Changing the World: Entrepreneurship:
How Innovation and Entrepreneurship Changes the World
-Jack M. Wilson

Chapter 9 Finding the Financing for your Venture

Introduction

Anyone who has watched Shark Tank knows that finding the financing is a big part of launching any new venture. In fact, this is the primary reason that one does a business plan and a pitch. The pitch is generally designed to get an investor to pony up some money to help the entrepreneur advance the new venture. It can be early-stage financing, before the venture has been able to establish itself, or it can be later stage financing to allow the business to expand once it has established its business model. As we shall see, there are a variety of stages and each one has its own challenges and requirements.

Of course, the type of funding that one might choose to go after will depend upon the form that the business might take. One might organize as a sole-proprietorship, a partnership, a Limited Liability Partnership (LLP), an S-Corporation, a C-Corporation, a Limited Liability Corporation (LLC), or even a non-profit corporation. In this chapter we will give a quick overview of the types of business organizations but would refer the reader to other references for more detail.

All ventures, including social ventures, need funding

Gathering the resources for a new venture is one of the most important first steps. The most important of those resources would be a good team and a good initial business model to be tested. Taking the next steps generally requires gathering financial resources to support the effort. For some projects the financial needs may be small. Some have said that the cost to launch is approaching zero. In many cases this is because one can now acquire computing power from Clouds like Amazon Web Service or others instead of needing to acquire one's own IT resources. There are substantial resources offered under Freemium models on the Internet, that allow one to get a start at very low cost, but then start to pay once the venture become established. While there is some truth to this, most new ventures require substantial financial investments before the venture can begin to have sufficient revenues to become self-supporting. Startups in information technology areas often require fewer resources, but startups in biotechnology, medical devices, and other life science fields can require much more -billions of dollars in many cases.

You had better have a very good pitch and a business plan and/or a business model canvas that is compelling to investors.

The first step in any effort to fund a startup begins with a careful analysis of the funding that you will need. How much money do you need? For some startups there are substantial capital requirements. You may need funding for capital items, facilities, or equipment. There are also operating requirements. How much funding will you need to have to cover operations until sufficient cash flow begins? Again, if this is a medical related startup, this might require billions, but if it is a food truck sales venture, it may require very little.

That brings the entrepreneur directly to the next challenge: Where to get the money? Who do I go to who is most likely to want to invest in the venture? Much of the rest of this chapter will focus on that!

As we shall see, the kind of funding available to a venture depends upon the way it is organized. Venture Capitalists and Angel investors will be expecting an exit strategy -or a way to get their money back. This usually means that the venture needs to be some kind of organization that can be sold publicly -usually on a stock market. This may happen due to an IPO (Initial purchase offer) or by selling the company to another company that is already public.

Deciding on a Business Organization

As we mentioned there are several legal forms that a new venture may consider including.

- Sole-proprietorship, a
- Partnership, a
- Limited Liability Partnership (LLP)
- S-Corporation,
- C-Corporation,
- Limited Liability Corporation (LLC)
- Non-profit corporation (501c3).

These forms differ in how various issues are handled and may offer different advantages and disadvantages to a venture. Considerations include:

- Cost of formation
- Liability protection -how protected is the owner from liability for issues that arise in the business?
- Tax -does the entity get taxed itself or does it pass profits through to the owners for taxation. In the former case, the owners will still have to pay taxes on any profits distributed. This is often termed double taxation.
- Types and numbers of investors
- Liquidity

Let us compare each of these on the issues above.

Sole Proprietorship

- Advantages

- Easy and inexpensive to create
- Owner retains complete control and keeps all profits
- The owner can deduct any losses against other owner income
- Is **taxed only once** to the owner
- Easy to dissolve the business

- Disadvantages
  - **Unlimited liability** to owner
  - Very reliant on skills, abilities, and dedication of owner
  - Can be difficult to raise capital
  - Loss of owner to death or disinterest terminate the business
  - **Low liquidity** of the investment

General Partnership- with partnership agreement

- Advantages
  - Easier and less expensive than a corporation or LLC
  - Pools several persons skills and resources
  - Can be easier to raise funds than a sole proprietorship
  - Business losses are deductible to partners against other income
  - Taxed only to the partners and not to the company
- Disadvantages
  - Unlimited personal liability
  - Relies on small number of people
  - Difficult to raise capital
  - Disagreements among partners are common
  - Unless a partnership agreement provides differently- the partnership ends at death or withdrawal.
  - Liquidity of the investment is low. It is hard to cash out any owner.

