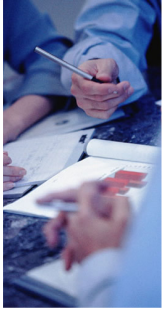


# Transitions

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## An 'insiders guide' to Raising Finance

**Simon Pratten – Transitions**  
**Simon Stockley – Cambridge University**

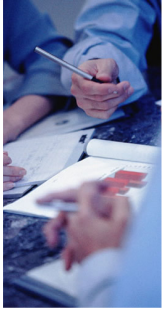


# Types of Capital

- Financial
- Physical
- Human
- Intellectual
- Social



*To function effectively, entrepreneurs depend on social capital. It is the hardest capital to accumulate, and the easiest to destroy!*



# The nature of Debt and Equity

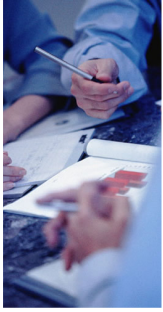
## Equity

- Money 'owned' by you or the business (therefore doesn't have to be repaid)
- Money invested in a business in return for an ownership stake
- Pure 'risk' capital
- Return to shareholders via sale of shares and/or dividends

## Debt

- Money 'owed' by you or the business (therefore has to be repaid with interest)
- No ownership stake by lender, but loans are usually secured against an asset
- Loans are not risk capital
- Return to lenders via repayment of principal, plus interest

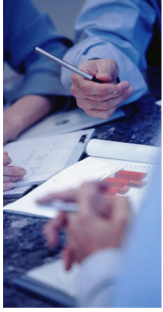
***61% of UK start-ups are funded entirely by the personal savings and investments of their owners***



# An Example



- Cecil and Quentin buy a property for £100,000
- They each invest £50,000 of their own savings
- Two years later, the value of the property has risen to £150,000.
- The boys want to build an extension which will cost £50,000.
- This will increase the value of the property to £250,000.

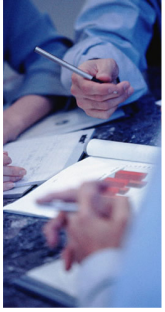


# Funding the project

- Unfortunately they can't borrow any money
- Their chum Rupert, a 'notorious' Venture Capitalist, offers to invest £50,000 of his own money in the project.
- He is expecting an equity share in the property and a healthy return on his investment when the property is sold.

## Key Questions

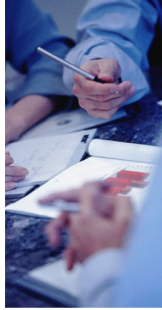
1. What 'share' of the enterprise should Quentin and Cecil offer Rupert?
2. Assuming the property sold for £250,000, what return would each partner make?
3. For Quentin and Cecil, how does this deal compare with borrowing £50000 at 7.5% for six months?



