

Module 5: RAISE OF FUNDING AND GOVERNANCE

Supplemental Material: Startup Funding

CONNECT 2021-2024

Connecting universities-industry through smart entrepreneurial cooperation and competitive intelligence of students in Moldova, Georgia and Armenia

Erasmus +, KA2,

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Capacity Building in the Field of Higher Education

617393-EPP-1-2020-1-MD-EPPKA2-CBHE-JP



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TYPES OF INVESTMENT (“Dilutive Capital”)

- **Debt:** Borrowing money with the promise to repay it at some point under specific terms
- **Equity:** Money purchases an ownership stake in the company
- **De-risking Factor:** what investors look for to make their investment less risky
- **Vehicle:** How the investment is structured

Source	Debt	Equity	De-risking	Typical Vehicle
Bootstrap founder self-finances the business	✓	✗	Not necessary	<ul style="list-style-type: none"> • Founder/s lend money to the company on a long-term basis via ACI “Additional Capital Increase” • Founder equity does not +/- (remains 100%) • If >1 founder, each contributes cash according to their ownership stake.
FFF Friends, Family & Fools	✓	✓	Not realistic	<ul style="list-style-type: none"> • Often the first outside investment; • Can be structured as convertible loan or straight equity.
Business Angel	✓	✓	Business case	<ul style="list-style-type: none"> • Usually convertible loan (or SAFE), sometimes straight equity or warrant.
Venture Capital Fund	✓	✓	IP (Patents, etc.), traction	<ul style="list-style-type: none"> • Early stage (Pre-Seed, Seed), convertible note or SAFE; • Later (Series A & beyond), straight equity (“Priced Round”)
Corporate Investment	✓	✓	IP (Patents, etc.), traction	<ul style="list-style-type: none"> • An established company buys part of the startup, usually for straight equity, although convertible notes are possible.
Equity Crowd Funding		✓	Prototype, vision	<ul style="list-style-type: none"> • Individual investors buy shares in the company via a platform; the project is open for investment during a limited time and under specific conditions (each platform is different).



Bootstrapping: Shutterstock

“I knew who my customers were, and the challenges they faced trying to find the right image to market their business.”

- Jon Oringer

Shutterstock

- >1M active customers in 150 countries
- currently worth \$2 billion.

Founder:

- Jon Oringer, professional software developer, amateur photographer
- Serial Entrepreneur (founded 10 companies)

Source of Idea

- the one commonality to all of the companies he founded was lack of options for affordable stock imagery for marketing or websites

MVP

- Codes the site himself
- Takes 30K pictures by himself, and licenses them to others at a nominal cost.
- Shot 30,000 images in the first year, coded the site himself
- Not many tools at the time to help individuals start a business.

Main innovation:

- Removed complex licensing rights
- Used simple subscription model



FFFs: SimpliSafe

“Many people didn’t want to sign a three-year contract...

The whole industry operates based on long-term contracts. Everyone thought it was nuts not to have customers sign a contract..”

- Eleanor & Chad Laurans



SimpliSafe

- ~ 40M installs
- Product launched 2009

Founders:

- Chad & Eleanor Laurans

Investors

- First investment: Friends (undisclosed)
- Total amount of Funding to date: \$187M

Source of Idea

- Classmates were victims of multiple break-ins, but couldn’t sign long-term contracts with alarm companies

MVP

- Built prototypes at home
- Full product is a modular, easy to install home security system with sensors & app

Main innovation:

- Eliminate installer
- Eliminate obligatory contract
- Subscription fee for monitoring services

INVESTMENT: Angel Investors

An angel investor is an individual who provides financial backing to startups. They typically expect a return of 3-5X their investment.

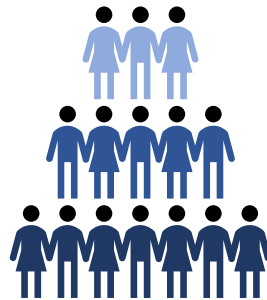


Source of Funds: personal money
Typical Range: \$5000 – \$100,000
Also Provide: advice, networking



Many countries have specific regulations for Angels:

- Personal finances
- Degree of experience
- Investment process &/or amount, Tax or other incentives