Limited Partnerships

- often have both general and limited partners
- General partners are liable for debt, but the limited partners are limited to the amount of their investment
- Limited partners do not share in control (or jeopardize the limited liability)
- This is common in real estate development, oil and gas exploration, motion picture venture.

There are two slightly different types of corporation termed **C Corporations** or **S Corporations**

C Corporation – allows both preferred and common stock

- The preferred has special rights over common stockholders for dividends and liquidation.

  - Must file **articles of incorporation** with the Secretary of State (SOS) in the state of incorporation that give: Name, purpose, number of shares, classes of stock, other items
- Corporations must file annual papers with Secretary of State and pay annual fees.
- Provides protection against personal liability in most cases
  - *Piercing the corporate veil* – in some cases, especially if malfeasance or malicious behavior can be shown, the directors may be held personally liable.
- Profits are taxed to the corporation and then taxed again to the stockholders -if distributed to stockholders through dividends For that reason many companies prefer to re-invest earnings rather than pay them out as dividends.
  - This is often called **double taxation**
  - Many owners prefer to profit through stock appreciation rather than through dividends because capital gains are generally taxed at lower rates and do not have to be paid until the stock is sold. Taxes on dividends received must be paid in the year received.

The C corporations can be of several varieties.

- Public Corporations
  - Stock is listed and traded publicly on the stock exchanges.
  - It is very liquid –allowing stocks to be sold or bought at will.
- Private corporation
  - In a private corporation the stock is held very closely and not traded publicly. It is very illiquid because buying and selling ownership cannot be done on exchanges. Only accredited investors can invest.
- Closely held corporation
  - In a closely held corporation the stock is infrequently traded among a small group even though the stock may be available publicly. It is somewhat illiquid.
  -

Stock options are often issued to reward employees. This gives them the right to buy stock at some set price. If stock appreciates, then one can buy -then sell and take the profit. This links the success of employee to the success of firm. However, it can also handcuff the employee, or keep them working at the firm in order to obtain vesting of stock options.

In summary, the C-Corp has both advantages and disadvantages:

- Advantages
  - Protection from liability
  - More ways to raise capital –easier to do so
  - No restrictions on the number of shareholders
  - If traded, then very liquid
    - Private->Public=IPO –initial public offering
  - Can Offer stock options.
- Disadvantages

- Requires more work and legal advice to set up.
- Cannot deduct business loses against your personal income.
- Double taxation –at corporate and at shareholder level
- Small shareholders have little influence in management

The S-Corp:

The S-Corp has some aspects of a partnership but is an incorporated public corporation.

- Most notable the S-Corp does not pay taxes. It files an information return and passes the profits/losses to the stockholders for their personal tax returns. (This tax treatment is similar to partnerships)
- The S-Corp provides protection from liability like the C-Corp (with the same caveat that the corporate veil can be pierced legally under some circumstances making the owners personally liable
- Only actual salaries are subject to Self-Employment tax –not passed through income to shareholders
- Requirements for an S-Corp
  - It cannot be subsidiary of another corporation.
  - The shareholders must be US citizens and cannot be partnerships or corporations
    - They can have no more than 100 ownership units (husband-wife is one unit)
  - All shareholders must agree to the formation of an S-Corp
  - There is only one class of stock –either preferred or common

Limited Liability Company (LLC)

The LLC Originated in Germany. Wyoming was the first state in US to allow LLCs, but the model has spread throughout the US. All the of members (similar to partners or stockholders) have limited liability –this is similar to corporations. However, it must be a private business and not a publicly traded company. The income is passed through to owners for taxation, much like a partnership. Thus, there is no double taxation. Income may be split any way they wish. It is more flexible than S-Corp on the number of members and on tax-related issues.

The LLC introduces new terminology to describe owners and the type of Ownership.