## One possible deal...

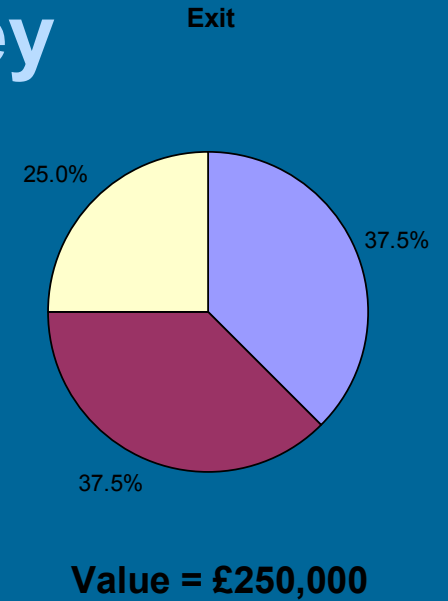
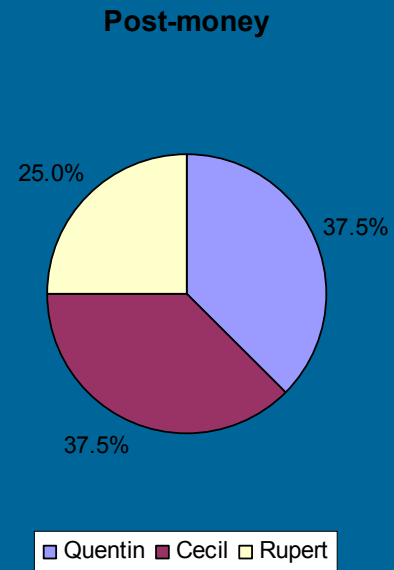
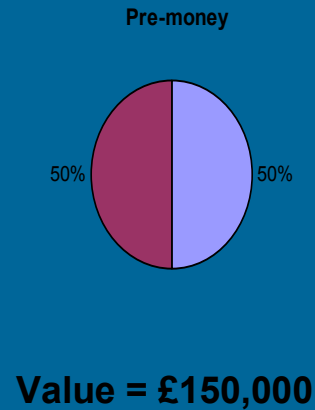
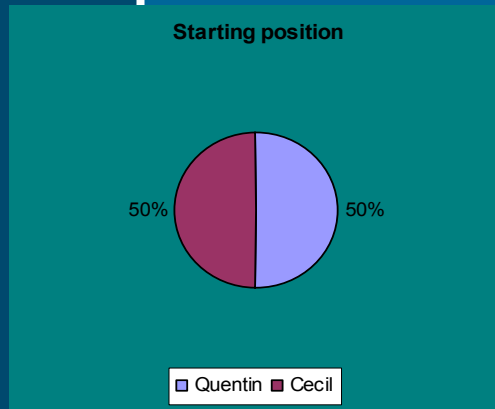
- The existing investment is valued at £150,000. Rupert's £50,000 raises this to £200,000 (the value of the equity in the property plus the £50,000 in cash)
- Rupert would therefore expect a 50000/200000 share in the venture, or 25%. This leaves 37.5% each for Quentin and Cecil.
- If the property subsequently sells for £250000 Rupert will receive £62,500. The boys will exit with £93,750 each.

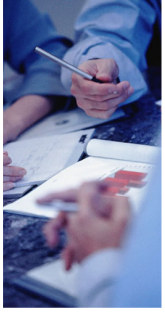
**Q. What could Rupert do to increase the return on his investment?**



# Cecil and Quentin's Odyssey

## Dilution of Ownership and Growth in Value

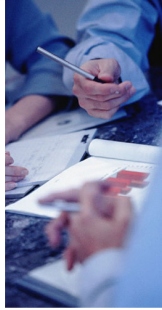




## Using debt instead of equity

- Assuming that Quentin and Cecil could raise a £50,000 interest only mortgage at a rate of 7.5% over 6 months they would pay:
- $(£50000 \times .075) / 2 = £1875$  interest
- Plus fees of approximately £250
- Therefore they would exit with approximately £98,935 each, rather than £93,750 under the deal with Rupert. Using equity instead of debt has cost them over £5000 each.
- Equity invested by 'professional' investors is invariably a far more expensive source of capital than debt.

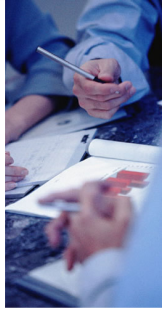
**Q. Why, then, is equity usually the best, and only, way to fund a high potential new venture?**



## Health Warning



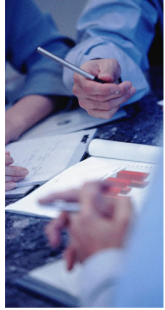
Don't try to finance your business with  
debt until you have reliable cash flow  
from sales



# Determining your capital requirements

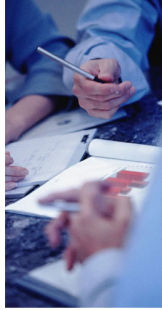
Some basic questions:

- What does my business need the money for?
- What type of money does it need?
- How much money does my venture need?
- When is it needed, and for how long?
- Where and from whom can it be raised?
- How long will it last?
- How do I manage this process?