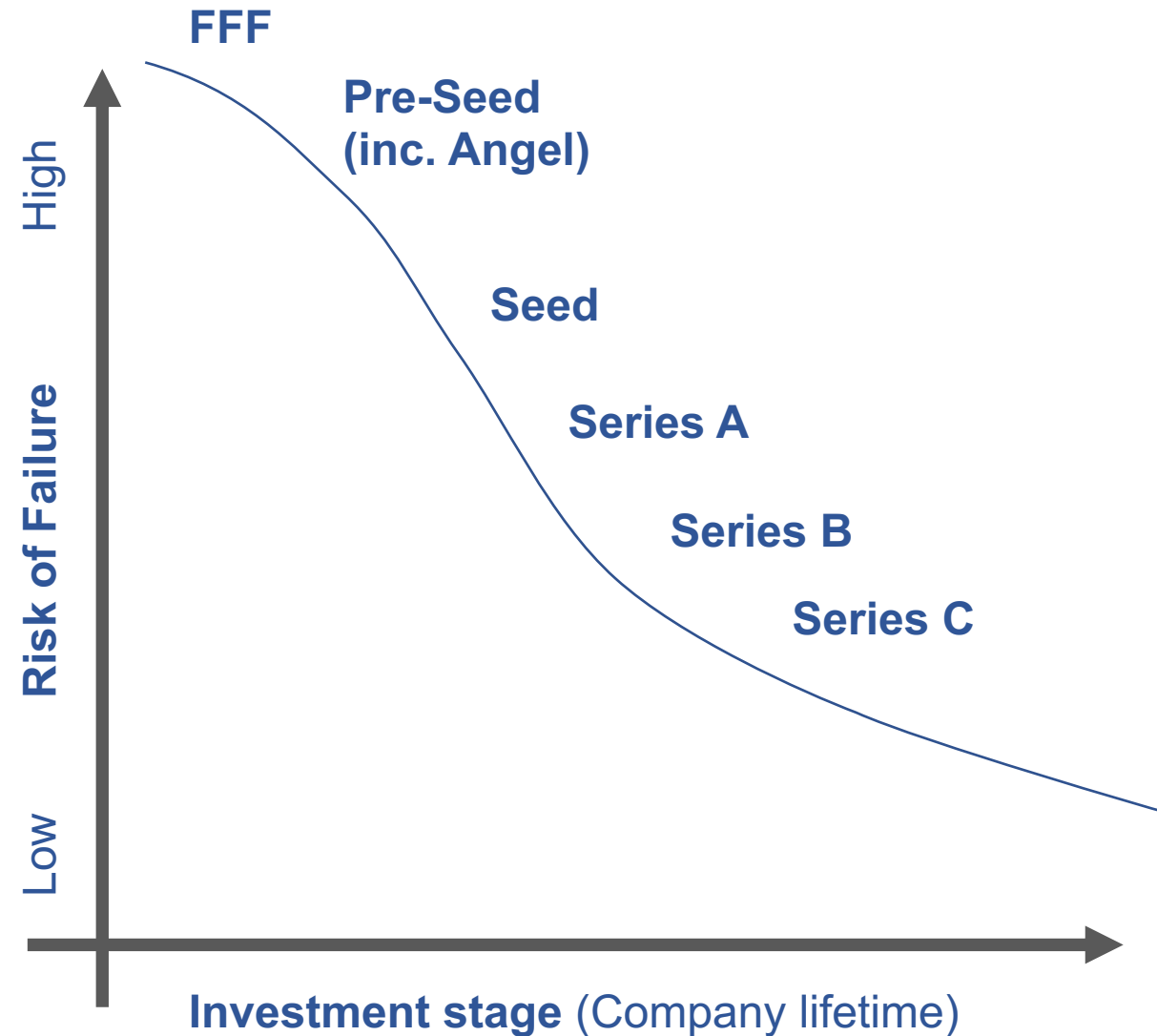
Sometimes, Angels get together in Networks (BANs):

- Better access to potential investments (“dealflow”)
- Possible to invest together (“syndicated investment”)



INVESTMENT: Measuring Risk

The earlier the investment, the higher the risk



INVESTMENT: Venture Capitalist

A Venture Capitalist is an employee of a VC Fund, who identifies and evaluates candidate startup companies for investment from their Fund.



Source of Funds: VC Fund
Typical Range: \$125,000 – \$10,000,000



Many Venture Capitalists have previous experience as:

- Startup or corporate employees
- Entrepreneurs/Startup Founders
- Consultants (McKinsey, SAP, etc.)