- Stockholder → "members"
- Owning stock → "interests"

If the LLC wants to "go public," and sell their shares publicly then they must convert to a C-Corp.

Non-Profit Corporations

Many forms of social entrepreneurship are accomplished through non-profit ventures and these are often organized into 501c(3) corporations that must be focused on one or more of these charitable public purposes: charitable, religious, educational, scientific, literary, testing for public safety, fostering amateur sports competition, or preventing cruelty to children or animals.

The key provision for a non-profit is a complete prohibition on "**self inurement**" –or using the profits or assets of the non-profit organization to provide any private benefit to any person who is in a position to control or influence the non-profit. In fact, there is never a profit. There may be a surplus of revenues over expenses, but it cannot be distributed to those operating the non-profit or used for purposes other than the charitable purposes for which the non-profit was chartered.

Non-profit corporations do not pay taxes unless they engage in some unrelated business. Then they must pay taxes, called the unrelated business income tax (**UBIT**), on the unrelated income. Donations to legally chartered 501c(3) corporations are generally tax exempt, although any portion that returns benefits (dinners, entertainment, etc.) to the donor is non-deductible.

In order to become a non-profit organization, once must first be chartered according to state law –usually requiring articles of incorporation that set out the charitable or other non-profit purpose, specify how it will be governed, and other items. (Example from Massachusetts: http://www.sec.state.ma.us/cor/corpweb/cornp/npfrm.htm)

The organization can then apply to the IRS for the 501c(3) designation. (http://www.irs.gov/pub/irs-pdf/p557.pdf)

Each year the organization must file a "Return of Organization Exempt From Income Tax" (Form 990) and must keep proper accounting and governance records. (http://www.irs.gov/pub/irs-pdf/f990.pdf)

The organization cannot use its resources to lobby for political issues or to support political organizations or individuals. A very small percentage of annual expenses may be spent on lobbying (generally less than 5%), but if that is exceeded then the organization may have its non-profit status revoked.

There are many other kinds of non -profits, but that is beyond the scope of this text.

Developing Your Financial Model

Most entrepreneurs do not come to the new venture with a background in finance or accounting, but they will need to learn a little bit about finance, particularly about financial objectives and ratio analysis, because they will rarely want to spend the money to add a financial professional to the team. You will need to learn the jargon of financial analysis to be able to speak to funders. A detailed exposition of new venture finance is beyond the scope of this course, but those interested in a little more detail may wish to explore some web materials on financial analysis in the Technological Entrepreneurship website[1].

Step one is to determine the resources that you will need. That starts with the use of the Lean Launchpad model and the development of a business model canvas. You may also want to do a traditional business plan.

The most important first step, as Steve Blank says, is to get out of the office and talk to potential customers. You may want to assemble and use a group of advisors or do brainstorming. This can be very helpful but does not replace the need to go out and interview customers.

Then you estimate your financial needs and very *clearly state the assumptions* that you are using. I promise you that you WILL be using assumptions. In most cases you will prepare a sales forecast and determine your breakeven point.

Finally, project your estimated cash needs for startup and initial operation.
A new venture needs to do a **Break-Even Analysis.** At what point, in both time and money, will you begin to break even? Investors will need information to judge the **overall attractiveness** of the investment. Does the investment look like it will return enough profit to make the risk worthwhile? Kevin O'Leary, Mr. Wonderful on Shark Tank, can sometimes seem like a broken record when he hammers away at an entrepreneur asking, "how do I get my money back." All investors are asking the same questions, no matter whether they say it so bluntly or not.

In your narrative you will need to be clear about your assumptions. There needs to be an explanation of the sources of numbers for the forecast and the assumptions used to generate them. Some typical assumptions might include things like:

- The inflation rate is 2.5%.
- The cost of main raw materials will be constant over time (or not).
- You are expecting to hire certain people at assumed salaries.
- The initial sales in the first year will be X.
- The annual growth in the first few years will be Y.
- The growth in expenses is expected to be Z.

You really want to see expenses growing less than revenues grow in order to reach profitability and achieve economies of scale. When you deliver your pitch to potential funders, they will be examining those assumptions very closely. If the assumptions do not sound reasonable, the rest of the pitch is probably going to fall on deaf ears.