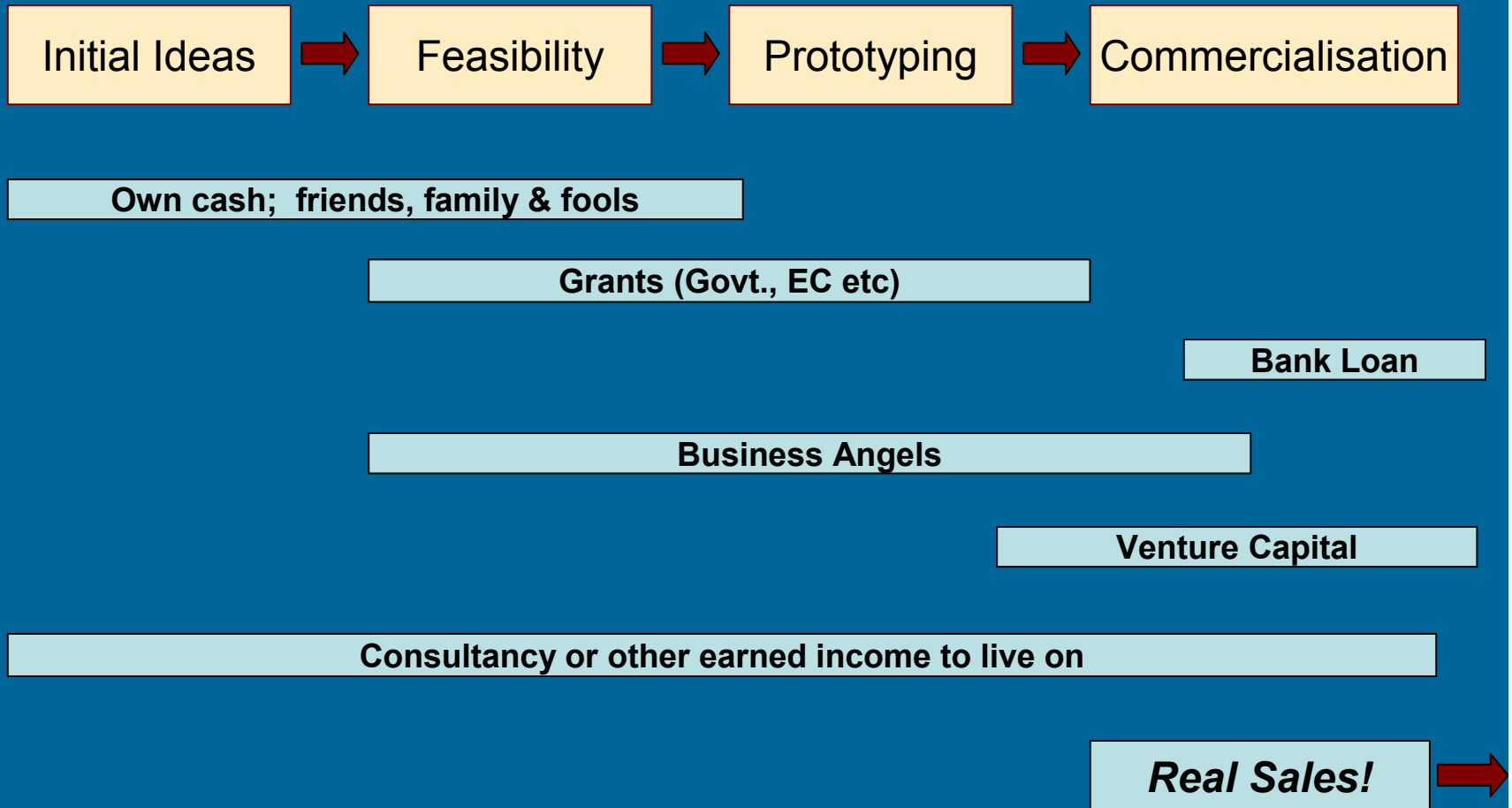


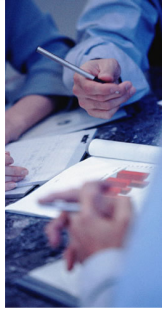
## Some key points to consider

- Your attitude towards growth and to sharing ownership and control
- What 'stage' your business is at
- The likely risks involved for financiers and their expected returns
- The rate at which your business will consume cash (the Burn Rate) and whether/when you are likely to run out of cash
- Your bargaining power relative to the providers of capital

