

Angel Investment Network's Guide to Raising Finance

The aim of this guide is to explain the types of finance available to you, which one is most suitable for your business and how to access it. We will also explain what investors look for in a business plan and how to improve yours. We hope you find our guide useful.

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Finance

There are two types of finance (debt and equity) and it is important to choose the right funding structure for your business.

Debt finance is usually secured against business assets or the personal assets of shareholders and/or directors. The difference for the chargee is his right of priority to receive repayment of any money owed, should the company be wound up (i.e. a bank has the power to place a business into administration or bankruptcy if it defaults on debt interest or repayments or its prospects decline). This right to appoint a receiver is not available to an equity investor.

There may come a time when a company cannot borrow any more debt, maybe due to a lack of security, and this is when the company may consider raising equity.

Equity capital is risk capital, meaning the investors bear the risk of losing their money if the company is unsuccessful or not as successful as projected. However should the business exceed expectations they will benefit through participation in increasing levels of profits and on the eventual sale of their stake.

The different types of finance available

Below we have listed and explained the most prevalent forms of finance available to you. These can be used individually or combined and are grouped into the two sections mentioned above - equity and debt.

Equity

❖ Private Investors:

Private investors are also known as an angel investor. They are an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity, typically investing between \$25,000 and \$100,000 per deal. A small but increasing number of angel investors organize themselves into angel groups or angel networks to share research and pool their investment capital, whereby the deal size can be greater. They have various and differing investment criteria and can bring a lot more to the table than just money i.e. business experience and industry contacts. Most will want to benefit from tax relief, which varies from country to country.

❖ Seed Funds:

"Seed funding" is a term that can be applied to any finance raised at the outset of a new venture to allow the business to develop. Many seed funds are affiliated to the technology transfer offices of universities and focus on areas such as technology invention and innovation. The risks involved in investment may be too high for venture capital investment at this early stage, but this isn't a great concern, as there are other sources of finance available.

Sources of seed funding:

- Family and Friends - The benefit of this may be little or no interest or equity loss.
- Grants - Government or benefactor grants can be a very good source of seed fund, as frequently you are not required to pay them back.
- Banks

❖ **Investment Funds and Syndicates:**

Business angel syndicates offer a half way solution between individual investors and venture capital. You'll have access to more money but potentially a lower equity stake. They offer individual investors more leverage to invest in larger businesses and wield more collective power. There are many investor syndicates to choose from, where individuals may invest anything between \$20,000 to several million of their own money with a syndicate who will then suggest investments based on their investor profile, attitude to risk and return expectations. The complexities of seeking funding from a syndicate mean of course that you will more often than not have more than one investor. How the advantage is they are likely to be made up of individual investors who have a broad range of skills who may be willing to offer advice as well as funding.

❖ **Corporate Venturing:**

The term "corporate venturing" covers a range of mutually beneficial relationships between companies. They are commonly formed between a larger company and a smaller independent one, usually in a related line of business. The larger company may invest in the smaller company, and so provide an alternative or supplementary source of finance. The benefits to this include making available particular skills or knowledge (i.e. by knowing immediate what you are talking about whereas some investors may struggle to understand the technology, perhaps in technical or management areas). They also provide access to established marketing and distribution channels, or complementary technologies.

This relationship is often beneficial for larger companies as it allows them to develop and broaden their business without acquiring other companies, and a way for small companies to grow faster than they otherwise would. A typical outcome would be the development of a new product or process, perhaps involving an exclusive licensing deal between the two companies.

❖ **Venture Capital Firms:**

This is a fund raising technique for companies who are willing to exchange equity in the company in return for money to grow or expand the business. Venture capital firms often want a high rate of return (20% and above) and invest quite large sums of money in the business (\$500,000 to millions). A venture capitalist differs from an angel investor in terms of wanting greater control of the company and a quicker return on investment.

❖ **Incubators:**

Business incubation provides a nurturing, instructive and supportive environment for entrepreneurs during the critical stages of starting up a new business. The goal of incubators is to increase the chance that a start-up will succeed, shorten the time and reduce the cost of establishing and growing its business.

❖ **Stock Markets:**

There are a number of small & mid-cap stock exchanges known as the junior stockmarkets which vary in each country. They all offer a simple, low cost, flexible stockmarket for small companies. The formalities are fewer than those of their larger counterparts and have a flexible approach to regulation and a streamlined admission process which make them the ideal market for smaller growing companies seeking to develop their business in a supportive environment.

Debt

❖ **Grants and Awards:**

There are thousands of grants schemes out there. They can vary from European and International Commissions, National Government to Local level. Availability of the grants is dependent on a number of criteria and objectives, which varies from country to country and are usually focused on sport, art, heritage, charities and health, education and environment.

