Funding and Finance

Big Bang

Value: An Introduction

Value Creation:  Value Capture:

(c) UC Davis Child Family Institute for Innovation and Entrepreneurship
Lifecycle of a new venture

Business Model

- How will you make money?
  - Revenues
  - Who are the customers for your product/service?
  - Why do they want it - “Value Proposition”?
- How much will it cost to generate your revenues?
  - Expenses: COGS, CAPEX, and OPEX
- How much revenue can you make and how quickly?
  - Capital Need and Cost of Capital
### Brainstorm: Revenues

- Who will pay you for your product/service?
  - Define your customer
- Why will they pay you for your product/service?
  - Value proposition
- How much will they pay you?
  - And why do you think so?

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### Revenue Models

<table>
<thead>
<tr>
<th>Model</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td><strong>Unit Sales</strong></td>
<td>Sell a product or service to customers (wholesale, retail, or direct).</td>
</tr>
<tr>
<td><strong>Advertising Fees</strong></td>
<td>Sell opportunities to distribute messages (viewers, readers, listeners, or others)</td>
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<tr>
<td><strong>Franchise Fees</strong></td>
<td>Sell and support a replicable business for others to invest in, grow, and manage</td>
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<tr>
<td><strong>Utility Fees</strong></td>
<td>Sell goods and services on a per-use basis</td>
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<tr>
<td><strong>Subscription Fees</strong></td>
<td>Charge a fixed price for providing access to your goods or services</td>
</tr>
<tr>
<td><strong>Transaction Fees</strong></td>
<td>Charge a fee for referring, enabling or executing a transaction</td>
</tr>
<tr>
<td><strong>License Fees</strong></td>
<td>Sell the rights (exclusive or non-exclusive) to use patent- or copyright-protected IP</td>
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</table>
Revenue Models for Software

• “Standard” – Unit sales (up-front license fee) plus maintenance & support subscriptions (Oracle)

• SAAS – “Software as a Service”: license fees, maintenance, & support all one on-going subscription fee (Salesforce.com)

• Premium Version – give away base product, sell premium product (Dropbox)

• Add-ons – give away base product, sell add-on products (Zynga - Freemium)

Distribution Models: Pies

• Bakeries
• Farmer’s Markets
• Restaurants
• Grocery Stores
• Big Box Stores
• Specialty Cooking Shops
• Online Retailers
Brainstorm: What is Your Revenue Model?

- How does your industry get products/services to customers?
  - Output – Research Tasks

- Where will your product/service enter that process? Who will make that buy decision? How will you get paid?
  - Output: Options

<table>
<thead>
<tr>
<th>Cost/unit</th>
<th>Price/unit</th>
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<table>
<thead>
<tr>
<th># units sold/year</th>
</tr>
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<tbody>
<tr>
<td></td>
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<table>
<thead>
<tr>
<th>Annual Gross Revenue</th>
</tr>
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<tbody>
<tr>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Annual Gross Profit</th>
</tr>
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The “Bottom Line”

- Even if “finance” and “accounting” aren’t your forte, every entrepreneur must understand the basics of the “bottom line”
  - Revenues & Margins
  - Expenses
  - Profitability
  - Financial Planning (Pro-Forma Statements)
  - Capital Structure
  - Return on Investment (ROI)
Definitions: Revenue & Margins

• Revenue
  – Money coming into the business from product/service

• Cost of Goods Sold (COGS)
  – What it costs to make your products

• Gross Margin
  – [Revenue – COGS]

Definitions: Expenses

• Fixed costs
  – Don’t change with time
  – Capital Expenses (CAPEX)
  – Salaries/Overhead

• Variable costs
  – Change with volume/time
  – Operating Expense (OPEX)
  – COGS
  – Salaries & Bonuses
Definitions: Profitability

- **Net Income**
  - Revenues minus all expenses

- **EBITDA**
  - *Earnings Before Interest, Tax, Depreciation and Amortization*
  - Useful for valuation comparisons

- **Cash Burn Rate**
  - How much cash you lose each month/quarter
  - Indicative of cash flow issues

Definitions: Pro-Forma Statements

- **Pro-Forma Statements**
  - “Best Guess” predictions
  - Allows for better product and financial planning
  - Designed to show the impact of certain choices or assumptions

- **Income Statements**
  - Looks at revenue, expenses, and burn rates
Definitions: Capital Structure

- Senior Debt
- Subordinated Debt (e.g., Mezzanine Debt)
- Hybrid Financing (e.g., Convertible Debt, Convertible Equity)
- Preferred Equity
- Common Equity

Definitions: Return on Investment (ROI)

- Score of profitability in relation to capital invested over time
- Calculated as (Profitability less Investment) ÷ Investment
  - Investors often use ROI to evaluate the "efficiency" of an opportunity, or to compare opportunities
  - A high ROI means the profitability compares favorably to the size of the investment
- ROI is also something entrepreneurs must assess regarding technology/capital expenditures
Lifecycle of a new venture

Definitions: J-Curve

Capital required to reach “Break Even”
How Much Capital will You Need?

- How much funding do you need?
- Look closely at your expenses
  - Create an Excel file and enter the following expenses
  - Delete the rows you don’t need (that aren’t significant)
  - Add categories that are specific to your business
  - Add time periods across the top
  - Start making assumptions...

INCOME:
- Gross Sales
- Returns/Refunds
- Net Sales (Gross Sales less Returns)
- GROSS PROFIT (Net Sales less COGS)

EXPENSES:
- Cost of Goods Sold (COGS)
- Salaries & Wages
- Sales Commissions
- Professional Services
- Rent
- Maintenance
- Equipment Rental
- Furniture/Equipment Purchase
- Insurance
- Utilities
- Telephone
- Internet
- Office Supplies
- Shipping & Handling
- Marketing & Advertising
- Travel & Subsistence
- Entertainment
- Other Expenses
- Taxes
- TOTAL EXPENSES

NET PROFIT (Net Sales less Total Expenses)
Brainstorm: Starting a Financial Model

• What does your financing plan look like?

• How much capital will you need at each step?

Thank you!