[1] http://www.jackmwilson.net/Entrepreneurship/TE/TE-Chap14-EvaluatingFinances.pdf

Start-up resources include:
- People (founding team, advisors, independent contractors)
- Physical assets (equipment, inventory, office or plant space)
- Financial (operations and emergency fund)

Many startups also draw upon more complex resources:
- Utilitarian Resources (i.e. patents, licenses, other intellectual property)
- Instrumental Resources (i.e. industry contacts, networks, partners)
- Intangible Resources (i.e. organizational culture, tacit knowledge)

Begin by estimating expenses and start-up costs -all costs incurred to get the business off the ground. This includes the cost of buying the equipment, the cost of buying (or leasing) the long-term assets (office space, etc.), sufficient working capital (the cost of keeping inventory, account receivable etc.), the operational expenses (telephone, fax, travel, advertising etc.), and any production costs (material costs, labor costs, etc.).

Some expenses are fixed, and some are variable. Typical **fixed expenses** include: equipment, office space, and other overhead. Examples of **variable costs** include: the costs of materials used to make the product, the costs of labor used to make the product, commissions or other compensation based on sales volume, and shipping and handling charges.

Other fixed or semi-fixed costs might include:
- Utilities
- Managers' Salaries
- Advertising
- Insurance
- Interest
- Rent
- Depreciation

Startups need funding for all of the previous reasons. Three categories of need stand out:
1. Money is needed to make the capital investments in equipment and (perhaps) facilities and to purchase material and resources and to pay some employees
2. Many startups have a long period of product development. This can be particularly long for biotechnology startups that may require billions to be invested before sales can begin. Computer software is usually less demanding.
3. All these needs for cash can lead to cash flow problems. In most cases, orders come in in bunches, but expenses like salaries, rents, and materials are a steady outflow. Funding is needed to keep the doors open until the orders are paid for after delivery.

Valuation: How do you know what you are worth?

From the entrepreneur's perspective the driving force may be how much funding you feel that you need to launch the venture. The investor has quite a different perspective. They are trying to figure out how much your venture is worth. They understand that if they invest in a new for-profit venture, they need to find a way to make a profit from it. They may do this by asking for equity (stock ownership), a royalty of sales, debt payments or a combination of debt and equity that is often done by offering a loan that can be converted into equity at some particular time in the future. That time could be because of another round of financing, an IPO, a particular date, or some other specific event.

Negotiating the value is always one of the most challenging parts of the process as we shall see in the case of the founding of Staples mentioned later in this chapter. Of course, fans of the Shark Tank have seen this negotiation play out in each new episode.

How can one decide on value? That is not easy and there are no rules. There are some general principles, but these are not prescriptive. In the end it comes down to a negotiation in which the entrepreneur tries to make the best case for a high value and the investor (angel, venture capitalist, etc.) tries to keep the value to a lower level where they have some likelihood of getting a good return on their investment.

For an established public business there is a simple rule of thumb based upon the price to earnings ratio. The P/E ratio should be similar to other similar businesses. For most of the last century the P/E of the S&P 500 has mostly been between 20 and 40, but has been as low as 4.78 in 1920 and as high as 44.2 in 1999. In late 2020 the ratio was just over 20.

This would be great except that new ventures rarely are making any money. Zero earnings. That makes the P/E infinite and not helpful at all. New ventures need some other kind of benchmark. One of the best of those is annual revenues. Even though the venture may not yet have reached break even, the fact that they have revenues indicates that they might be likely to be able to do that in the future. Investors also like to see a pattern of growth in revenues. The key factor is the multiple of revenues that leads to a value for the company. Slowly growing companies will generally have a multiple in the low single digits. Rapidly growing companies can see a multiple in the high single digits -or even higher in exceptional cases.

Of course, another metric of interest is customers. This is always important but is particularly important for many online ventures that are using the freemium model. If investors see a lot of customers, particular returning customers, then there is some confidence that the venture may be able to “monetize” those customers -or start to gain revenue from them. This metric has led to high values for new ventures like Facebook, Twitter. Tik Tok, and many others.

The value of a venture's assets might be another metric that is most useful for more traditional kinds of brick-and-mortar businesses.