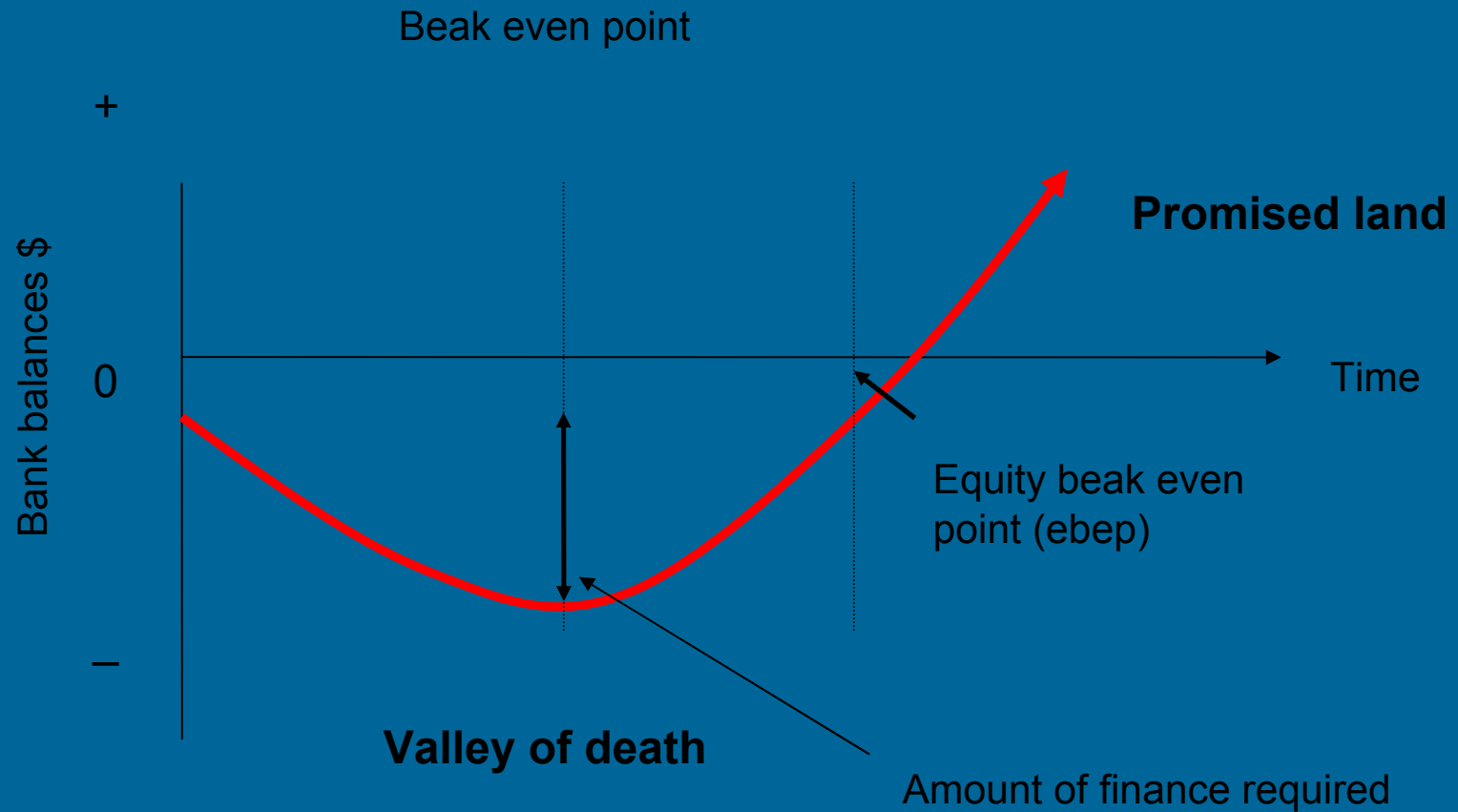


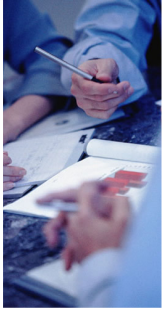
# Stage of Venture Development and Funding