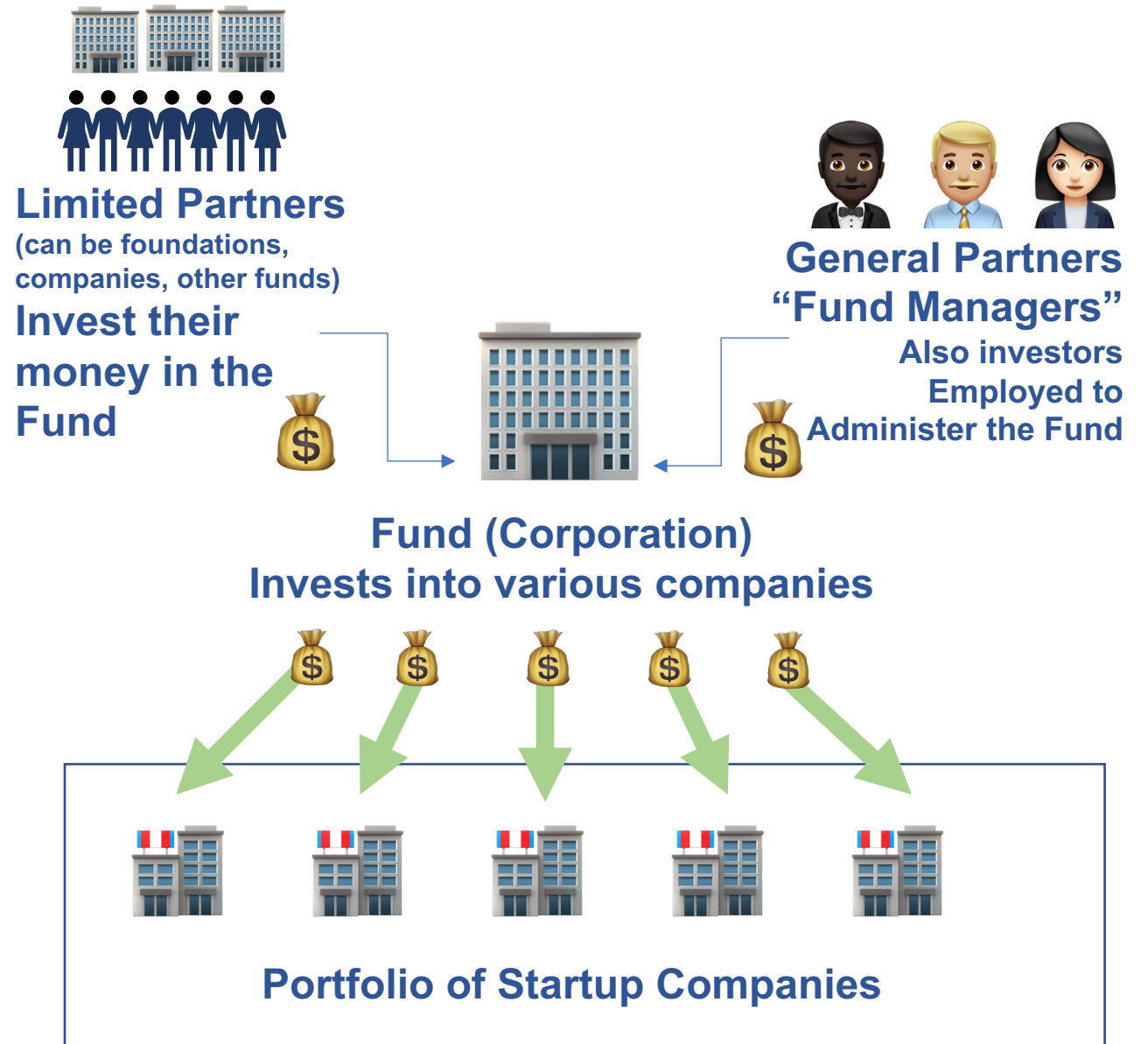
Most Venture Capitalists engage in:

- Evaluating startups
- Negotiating terms
- Monitoring their portfolio
- Assisting portfolio startups
- Attending events and competitions



INVESTMENT: Venture Capital Fund

A Venture
Capital Fund is
a company that
makes
investments
into startup
companies.



INVESTMENT: VC Fund lifetimes

**Most VC Funds
have a limited
time to turn a
profit for their
investors**

“Closed-End” Fund

- Avg. 10 years: 5+5
(Possible extension)
- Money Raised
- Fund Opens
- Money Deployed (investments)
- Investments realized (“Exits”)
- Fund Closes