It is not rocket science. In the end a company will get the multiple that it can negotiate based upon the evidence.

Sources of Capital

Searching for funding is always a challenge. New ventures can tap into quite a variety of sources of funding. Which funding source is best depends upon how much you need, how developed your venture is, and even the type of venture. Here is a list of potential sources of capital:

- Personal Savings
- Friends and family
- Crowdfunding -Kickstarter, IndieGogo, GoFundMe, etc.
- Bootstrapping
- Business angels: this could be equity, debt, or a combination.
- Venture capitalists: this could be equity, debt, or a combination.
- Corporations often invest in new ventures to later acquire or partner with.
- Loans, Banks will lend, but it is often difficult.
- The Small Business Administration (SBA) Guaranteed Loan Program
- Government grants
- Small Business Innovation research (SBIR) and Small Business Technology Transfer (STTR) government funding programs.

Sources of Personal Financing include savings, family and friends (often called friends, family, and other fools), and bootstrapping. Bootstrapping is finding ways to avoid the need for external financing or funding through creativity, ingenuity, thriftiness, cost-cutting, or any means necessary. Leasing, instead of buying, property or equipment is often one way to conserve funding.

ILINC used bootstrapping to get started by selling **vaporware**. Success Magazine described the bootstrapping model employed by ILinc as the “Wimpy” model –named after Popeye the Sailor Man’s friend who was always saying “I’ll gladly pay you Tuesday for a Hamburger today.” ILinc told IBM, Office Depot, News Corp, Sprint, AT&T, Aetna –United Healthcare, and others that they would deliver a software product next year for a $300,000 contract today. This is often called “**selling vaporware**.”

Bootstrapping methods include

- Avoiding unnecessary expenses
- Minimizing personal expenses
- Applying for and obtaining grants
- Obtaining payments in advance from customers
- Sharing office space with other businesses
- Coordinating purchases with other businesses

- Buying used instead of new equipment
- Leasing equipment instead of buying

Crowdfunding

One of the newest ways to raise money is to do it by making an appeal to the general public asking them to contribute to your venture. *Kickstarter* was begun to help raise funding for creative ventures[2]. *GoFundMe* is often used to raise funding in personally difficult times but is also used to jumpstart some kinds of ventures. I*ndieGoGo* raises funds for an idea, a charity, or a startup business.

These sites fund themselves by charging a commission on the funds raised –often about 5%. They can also raise revenues by charging for financial transactions or advertising.

One decision that you will need to make is whether to go for more debt or equity financing. Debt is a financial obligation to return capital provided plus a scheduled amount of interest, but debt often must be guaranteed by the entrepreneur's personal assets or earning power. This can create a lot of stress. In some cases, you can secure the debt with assets that you own. Sometimes you can get suppliers to provide you credit. Most new ventures have no way to make scheduled interest payments until they have positive cash flow.

Equity is a portion of ownership received in an organization in return for money provided. To raise equity, you must give up a portion of your company. Entrepreneurs find it difficult to give up equity because they naturally think that their new venture is going to be worth a lot and they hate to give up a portion. In some cases, they also fear that giving up equity could cause them to lose control of the company.

A combination of both is often used. This can be **convertible debt**. The investor will loan you the money that you need but will require an ability to convert the debt to equity at a later date.

- Step 1: Determine precisely how much money the company needs
- Step 2: Determine the most appropriate type of financing or funding
    - Equity financing
    - liquidity event
    - Debt financing
- Step 3: Develop a strategy for engaging potential investors or bankers
    - Elevator pitch
    - Identify and contact the best prospects
    - Personal introduction is best
    - Prepare a complete business plan to close the deal

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[2] http://www.jackmwilson.net/Entrepreneurship/Cases/Case-KickStarter.pdf

The elevator pitch, defined in the last chapter, is often a 60 second explanation of the company for potential investors.

- 20 seconds: Describe the Opportunity or Problem that needs to be solved.
- 20 seconds: Describe how your product or service addresses the opportunity or problem.
- 10 seconds: Describe the qualifications of the team and yourself
- 10 seconds: Describe your market

Remember: This is a pitch to INVESTORS not customers. End with a simple ask. "We are looking for an investment of (for example) $1 million for 50% of the company." The actual length of the pitch is determined by the audience and not by you, the entrepreneur.

