

4.0 FINANCING METHODS

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4.1 Introduction and Summary

There are many answers to a small company seeking financial support, none of them easy. The chances of attaining financing, whatever the source, depend on having a feasible business concept, a sound business model and principals who possess extensive business experience. Those who control sources of funding will require an exhaustive planning process and a convincing story, in writing. In general the plan must include pro forma financial statements that present in numerical form the expected results. It is a virtual certainty that the numbers will have to show profitability of the venture within three years and a reasonable strategy to attain that result. Depending on the source of funds, the requirements on a company seeking additional or startup monies vary from the writing of a simple grant proposal to the drafting of a comprehensive Business Plan.

4.2 Angel Investors

There are approximately a half million angel investors in the US, providing 300 times the funding coming from Venture Capitalists. Angels receive more than 2 million proposals each year, financing about 20% of those, or about 400,000 small companies. Angels are willing to take larger risks than VC's and generally don't seek voting control; their criteria are much less stringent and they can make quick decisions.

4.3 Establishing Financial Needs

There are two important first steps in defining initial financing required:

4.3.1 Startup cost budget, indicating monies for initial purchases and other cash outlays.

4.3.2 Cash flow statement, reflecting the startup costs and the anticipated cash balances over at least a two-year period. The minimum cash balance will determine initial financing requirements. In other words, the cash infusion at the start must provide an initial cash balance sufficient to insure that the cash balance remains positive through the formative stages of the business at a level sufficient to provide a cushion.

4.3.3 Available Financing is generally limited to 80% of the documented requirement, since most sources of outside funding will require a 20% capital infusion from the Principal business partners.

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4.4 Bootstrapping

Bootstrapping is a term that generally refers to means by which the enterprise generates its own funds, or reduces its financial needs through decreases in working capital or borrowing from non-traditional sources such as family, friends, credit cards, customers (through more rapid payment) or suppliers (through obtaining extended terms.) By bootstrapping, all avenues for minimizing the need for traditional debt financing are exhausted before other lines of credit are tapped.

4.5 Venture Capital

It is extremely difficult for any small firm to get venture capital. Those responsible for providing this type of funding are astute, seasoned business and financial managers who typically receive more than 1000 funding requests per year. Ninety percent are quickly rejected; the remaining are investigated with great care, since the VC principals invest only in companies promising double-digit returns. Funding from VC's goes to only 0.1 % of the one million businesses formed in the U.S. each year. Here is what they look for:

- **A clear description of the product or service** offering significant growth potential and strictly differentiated from other related concepts. Approaching a VC is fruitless unless one needs more than \$1,000,000 in an esoteric, technology-related field where the company can attain revenues of more than \$50,000,000 in 5 years or less.
- **A schedule for attaining profitability** entails a discussion of the market, including competition and what sets the present company apart, together with a logical description of costs, margins and strategies congruent with these.
- **The benefits from a capital infusion** indicating how the money will be used and how the investor will ultimately receive a return.
- **A Business Plan, providing a reasonable inference that management will attain the Plan objectives**, is considered by most investors as the most important element in making a decision to invest.
- **The reasonableness of the financial projections**, which will be determined by examining the market as described, marketing strategies and expected penetration of the market. If the product or service is new or innovative, it's important here to show how it is accepted in the market.
- **The direction and control** describing the principals in the business, their business background and the roles they will play in building the business.
- **An Exit Strategy** indicating how the business would be dissolved or sold.