❖ **Bank Loans:**

Bank loans may be secured or unsecured. Secured loans are just like a mortgage with repossession of the secured property (e.g. your office premises or home) possible in the event of default. The loan may be used for a totally different purpose to the property on which it is secured.

Unsecured loans are monetary loans that are not secured against the borrower's assets. These may be available from financial institutions under many different guises or marketing packages:

- Credit card debt
- Personal loans
- Bank overdrafts
- Credit facilities or lines of credit
- Corporate bonds

The interest rates applicable to these different forms may vary depending on the lender and the borrower. These may or may not be regulated by law.

❖ **Bank Overdraft:**

It is normally secured on current assets, repayable on demand and used for short term working capital fluctuations. The interest cost is normally variable and linked to bank base rate.

❖ **Factoring / Invoice Discounting:**

Factoring / Invoice Discounting is a funding option available to companies that provide a product or service on credit terms to their customers. The purpose of the finance is to give you access to immediate funds, without having to wait for the customer to pay the invoice. This is particularly beneficial to those of you who are in a growth period. It is commonly used by businesses to improve cashflow but can also be used to reduce administration overheads.

The company lending you the money will agree that for all invoices raised you will have available 80-85% of the value of the invoice at your disposal. You do not have to take available amounts. The cost

structure is similar to that of an overdraft: you pay a service fee and an agreed percentage above bank base rate, calculated on the amount of funding you require and the length of time your customer takes to pay the invoice.

❖ **Leasing:**

Leasing is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductible payments. i.e. Hire purchase, finance lease and contract hire.

❖ **Mezzanine Debt:**

A hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. Mezzanine financing is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies.

Since mezzanine financing is usually provided to the borrower very quickly with little due diligence on the part of the lender and little or no collateral on the part of the borrower, this type of financing is aggressively priced with the lender seeking a return in the 20-30% range.

Which type of finance is appropriate to your business?

Stages of company development and funding needs		Usual Investment amounts required	Finance types which are applicable
Seed capital	Pre-start - cash required for research or to develop a prototype	Up to \$50,000	<ul style="list-style-type: none"> ✓ Business Angels ✓ Seed Funds ✓ Grants and Awards ✓ Investment Funds ✓ Incubators ✓ Corporate Venturing ✓ Bank Debt
Start-up	You have researched the market but have no sales yet	Up to \$500,000	<ul style="list-style-type: none"> ✓ Business Angels ✓ Seed Funds ✓ Grants and Awards ✓ Investment Funds ✓ Incubators ✓ Corporate Venturing ✓ Bank Debt
Early stage	You have generated a few sales and need cash for marketing and operations	Up to \$750,000	<ul style="list-style-type: none"> ✓ ALL types of equity finance ✓ Bank Debt
Expansion	You are generating revenue but need cash for new products or new markets	\$100,000 Upwards	<ul style="list-style-type: none"> ✓ ALL types of equity finance

Raising private equity

Identifying the potential opportunity to turnaround a business, private equity provides the long-term investment that is suited to companies jeopardised by financial constraints or operational inefficiencies. Besides injecting much-needed capital, private equity stays through thick and thin with the right leadership and the business benefits from the strategic advice and business know-how brought on board.

What are the advantages of private equity?

- ❖ Long-term equity finance with no interest charges. There is no sudden requirement to repay and no personal security to provide.
- ❖ Investment is committed to the business and the project concerned alone. The investor's interests are closely aligned to those of the entrepreneur in helping to make the business work as this would reflect in the value of their equity.
- ❖ The correctly chosen investors can add value to the existing project. If the investor's background is in that field/industry, they can give their expertise, contacts and experience. They can also provide invaluable assistance in key decision-making, strategies and putting processes in place for policies and procedures.
- ❖ Further financing is easier to obtain as the investors are involved from the very beginning and so would be interested to provide follow-up capital for further expansion and growth. It is also easier to raise further bank debt on the back of equity provided by the investor.

What are the disadvantages of private equity?

- ❖ Raising equity finance is time consuming and costly. Due diligence usually last from 3-12months and cannot always be successful.
- ❖ Once finance is attained it can be costly to pay out monthly dividends, and high annual returns.
- ❖ The share held by the owner is diluted.
- ❖ Investors often exert control over the business which can impede key strategic and financial issues.
- ❖ It can often be hard to find the right partnership between the company and investor. This can effect time it takes to raise the private equity and could also affect the growth of the company if the investor chosen is unsuitable and a hindrance.

Business Plan

What investors are looking to invest in depends on a number of criteria and is often dependent on who you are raising finance from. However they are looking for the same things when reading a business plan. Your job in writing the business plan is to address these questions convincingly and clearly. All the following points are crucial.

What do investors look for?