There are three major sources of equity funding. **Angel Investors** are private investors using their own funds and often their own time to help launch a business. **Venture capital providers** who use pooled investment funds that are invested by professionals in anticipation of large returns. Another potential source of equity is not usually able to be accessed until the company has a proven track record. At that point the company can begin to sell stock to the public by registering on a stock exchange. This **Initial Public Offering** (IPO), or offering stock for sale to public investors, allows more established companies to raise equity funding. Before the IPO, the company may only sell stock to accredited (qualified) **professional investors** who can prove that they have a high net worth and understand the risks of investing in unregistered securities. In the United States this means that the investor has a net worth of over $1 million -not including the home. The investor should have an income of over $200,000 per year for the previous two years and an expectation of at least that in the future.

What are investors looking for? An excellent venture team with motivation, passion, honesty, and experience. An excellent business opportunity with a large and desirable market, appropriate growth strategy, compelling product description, competitive advantage, and one that solves a business or social problem (or both!)

Investors are generally looking for an **exit strategy**. This could occur by doing an IPO or by selling the new venture to a larger firm –being acquired.

As discussed earlier, many investors look at the team as more important than the product, others see market-product fit as the most important aspect. Research tends to indicate that the team is about half of the key to success.

Angel Investors

Angel investors or Business Angels are individuals who invest their personal capital directly in start-ups. The prototypical business angel is about 50-70 years old, has high income and wealth, is well educated, has succeeded as an entrepreneur, and is interested in the startup process. Business angels are valuable because of their willingness to make relatively small investments, and the experience they often bring to the new venture. The Angels tend to fill the gap between friends and family or bootstrapping and access to formal venture capital. Because of this, they often require very high returns on investment –often over 10 times the initial investment in five years.

Venture Capital

Venture capital has been mostly a US phenomenon, but the rest of the globe is quickly catching up to this model. There was a surge in venture capital funds during the dot com boom of the 90's, but that fell precipitously with the dot com bust in 2000 and 2001.

Figure 1 Venture Capital Boom and Bust from the Economist

The dot com boom and bust was followed by a period of relatively flat funding but has tended to rise since the low in 2009 at the end of the subprime bust. The Economist article chronicles these changes and tracks them to other economic indicators[3].

[3] To fly, to fall, to fly again: The tech boom may get bumpy, but it will not end in a repeat of the dotcom crash; The Economist; June 25, 2015 http://www.economist.com/news/briefing/21659722-tech-boom-may-get-bumpy-it-will-not-end-repeat-dotcom-crash-fly

The same article chronicles the rise of the Unicorns. The chart below is compiled from the Economist article and from other listings[4]. It shows the top ten US Unicorns as of July 2015 and their estimated valuations in 2017.

Company	Business	$B -Val-July-2015	$B-Val 2017	$ B -VC - 2015	Rev.$M 2014	Employees -1000s
Uber	Car sharing	$ 41.0	$ 68.0	$ 6.0	$ 800	7.5
Airbnb	Roomsharing	$ 26.0	$ 29.3	$ 2.3	$ 450	3.0
Snapchat	Disappearing messages	$ 16.0	$ 16.4	$ 1.2	$ 0	0.4
Palantir	Big data analytics	$ 15.0	$ 20.0	$ 1.1	$ 600	1.5
SpaceX	Space Exploitation	$ 12.0	$ 21.2	$ 1.1	$ 825	3.0
Pinterest	Photo &Craft sharing	$ 11.0	$ 12.3	$ 1.3	$ 15	0.7
Dropbox	Filesharing in the cloud	$ 10.0	$ 10.0	$ 1.1	$ 400	1.5
Wework	Office Space Provision	$ 10.0	$ 20.0	$ 1.0	$ 145	0.4
Theranos	Lab diagnostics	$ 9.0	$ 0.8	$ 0.1	$ 45	0.2
Square	Mobile Payment system	$ 6.0	$ 15.9	$ 0.6	$ 900	1.3

Both Square and Snapchat[5] had gone public by mid-2017, and are no longer considered Unicorns. Theranos had encountered difficult challenges and government scrutiny and had essentially stopped doing business and returned to only research[6]. Its valuation was overstated at $800 million in 2017. Eventually Theranos collapsed and its founder faces criminal prosecution.[7]

Venture Capital is the rocket fuel of economic development and has boosted many of the largest public companies today. This includes the famous **FANG** group (Facebook, Amazon, Neflix, and Google) which are all public corporations today.