**Most Early-stage
VC Funds**

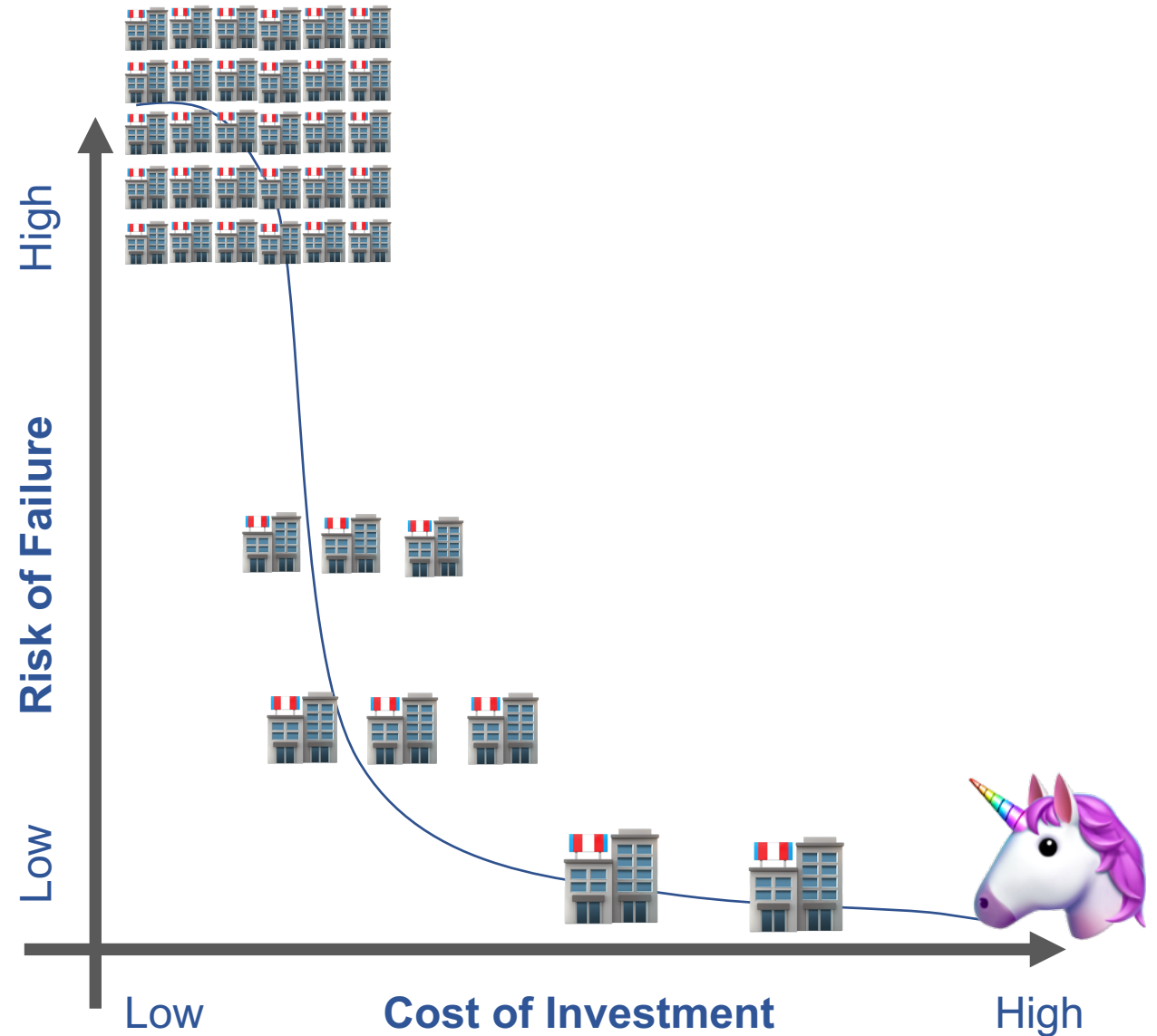
“Evergreen”

- Ongoing Raise from LPs
- Ongoing Investments & Divestments
- Can participate in public co’s
(Sequoia)
- Not typical