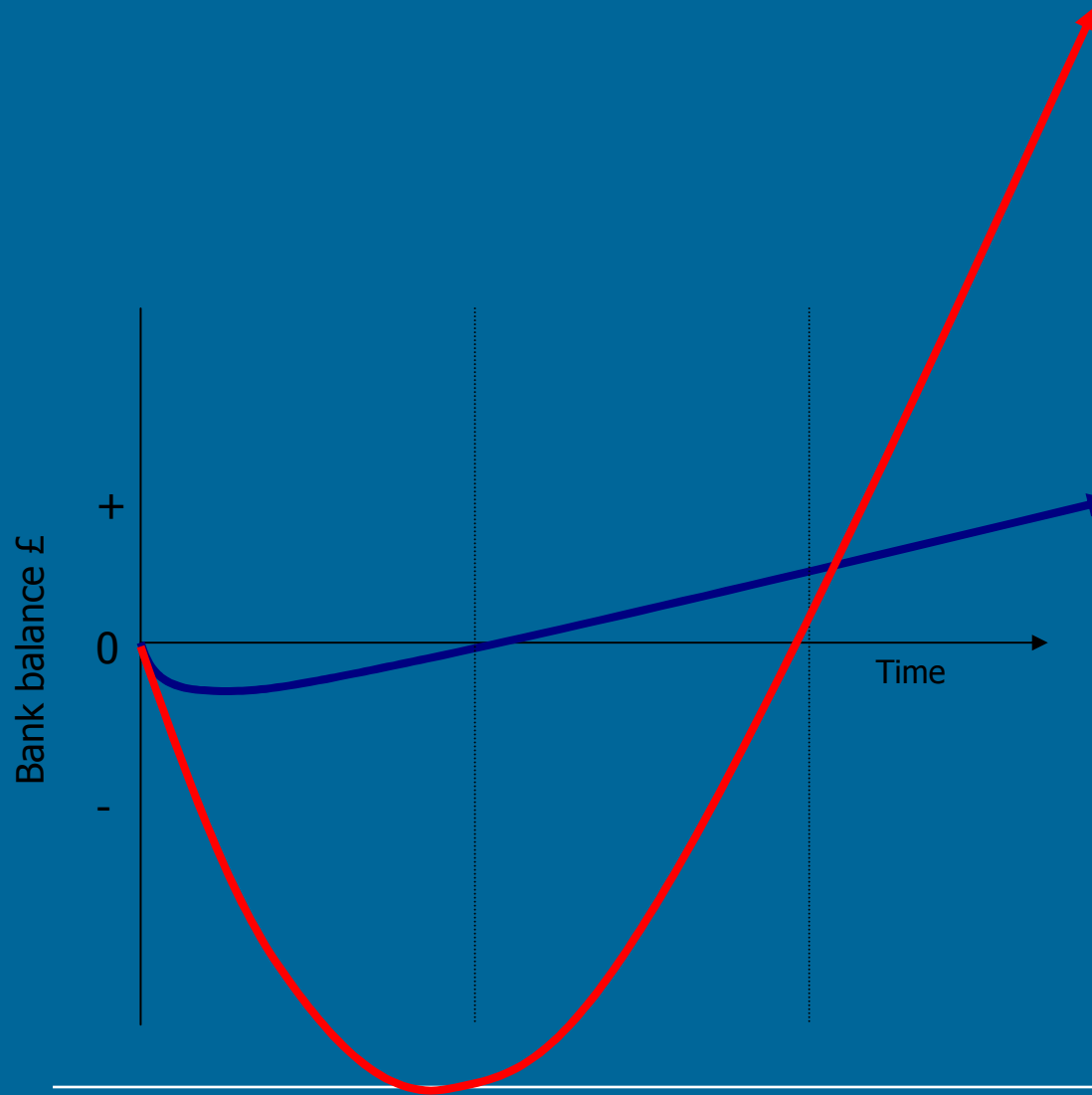


# Financing the journey to the promised land





# Different Firms, Different Profiles...

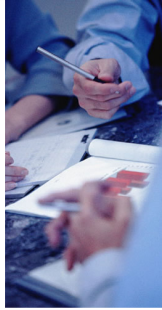


## Technology firm

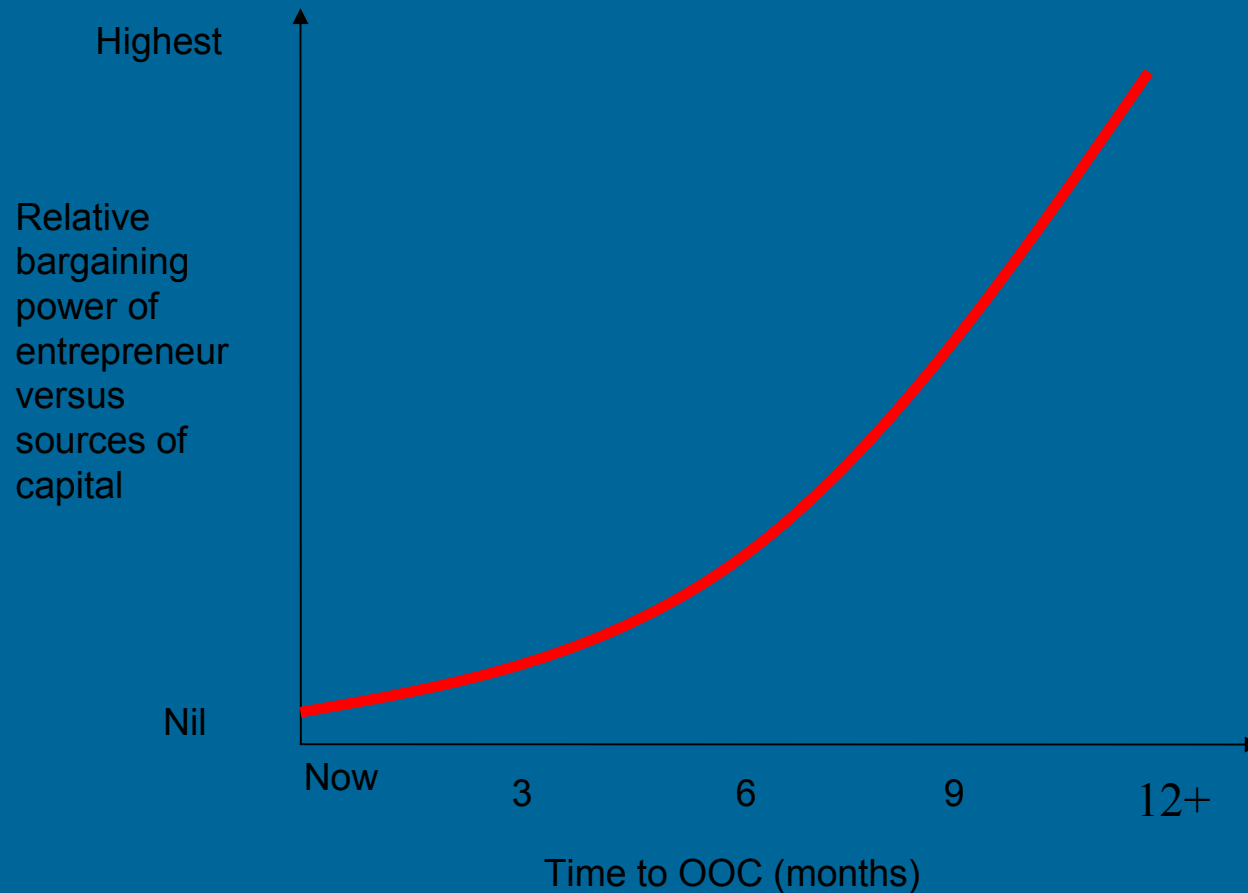
- Large investment required
- Late break-even
- Huge upside (Microsoft)

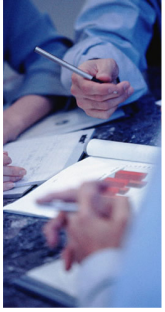
## Consulting firm

- Low investment required
- Early break-even