Entrepreneurship is increasingly a Global Opportunity, and the venture capital is going global as well. Consider the graph of the number of global unicorns and the total valuation of global and US unicorns. The world is catching up.

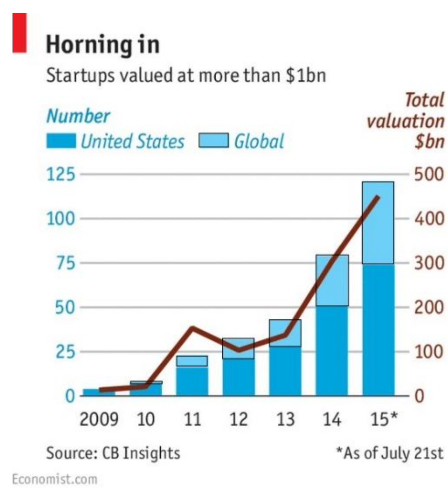

Figure 2 Global vs US Unicorns

[4] https://www.cbinsights.com/research-unicorn-companies?utm_source=Facebook&utm_medium=Paid&utm_campaign=Unicorn%20Club
[5] www.jackmwilson.net/Entrepreneurship/Cases/Case-Snapchat.pdf
[6] www.jackmwilson.net/Entrepreneurship/Cases/Case-Theranos-ElizabethHolmes.pdf
[7] http://www.jackmwilson.net/Entrepreneurship/Cases/Case-Theranos-ElizabethHolmes.pdf

Compare the list of Global Unicorns in 2020 to the list above of US Unicorns. China is rapidly growing to rival the United States as a producer of Unicorns, and the companies that they are producing are among the largest on the list.[8]

Company	**Valuation ($B)**	**Date Joined**	**Country**	**Industry**
Bytedance	$140.00	4/7/2017	China	Artificial intelligence
Didi Chuxing	$62.00	3/31/2015	China	Auto & transportation
SpaceX	$46.00	12/1/2012	US	Other
Stripe	$36.00	1/23/2014	US	Fintech
Airbnb	$18.00	7/26/2011	US	Travel
Kuaishou	$18.00	1/1/2015	China	Mobile & telecommunications
Instacart	$17.70	12/30/2014	US	Supply chain, logistics, & delivery
Epic Games	$17.30	10/26/2018	US	Other
One97 Communications	$16.00	5/12/2015	India	Fintech
DoorDash	$16.00	3/1/2018	US	Supply chain, logistics, & delivery
Yuanfudao	$15.50	5/31/2017	China	Edtech
DJI Innovations	$15.00	1/23/2015	China	Hardware
SHEIN	$15.00	7/3/2018	China	E-commerce & direct-to-consumer
Chime	$14.50	3/5/2019	US	Fintech
Grab	$14.30	12/4/2014	Singapore	Auto & transportation
Samumed	$12.44	8/6/2018	US	Health
JUUL Labs	$12.00	12/20/2017	US	Consumer & retail
Bitmain Technologies	$12.00	7/6/2018	China	Hardware
Robinhood	$11.70	4/26/2017	US	Fintech
Wish	$11.20	5/18/2015	US	E-commerce & direct-to-consumer

As we saw in the earlier slide, venture capital provides the rocket fuel for most new ventures. Over $100 Billion was invested in 2019 in new start-ups[9].

In overall venture capital investments, California easily leads all regions. New York is second and Massachusetts is third. For many years they were close to being tied, but New York has moved ahead -although it is still less than a third of California

Here are the rankings in 2019[10].