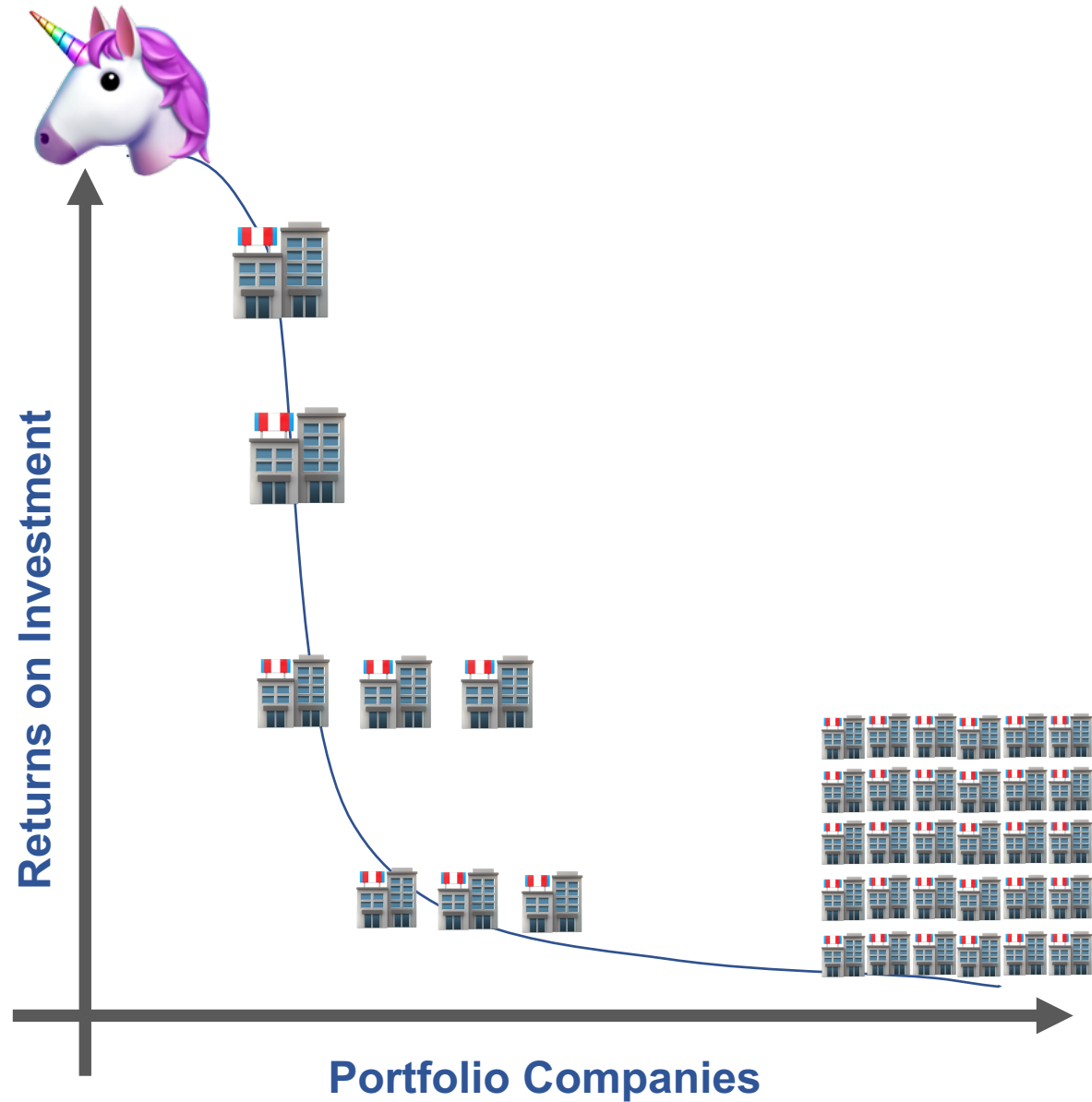
INVESTMENT: Measuring Risk

Later-stage investments are more expensive than earlier stage, as the company value increases



INVESTMENT: The “Power Law” of VC

The minority of portfolio startups will achieve the majority of returns



INVESTMENT: The “Power Law” of VC

- Assume: 90% of investments will fail to return any meaningful increase in value.
- Depend on 10% to generate significant returns.
- Typical expected returns on a VC fund range from 15X-30X.
- Target companies that can return up to 100X to compensate for all the failures.