- Modest upside



# Your bargaining power based on time to 'out of cash' (OOC)



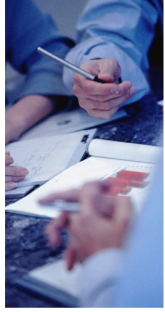


# Time to Close (TTC)

How long does it take to 'close the deal'?

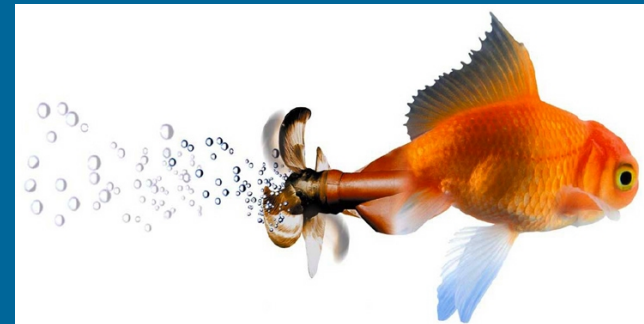
- Debt - Secured/Unsecured
- Equity- Formal/Informal
- Off Balance Sheet (leasing/contract hire)

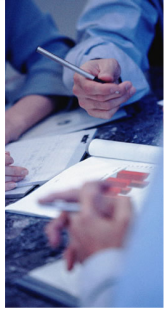
***It always takes longer than you anticipate!!***