- ❖ **Experience and a good management team** - They want you to be determined and ambitious in terms of achieving your long-term and short-term goals - passion and good business acumen obviously helps!
- ❖ **Good relationships** - Your ability to work with the investors and commitment to the business can be shown by investing your own money, taking a low salary and being receptive to their input.
- ❖ **Openness and honesty** - Investors will want to be able to trust you with their money. If you mislead the investor, they will probably find out during the due diligence process.
- ❖ **Knowledge** - It is important to do extensive research on the market - both your competitors and your customers. You should be able to answer any questions about your industry with complete understanding and insight. Private investors tend to back businesses that interest them, and prefer to invest in sectors they have experience in.
- ❖ **Realistic Financials** - Investors expect to see a business plan that paints a realistic financial picture of the anticipated growth of the company. If the plan is overly aggressive and not consistent with growth in the industry, your plan may be shelved. Be realistic with your financial projections, and be prepared to explain your numbers and assumptions. Even if you're a new venture and cannot give specific figures on the performance of your business, quote figures from the industry or your competitors. These real figures can carry more weight than your assumed projections and give more reality to your plan.
- ❖ **Exit Plan** - The exit is critical to investors, as it allows them to get their money back (hopefully with a healthy return). The exit strategy section of your business plan should also outline your long-term plans for your business. Venture Capitalists look for a high return and an exit strategy of approximately 3-7 years. Angel Investor look for a high return but are more flexible with the terms of the exit strategy. Possible exit strategies include:
 - Initial Public Offering
 - Merger/Acquisition
 - Buyout by a partner in the business
 - Franchising the business,
 - Handing down the business to another family member.

- ❖ **Rate on Investment (ROI)** - Investors are looking for a high return on their capital. Anything below 20% will be of no interest to them as they could earn this from bank interest rates. They usually look for a 40-50% annual return, which may seem high but the risks involved are equally high.
- ❖ **Scalability** - A market with high growth potential is very attractive to investor. A business that targets teenage girls who listen to music and has a reasonable chance of capturing 90% of the girls that are online is a huge opportunity; but a business which targets net-savvy SAAB mechanics who need prosthetic limbs is not. Investors will also be interested in businesses that can be successfully reproduced as a concept form or franchise.
- ❖ **Intellectual Property** - If necessary, a trademark, copyright or patent can be attractive to the investor as it creates a clear barrier to entry and secures a competitive advantage.

The 10 most common reasons Investors reject proposals

1. Poor writing and communication skills;
2. Untrustworthy;
3. Inability to respond well to comments, questions and criticism;
4. Too complex;
5. Inadequate information (i.e. no track record, proof of concept, market awareness, etc.)
6. Lack of management and business experience;
7. Unwillingness for sharing equity and control of the business;
8. Inaccurate or unrealistic financial projections and inadequate financial returns;
9. Not scalable;
10. No clear exit route and sustainability (i.e. viable and controllable if the founder leaves).

What needs to be in your Business Plan?

Once you have identified a need to raise finance, you then need to prepare a business plan. If the management team intends to turn a business around or start a new phase of growth, a business plan is an important tool to articulate their ideas and convince investors to support it.

There are many potential contents of a business plan. The European Venture Capital Association suggests the following:

- Profiles of company founders directors and other key managers; make sure you highlight the team member's relevant expertise in the area to show how valuable their contribution is;
- Statistics relating to sales and markets;
- Names of potential customers and anticipated demand;
- Names of, information about and assessment of competitors;
- Financial information required to support specific projects (for example, major capital investment or new product development);
- Research and development information;
- Production process and sources of supply;
- Information on requirements for factory and plant;

- Magazine and newspaper articles about the business and industry;
- Regulations and laws that could affect the business product and process protection (patents, copyrights, trademarks).

You need to communicate your ideas clearly and succinctly. The very process of researching and writing the business plan should help clarify ideas and identify gaps in your knowledge about the business, competitors and market.

What not to say in your Business Plan

❖ Economy lingo, business jargon and clichés as well as value inflation.

Disintermediation, win-win and phrases like "unparalleled in the industry;" "unique and limited opportunity;" or "superb returns with limited capital investment" are nothing but assertions and hype.

❖ Trying to be all things to all people.

Many early-stage companies believe that more is better. They explain how their product can be applied to multiple, diverse markets, or they devise a complex suite of products to bring to a market. Most investors prefer to see a more focused strategy.

❖ "The product will sell itself".

Business plans that fail to explain the sales, marketing, and distribution strategy are doomed. The key questions that must be answered are: who will buy it, why, and most importantly, how will you get it to them? You must explain how you have already generated customer interest, obtained pre-orders, or better yet, made actual sales - and describe how you will leverage this experience through a cost-effective go-to-market strategy.

❖ "We have no competition".