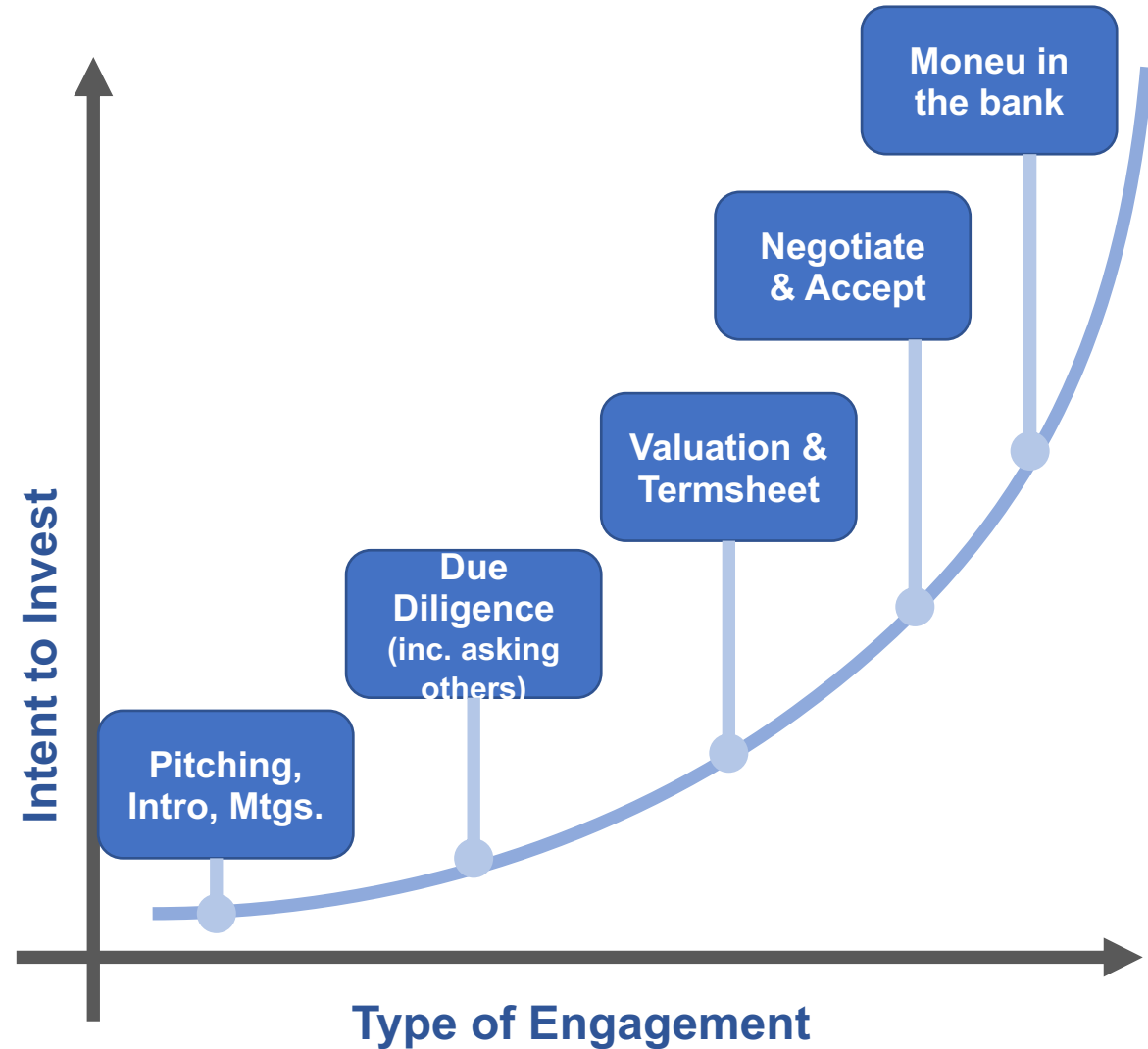
Valued @
\$1 Billion



INVESTMENT: Dealflow

How an investment happens

Most early-stage investments take
6-9 months, from first contact



INVESTMENT: Valuations

Early stage
company
valuations are
mostly
aspirational,
because the
startup has no
historical data
yet

Examine each case and compare with industry knowledge, methods, metrics

Standard factors:

- Fit with their Focus / Portfolio
- Team
- Product/prototype
- Market Size
- Competition
- Burn Rate & Financials

Comparable cases – VCs will look at similar deals and companies

Negotiations always balance:

- Investor's **Risk**
- Entrepreneur's **Need**



INVESTMENT: Valuations

Early stage
company
valuations are
mostly
aspirational,
because the
startup has no
historical data
yet

Company Valuations & Investment Amount (“Ask”)

My Company
Valuation is
\$5 Million



Startup Founder:

- Needs: \$500,000
- For: marketing, growth
- Willing to give up: 10% ownership

Valuation: \$5 Million (pre-money)

Raise: \$500,000

Post-money Valuation: \$5.5 Million

Investor's share: 9% ($500,000 / 5.5 \text{ M} = 9\%$)

I think its
more like
\$2 Million...



VC:

- Knows the market (other similar companies)

Valuation: \$2 Million (pre-money)

Raise: \$500,000

Post-money Valuation: \$2.5 Million

Investor's share: 20% ($500,000 / 2.5 \text{ M} = 20\%$)



INVESTMENT: Structure

“Priced” Round:
When the
company’s value
can be set at a
specific amount

A “Priced Round” means that the investor and startup have agreed on a specific company valuation:

The equity % and number of shares are settled and the investment is closed:

Valuation: \$8 Million (pre-money)

Raise: \$2 Million

Post-money Valuation: \$10 Million

Investor’s share: 20% (2M / 10M = 20%)

Type of stock (**preferred** vs. **common**)

- Discounts
- Pro-rata Rights
- Control
- Other Terms

The fund hopes the value of the company will increase so that the value of owned shares will rise.



INVESTMENT: Structure

Convertible Debt:

When its better to wait on the Valuation

Convertible debt is a good solution when it is **too early** to derive logical valuation for the company

Money is '**loaned**' to the company in return for a promise to be repaid:

- Shares
- Returned cash

Convertible Notes:

- **Amount of loan** (Principal + Interest rate)
- **Maturity date** (Return or Conversion)
- **Discount** (for next rounds)
- **Control** (oversight of certain decisions)
- **Use of Funds** (% devoted to salaries, etc.)
- **Other Terms** (founder vesting, option pool, etc.)