# Sources of Private Equity

- Your personal wealth (savings, equity in house) and that of business partners
- Family ('Love money')
- Venture capital
- Business Angels
- Corporate partners

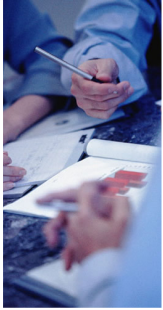




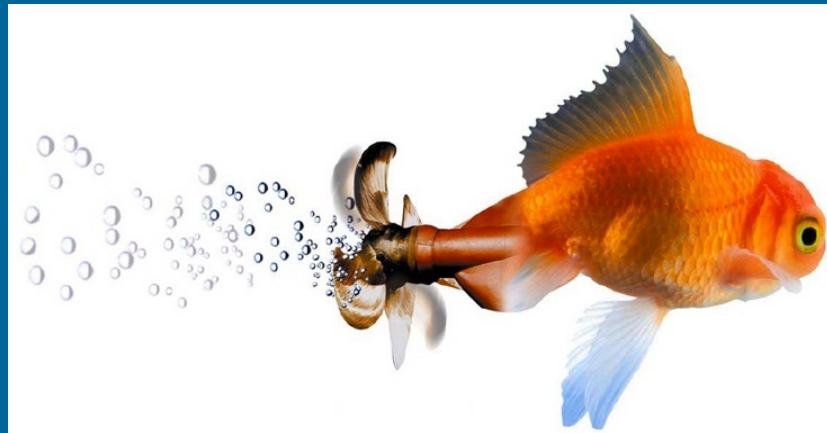
# Business Angels

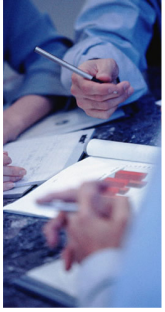
- **Wealthy private investors, often experienced entrepreneurs**
- **Usually want hands-on involvement in a sector that they understand**
- **£10-£100k is usual investment (syndicates may do more)**
- **Use their friends and networks to spot opportunities**
- **There are numerous Business Angel Networks throughout the UK**

**Visit the National Business Angel Network  
site at [www.bestmatch.co.uk](http://www.bestmatch.co.uk)**



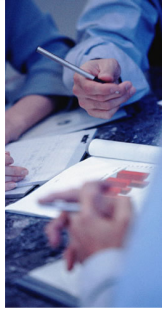
# Venture Capital



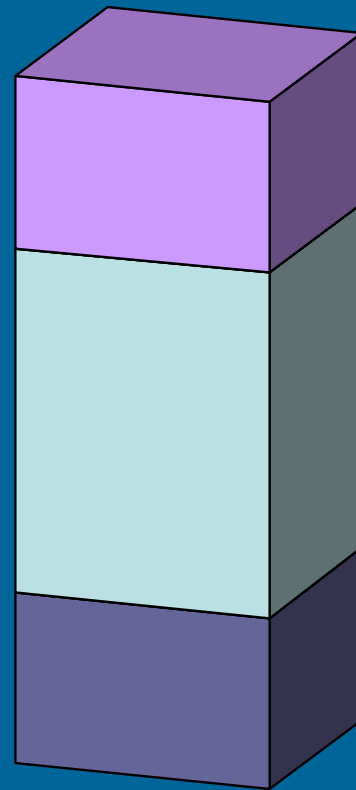


## Venture Capital - Some basics

- Equity is invested in stages or rounds (seed, start-up, expansion, etc)
- Targets and milestones are set by VCs at each stage - gives VCs the chance to abandon 'lemons' and provides an incentive to the entrepreneurial team to use capital wisely
- Deal structures vary widely, you need to take professional advice
- Some terms can be 'amusing' – e.g. WaySearch
- The VC firm may or may not require a controlling share, they may be able to fire you!



# High attrition rate Even VCs don't see 100% success



⇨ 20-30% big winners (Payday...)

⇨ 50% 'Living Dead' (money back?)

⇨ 20-30% failures (total loss!)

