Show me the Money
Funding and Financing Startup
Big Bang Workshop 11/19/2015
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About me, and you

- GSM graduate, software engineer, manager.
- I have worked at big and small companies.
- I do not care about the startup game.
- I am an investor, and so are you.
- You are probably not an entrepreneur.
The Startup Game

- Who’s who of VCs
- Trying to time waves of investment
- Fooling investors into giving you money that you use to pay yourself
  - No one wants to pay you to start a business for yourself. No one cares about you.

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Workshop Plan

- Myths about financing
  - Angel, VC, Private Equity, RE, Loans, Sweat Equity
  - Why you should not have a party when you get money from VCs
- Financing as risk management
- How to find financiers
- Mechanics of asking for money

Myth 1

- Most companies are VC funded
Truth 1

- At least 99.9% of businesses never receive VC funding
- AND... 97% of VC funding is not for truly brand new companies
  - It’s investment after seed/startup stage

Myth 2

- People invest in great ideas
Truth 2

- Ideas are a dime a dozen. People invest in ventures where the risk/reward ratio is favorable.
  - Reward is about how much value you create for each customer, total market size, how fast you can grow, and how you can do it better than other people
  - Managing risk is about having the right team, plan, partners, and incentives

Myth 3

- Investors care about our 5 year revenue forecasts
Truth 3

No one cares about your 5 year forecasts, at all, unless you have 2 years of actual revenue-earning history. They care, instead, about the story you can tell about why you’ll be able to make lots of sales. The best way to make them believe this story is to make some sales.

Myth 4

I have to get the funding first, before I start working on my business.
Truth 4

- You have to start working on your business, first, before anyone will give you any money.

Myth 5

- It’s better to raise more money earlier so I don’t have to spend as much time raising money.
Truth 5

- You want to raise as little money as you possibly can each time, unless you enjoy giving away things of value. Wanting to raise more money than you need, early on, is a signal that you are planning on having a company that does not go up in value.

Types of financing

- Angel
- Friends & Family
- VC
- Private Equity
- Retained Earnings
- Loans
- Sweat Equity
- A/P, A/R financing
- Grants
- Crowd-funding
Why you should not have a party

- VC investments are really expensive loans. They’re the most potentially damaging thing you can do to your future wealth.

Financing as Risk Management

- Every financing decision is a risk decision
  - How much is it worth for me to give up now to grow faster?
  - How much to I expect to make back on my cash investment? How much risk is there?
- Each risk should be tied to a part of the business model or plan
Business Model and Plan

- What is a business model?
  - Price you can charge for something and why
  - Cost of providing that something (COGS)
  - What do you do with the difference?
  - Scale required to cover overhead
- What is a business plan?
  - A plan is how you achieve or modify the business model
    - New business model around new product
    - Undertake cost savings program to reduce cost of goods sold
    - Increase scale to increase margins

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- What projects can I undertake to make the business model or plan work?
  - Hire a sales person for 1 year to generate 5 sales to scale up to profitable size
  - Hire engineers or scientists to develop a product that will command a price of X
Financing need

- Tie business models and plans directly to investments
  - Seeking $500K in seed funding
    - $200K for 2 salespeople for 1 year to raise sales from 3/year to 10/year
    - $200K to buy raw materials to build 7 units
    - $100K to pay for rent and admin expenses

Closer look

- $200K for 2 salespeople for 1 year to raise sales from 3/year to 10/year
  - What is the risk here?

- $200K to buy raw materials to build 7 units
  - What is the risk here?

- $100K to pay for rent and admin expenses
  - What is the risk here?
Closer look 2

- $200K for 2 salespeople for 1 year to raise sales from 3/year to 10/year
  - What is the risk here?
  - How much interest am I willing to pay for this?

- $200K to buy raw materials to build 7 units
  - What is the risk here?
  - How much interest am I willing to pay for this?

- $100K to pay for rent and admin expenses
  - What is the risk here?
  - How much interest am I willing to pay for this?

Financing plan

- 2 sales booked, revenue of $60,000. Need raw materials for them.
- 1 sale very likely, revenue of $30,000.
- What’s the cost of borrowing for this?

- Financing plan:
  - Get revolving line of credit for $100,000 against A/R, personal guarantee
  - Raise $200K from angel investor
  - Raise $100K in ‘sweat equity’ from sales people by giving them actual equity in the company in lieu of salary

This is a contrived example - but the key is to go through this thought process for your own company
But I just need $1M to make my idea

- Remember:
  - No one cares about your idea
  - No one cares about your take home pay
  - No one trusts you to just take the money and figure it out
  - If you sell 50% of your business for $2M, your business was worth $4M. The investor expects $20M back in 5 years. That means your business is then worth $40M. You only own 50% of it. You have $20M instead of $40M. What if you only took $500K instead?
  - Let’s say that the investors won’t give you the $M. Then it’s a waste of time. You need to do more to make your business more attractive to an investor, first. Focus on non-VC, non-angel funding options until there.

How to find financiers

- Depends on size
- Friends & Family / Crowdfunding
- Pitch people who have invested in other businesses
- Establish a relationship with a bank as soon as possible. Then, get credit from them. Need a credit history just like an individual.
- Have a really clear story about why the investor’s investment will return the level of reward, with the level of risk they expect
  - Security Market Line
Mechanics of Asking for Money

- Make a list of companies
  - Your own list
  - Banks
  - Angels / VCs from Angel list, VC companies
- Treat it like a CRM problem
  - Turn a lead->qualified lead->meeting->follow-up->sale->follow-up
- Have a good pitch deck
- Keep working on the business all the time
  - Keep investing your sweat equity