Convertible Loan Agreement

INVESTMENT: Structure

Term Sheet

Pre-money: 450K Euros
Total Loan Amount: 50K Euros

Net Loan Amount: 48K Euros

Length of Loan: 2 Years
Interest Rate: 1% / year
"Capital Contribution"

Number of Shares to VC

FRC2 Croatia Partners SCSp, Côte d'Eich 1, 1450 Luxembourg, Luxembourg, OIB 40910710208, represented by FRC2 GP S.à r.l., Côte d'Eich 1, 1450 Luxembourg, Luxembourg, represented by Manager A [*] and Manager B [*] (hereinafter: "Lender");

[*] (hereinafter: "Borrower");

[*],

[*], and

[*],

(hereinafter together: "Founders"),

The terms set forth below in the first column shall in this Agreement equal the meaning, amount or other content set forth in the respective second column:

Contracting Parties	Lender, Borrower, and Founders
Borrower Pre-Money Valuation	450,000.00 EUR (four hundred fifty thousand euros)
Commitment Amount	50,000.00 EUR (fifty thousand euros)
Loan Amount:	Commitment Amount reduced for the Capital Contribution Amount in EUR equivalent (converted from HRK to EUR at the median rate of the Croatian National Bank on the Drawdown Date)
Maturity Date:	2 (two) years from the Drawdown Date
Interest Rate:	1% (one percent) per annum
Capital Contribution Amount:	2,000.00 HRK (two thousand kunas)
Lender's Share:	Business share(s) in the Borrower with a nominal amount equalling the Capital Contribution Amount



INVESTMENT: Structure

Term Sheet

No Repayment

3.8 The Borrower is not allowed to repay the Loan or any accrued interest prior to the Maturity Date. Any transfer of money for the purpose of repayment of the Loan to the Lender's bank account shall not constitute Loan repayment and the Lender has the right to transfer it back to the Borrower's Bank Account.

Re-investment

5. ADDITIONAL COMMERCIAL RIGHTS AND OBLIGATIONS

5.1 **Next Financing Round.** The Founders agree that the Lender shall have the right (but not an obligation) to participate in the Next Financing Round with amount of up to a 50% (fifty per cent) of the total amount invested into that Next Financing Round.

Non-dilution

5.2 **Down Round Adjustment.** If, before conversion or repayment of the Loan, the Borrower closes a financing round at a pre-money valuation lower than the Borrower Pre-Money Valuation ("Down Round"), the Lender has the right to a proportional increase of the Lender's Share. In such a case, the Lender's Share shall be increased to the amount that the Lender would have received if this Agreement was concluded at the Borrower Pre-Money Valuation that equals the pre-money valuation of the Borrower in the Down Round.

Pro-rata

1.2 **Future funding rounds.** The Investor shall have the right (but not an obligation) to participate in all future funding rounds of the Company, with an amount pro-rata to its relative share in the total share capital of the Company.



INVESTMENT: Ownership

Types of stock

The “class” of stock you get varies with the investment terms

Common Stock

- 1 vote / share
- ”normal” liquidation
- Founders, employees (options)

Preferred Stock

- Multiple votes / share
- ”first-out” liquidation
- Investors (VCs)



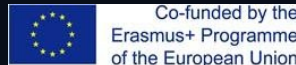
INVESTMENT: Ownership

Pro-Rata rights
Give investors the right to invest in a startup's future fundraising rounds and maintain their ownership % in the company as it grows and raises more capital.

For a longer discussion of this see [Mark Suster's post here](#)



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Important for Investors – VCs and Angels
– to protect their early investments, that turn out to be super successful.

Investor has right (not obligation) to invest their **proportional** ownership in the next round of financing.

Example

- Investor owns 20% of your company from the Series A round
- They have the right to take 20% of the next financing (and possibly even later financings).

Pro-rata rights are designed to protect investors from being diluted in future rounds of financing

INVESTMENT: Ownership

Pro-Rata rights
Can be a key factor in
raising additional
rounds

For a longer discussion of
this see [Mark Suster's post
here](#)



Also, confidence building measure to signal
incoming investors that you still believe in the
company

Example:

- **Series A, you invest \$5**
- **Series B, new investor will invest \$5 million if you do also**
- **Follow-on investor is protecting your initial investment by extending the runway of the company**
- **Even if you don't want to invest, it may be prudent to do so to keep the company going.**

Without the new investor, you must decide:

- **Continue to fund the company yourself**
- **Let it go bankrupt**
- **Try to sell the assets and recover as much of the original \$5 million investment as possible.**

INVESTMENT: Ownership

**Pro-Rata rights
Can cause tension
between Investors if
larger VCs come into
later rounds**

For a longer discussion of
this see [Mark Suster's post
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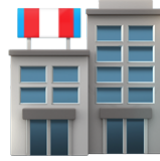
- Sometimes VCs will employ “Super Pro Rata” – the right to **increase** their share in later rounds.
- Some larger VCs have a “Minimum Ownership” rule – ie, 20% minimum stake in every company they invest in.



