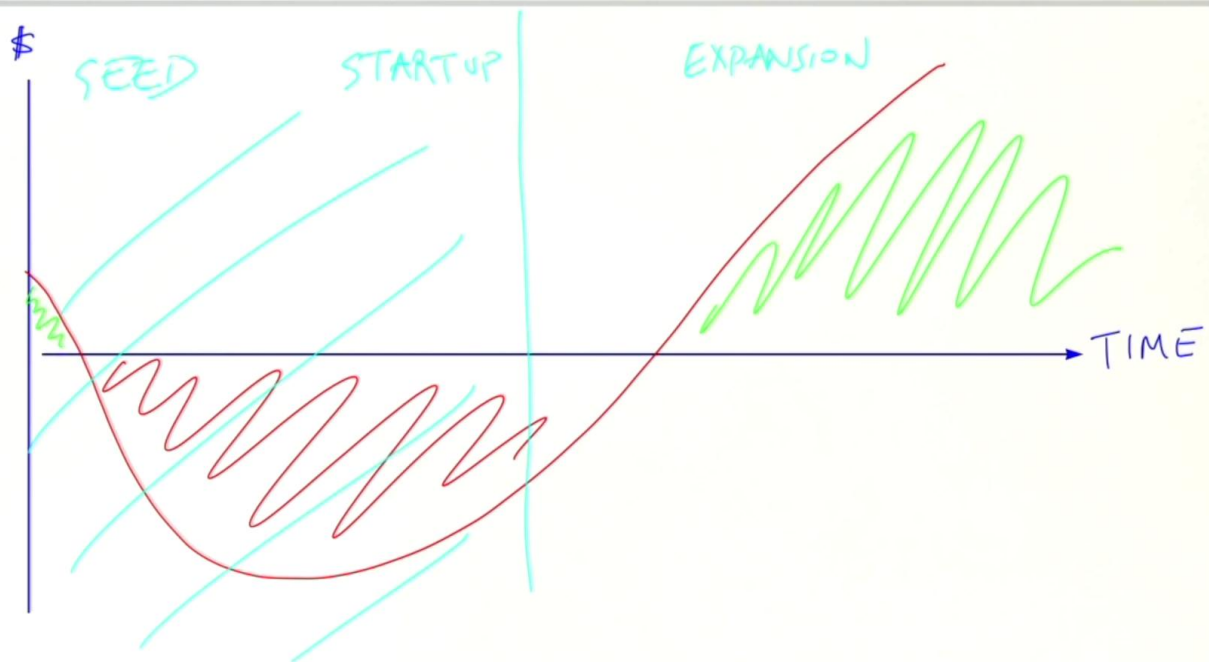
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When you can claim that you received venture capital, it has a lot of other benefits when you're dealing with suppliers, customers. You say, "Oh, I'm a start up company. Yeah, I don't really have any investors I'm doing everything my own." Versus: "I just got a major investment from this company." That can be quite useful when you're talking with potential customers. Just to continue on with the venture capitalist here: support in the funding process. I put "Be careful!" What I meant by that is the incentives and the venture capitalists, and the incentives and the entrepreneur is not always 100% aligned, especially when it comes to funding the business. Of course, if the business does very well, everyone is happy, and there's really no problem. The only problem happens sometimes when the business isn't taking off, and then some of the structures that you can get within your term sheet you really have to look those over carefully to see how it happened. In case things go well and in case things go less well, and they're going to take an equity position in your company. They're all going to take equity positions. But they're going to be more active investors, venture capitalists.

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The only last couple things that I wanted to say here about angel groups. You can have many investors and as it's a group, they're not working together for the same company. They are independent people and so you may have to deal with many investors. On the other hand, they can give you advice not only on the funding process but also on management decisions, and they also give you a good reputation. If you can say, you've received an investment from an angel group. That could be considered beneficial when you negotiate with other partners. Independence, as I mentioned, you're going to relinquish some control no matter what. You're probably going to relinquish more decision making control if you receive venture capital investment. And in terms of the separation, as I mentioned in the very beginning-- I didn't write anything here because basically all of these sources are very, very separated from your typical team, your founding team. You're not related to them. You're not working with them all the time, etc. So there's a very very clean separation and they're all going to do very, very careful due diligence, which can take some time. They're going to investigate your business, your business model, your business plan.

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Summary



Overview of Funding Sources & Process

Source	How much?	How quickly?	Time Horizon	Cost	Support in Funding Process	Support in ongoing Management	Reputation	Independence	Degree of separation
Angel Groups	typically \$500K	1-2 months	5-10 years	Dealing with many investors	Can get Input	Can get Input	Good	You relinquish some control	
Family Offices	typically ~\$8M	1-3 months	5-10 years			Can get Input		You relinquish some control	
Venture Capital	typically ~\$2M	2-3 months	5-7 years	Equity position	Be careful!	Can get Input Can get Input	Credible	You relinquish more control	
Strategic Investors	typically ~\$10M	2-5 months	8-10 years	Time		Can get Input	Good	You relinquish some control	

Launching new ventures

They're going to decide in a neutral way whether it's worth it for them to make an investment because they're looking for an eventual exit or in the case of a corporate venture capital, they're looking for some kind of strategic bonus for their own business that will help their own business. So let's have a look at an interview now to talk a little bit about some of these sources of financing, and we're going to see you soon for the next segment. Thanks a lot.

Notes

Summary