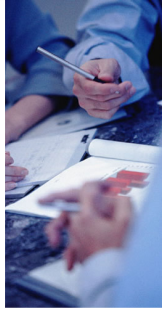
Because of the high risks, very high returns are required



## VCs as People

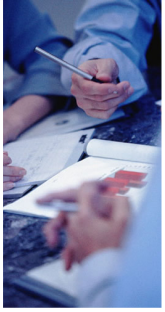
- High level of education and experience
- Live on their reputations and networks
- Very tough, very hard, ruthless
- Professional early stage investment firms
- Specialise in industry sectors
- Portfolio managers
- Their focus is on generating a return to investors

***Often called Rupert, Simon, Piers or Percy...but don't be fooled!***



## VCs think in milestones...and dream of EXITS

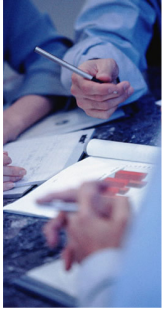
***“Nobody makes real money until the exit”***



## Approaching a VC

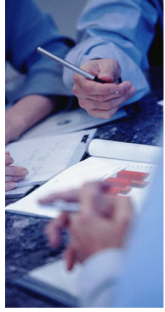
- Research the market to be sure you contact the most appropriate VC.
- Personal introductions invariably work better than a cold call (e.g. don't cold call!)
- Make contact by telephone, if they can't help ask them who can.
- Send a summary of your opportunity and try to meet before you hand over a full plan.
- Absolutely do not approach before you and your team have fully thought through the opportunity.

***Prepare, practice and test your pitch with a critical, but friendly, outsider...***



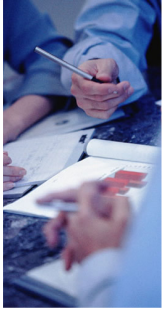
## The view of Black & Williams

- The team - especially if they have worked together successfully before
- Sector - Investors back what they know (so check out their portfolio). They also learn from their mistakes.
- Financial indicators - Gross margin is a favourite
- Entry valuation - typically 30% less than an equivalent quoted company (a black art...)
- Exit route - can I get out? When? How much will it be worth? (also a black art..)
- Due diligence - any skeletons?

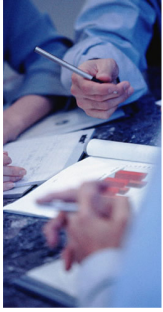


**The voice of experience:**

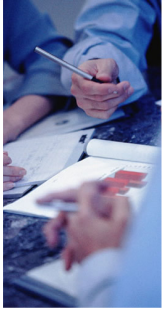
What some entrepreneurs  
have said.....



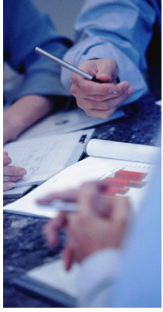
“Overall, it is the most soul-destroying, degrading process any entrepreneur is likely to go through, when rejection becomes part of daily life. However, those entrepreneurs with the strength of character to persevere, and a business concept that withstands intense and prolonged scrutiny, probably have a very good chance of success. So there is a sort of Darwinian logic to the whole process”.



“Securing VC funding is a very long process. VCs are, as a group, unprofessional, rude and frequently unintelligent. I’ve never met a bigger bunch of so-called professionals who in reality are cretins, with perhaps the exception of estate agents and head-hunters”.

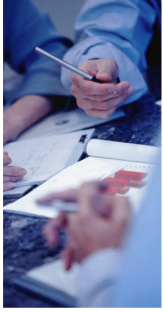


“Securing VC funding is bloody hard work. VCs are a cross between weasels and lemmings. You will always know more about your market than they do”.



# Debt Finance

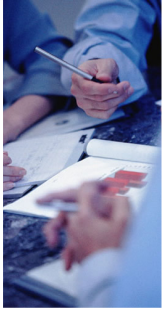




# CAMPARI : The Banker's Maxim

- Character - 'respectable & trustworthy'
- Ability - track record, team, potential
- Margin - % above base rate
- Purpose - expansion, rescue or buying toys
- Amount - is this realistic, too much or too little?
- Repayment - can you pay the interest and repay the principal
- Insurance - if required, is there security?

*'Honest, open and timely communication is the key to building a relationship with your bankers. Bankers HATE surprises!'*



## In summary....

- Until cash is flowing from sales, you'll have to use equity
- It is always easier to raise money when you don't need it
- Raising money always takes longer than you anticipate, plan accordingly
- You will rarely get all the money you require to begin with
- You nearly always underestimate how much you will need
- Getting your sums wrong does not inspire confidence!

***'There is no shortage of capital, the real shortage is of talented of management pursuing genuine opportunities'***