INVESTMENT: Ownership

Pro-Rata rights Can cause tension between Investors if larger VCs come into later rounds

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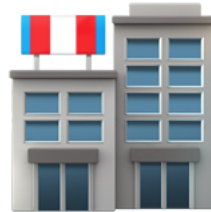
Series A round:
Raising: \$2 Million
Valuation: \$8 Million
(\$10M post-money)



1st VC:
"I'll Invest!"



1st VC gets 20% ownership
(\$2M/\$10M = 20%)



Series B round:
Raising: \$10 Million (20%)
Valuation: \$40 Million
(\$50 Million post-money)



2nd VC:
"Take it or
leave it"



**2nd VC: 20% ownership rule
for all investments**



**1st VC is locked-out of the round, and
diluted to 10% (20% of \$50M), unless
they can use their pro-rata rights**



areholders:

10 Million
(no more)

no-go"

share non-diluted (or even

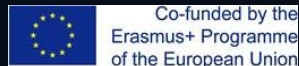
INVESTMENT: Ownership

Pro-Rata rights Can cause tension between Investors if larger VCs come into later rounds

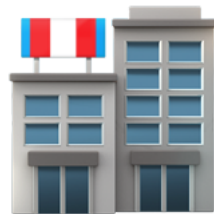
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Series B round:
Raising: \$10 Million (20%)
Valuation: \$40 Million
(\$50 Million post-money)



Insists on Pro-Rata

"Ok, No
Thanks"



Walks Away from Deal



**Must find another investor
or risk losing the value of
his shares**

OTHER SOURCES OF CAPITAL (“Non-Dilutive”)

- **Debt:** Borrowing money with the promise to repay it at some point under specific terms
- **Equity:** Money purchases an ownership stake in the company
- **De-risking Factor:** what investors look for to make their investment less risky
- **Vehicle:** How the investment is structured

Source	Debt	Equity	De-Risking	Typical Vehicle
Bank Loan	✓	✗	Physical assets	<ul style="list-style-type: none"> • Banks usually require historical data on company operations, profit, etc. • The loan is not an investment as the bank is simply lending money that will be returned later at a profit (interest)
Grant	✗	✗	Not necessary	<ul style="list-style-type: none"> • Usually Tax-Deductible, often from public sources • Foundations (private) may be constrained from offering grants to a business, due to complicated legal restrictions around the practice.
Donation	✗	✗	Not necessary	<ul style="list-style-type: none"> • Simple & less bureaucratic than Grants • Usually not tax-deductible for the startup
Crowd Funding	✓	✗	Prototype, Vision	<ul style="list-style-type: none"> • Individual investors make contributions (“pledges”) to the company to fund the product’s development; • Different amounts of money result in different rewards (anything from a “thank you” note to the actual product itself); • Crowdfunding campaigns can play a significant role in a product’s Go-to-Market strategy by publicizing and proving consumer demand before the product has been manufactured; • Successful crowdfunding can be a pre-requisite for later VC funding.



CROWD FUNDING PLATFORMS:

Rewards-based & Donations-based

KICKSTARTER

- Most well-known and longest running site
- For profit Campaigns
- Helps with set-up and managing campaign
- Campaigns that do not reach goal forfeit all money raised

INDIEGOGO

- Close 2nd to Kickstarter
- For profit Campaigns
- Helps with set-up and managing campaign
- Campaigns that do not reach goal keep all money raised

gofundme

- Specifically for “cause-based” campaigns
- High social impact factor
- Helps with set-up and managing campaign
- Campaigns that do not reach goal keep all money raised



SELF-SOURCED CROWD FUNDING: LumoLift

“Because your customers interact with you on your website, you end up having a closer relationship with them.

You can engage them more without having a third party between you, and you can also develop your own brand and messaging”

- Monisha Perkash

LumoLift

- >14,000 pre-orders
- \$1M raised in 1 month
- Avg. raise \$32,000 per day

Founders:

- Monisha Perkash

Product

- Tech wearables & Platform (data analytics)

MVPs

- Several products, including back, posture correction, running, software platform

Funding totals: \$17.1 M

Company closure & bankruptcy

- Co-founder problems
- HR problems
- Industry changes (couldn't compete beyond a certain point)



EQUITY CROWD FUNDING

Individuals and companies can invest directly into startups in exchange for equity.

- 2016 "Regulation Crowdfunder" approved in US: 2016-20 > \$515 M
- Legal in UK since 2013: > \$730 M
- Long history in Europe (1997?): > \$280 M

[SpeedInvest](#) USA

[WeFunder](#) USA

[MicroVentures](#) USA

[Republic](#) USA

[CrowdCube](#) United Kingdom

[Seedrs](#) United Kingdom

[SeedBlink](#) Romania

[Companisto](#) Germany

[WiSeed](#) France

[StartupExplore](#) Spain

[Funderbeam](#) Estonia