No matter what you may think, you have competitors. Maybe not a direct competitor - in the sense of a company offering an identical solution - but at least a substitute.

❖ "Our target market is X million" or "Achieving a return of \$Xm for the investor after X years".

Complete overestimations or if cannot be guaranteed should not be included on the plan.

❖ Long winded and encompassing sentences.

It is much more beneficial to use a precise and solid choice of words. Write in plain English stick to a tight, simple explanation of your idea. A 20-page plan which clearly lays out your business is far more likely to be read than a 100-page plan. Often entrepreneurs use a 15 slide PowerPoint presentation.

❖ Don't give more away than you want to.

Be aware of who is reading your information, and never give away more information than you feel comfortable with. Do due diligence on anyone who you are dealing with. If you do need to reveal sensitive information, ask for a Non Disclosure Agreement (NDA) to be signed (See Confidentiality section).

FAQ

Who are the private investors?

There are 3 types of private investors. These are the entrepreneurial and occupational, who are wealthy individuals who are either retired or have sold their business and are looking to bring their skills and experience into a new venture. There are also professional investors who work for large organisations and invest in a portfolio and make high risk / high return investments.

What are the costs of raising finance?

It is important to be aware of the cost of the money raised. Apart from interest charges and dividends, other costs you may need to consider will relate to third parties, such as lawyers, accountants and fees.

Investment costs

These relate to the costs of the particular investment and are not annual charges. An indication of the types of costs that you might expect is as follows:

- ❖ Arrangement fees - normally expressed as a percentage based on the sums invested.
- ❖ Due diligence costs - These are fees charged by third party industry, technology and financial experts to conduct due diligence on your proposal from a commercial and financial perspective prior to completion of the proposed investment. These experts may also make useful recommendations to you.
- ❖ Legal costs - These are fees charged by lawyers for providing the necessary advice and documentation, and will vary according to the complexity of the deal. These fees are paid out of the investment and relate to work undertaken for you and for investors.
- ❖ Negotiation and commitment fees on bank borrowing and Venture Capital investment.
- ❖ Success fees - these are usually charged by brokering companies and individuals and can vary from 2-5% of the amount of finance raised through their contacts.
- ❖ Advisory fees - These are charged for reviewing, amending your business plan, financial forecasts and to enable you to become investor ready before approaching financial sources. They often charge a one-off fee between \$1000 - \$10,000.
- ❖ Registration fees - These are for introductory services and can vary from \$99 to around \$2000 for promoting your business to their database of investors.

Ongoing costs

These relate to the ongoing costs of having secured investment.

- ❖ Monitoring Fees - It is normal for venture capital investors to charge an annual monitoring fee, which is expressed as a percentage of the sum invested.
- ❖ Non-Executive Director Fees - Some investors may take a board position and charge a fee for this role. The fee is negotiated between the non-executive and the company.
- ❖ Consultancy Fees - Some investors will charge consultancy fees.

How long does it take to raise private equity?

Raising finance is often a complex process and rarely does it take less than 3 months. Business management need to assess several alternatives and then negotiate terms which are acceptable to the finance provider. The main negotiating points are often as follows:

- Whether equity investors take a seat on the board;
- Votes ascribed to equity investors;
- Level of warranties and indemnities provided by the directors;
- Financier's fees and costs;
- Who bears costs of due diligence.

During the finance-raising process, accountants are often called to review the financial aspects of the plan. Their report may be formal or informal, an overview or an extensive review of the company's management information system, forecasting methods and their accuracy, review of latest management accounts including working capital, pension funding and employee contracts etc. This due diligence process is used to highlight any fundamental problems that may exist.

How can you ensure confidentiality?

❖ Non-disclosure agreement (NDA)

This is also known as a confidentiality agreement, confidential disclosure agreement (CDA), proprietary information agreement (PIA), or secrecy agreement, is a legal contract between at least two parties that outlines confidential materials or knowledge the parties wish to share with one another for certain purposes, but wish to restrict access to. It is a contract through which the parties agree not to disclose information covered by the agreement. An NDA creates a confidential relationship between the parties to protect any type of confidential and proprietary information or a trade secret. As such, an NDA protects non-public business information.

NDAs are commonly signed when two companies or individuals are considering doing business and need to understand the processes used in each other's business for the purpose of evaluating the potential business relationship. NDAs can be "mutual", meaning both parties are restricted in their use of the materials provided, or they can restrict the use of material by a single party.

In rare cases, the contract may state that the existence of the NDA itself cannot be disclosed.

About Us

How can Angel Investment Network help you?

We are the world's largest online angel investment network with more investors than any other angel group. We also have 30 network covering over 80 countries worldwide, so your project will get global exposure. We can connect you directly with private investors, business angels, venture capitalists and business funds.