1. California $65.6 B
2. New York $20.9 B
3. Massachusetts $10.8 B
4. Washington $3.9 B

[8] https://www.cbinsights.com/research-unicorn-companies
[9] https://www.statista.com/topics/2565/venture-capital-in-north-america/
[10] https://www.statista.com/statistics/424167/venture-capital-investments-usa-by-state/

5. Texas $3.7 B
6. Florida $2.9 B
7. Illinois $2.2 B
8. Colorado $2.5 B
9. Pennsylvania $2.6 B
10. Georgia $1.7 B

California leads this dramatically because of the effect that Silicon Valley had on the creation of a cluster in information technology and all of its applications. This has included social media as well as ecommerce applications. Biotechnology is a different case. According to BioPharmaDive.com, Massachusetts led the nation in both venture capital invested in biotech startups and in the employment in the biotech industry[11]. Mass bio reported that there was a $26% increase in venture funding to Massachusetts companies in 2016 to a total of $2.9 billion of venture funding[12].

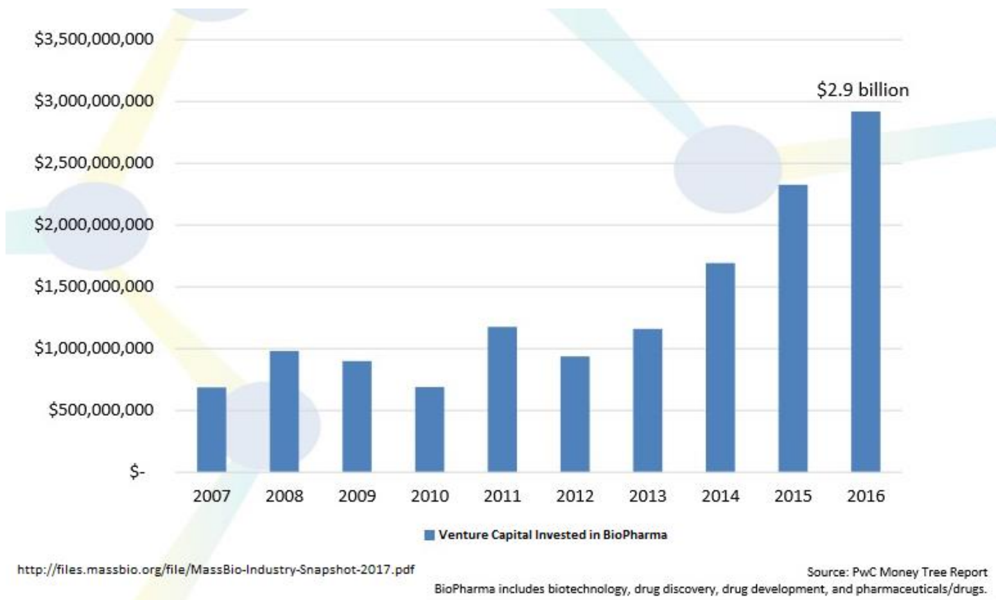

Figure 3 Massachusetts Venture Capital in Biotech

[11] https://www.biopharmadive.com/news/massachusetts-biopharma-venture-capital-jobs-research/507466/

[12] https://www.massbio.org/news/recent-news/massbio-s-2017-industry-snapshot-shows-venture-capital-investment-in-massachusetts-biopharma-industry-reached-a-record-2-9-billion-last-year-137592

Staples as an example of venture funding attitudes.

The founding of Staples and the Venture investment that Bain Capital made in Staples provides a good example of the tension and negotiation required between an entrepreneur and a venture capitalist as they try to find a fair valuation for the company but start with very different needs and perspectives.


Business

Area's home prices rise, foreclosures fall

STAPLES

AN UNEASY START

Staples revolutionized the office supply business, but its success was far from guaranteed. Mitt Romney's testimony in its founder's divorce case reveals insight into its rocky beginnings.

Figure 4

Boston Globe Article on Staples Funding

The Boston Globe did a nice article on this entitled "*An Uneasy Start: Staples revolutionized the office supply business, but it success was far from guaranteed*[13]."
This article on the founding of Staples, features the CEO Tom Stemberg and the Venture Capitalist, Mitt Romney, who later became Governor of Massachusetts and candidate for the Presidency.

The opening line was, "*It was early 1987, and Mitt Romney was shopping. And he was angry. He was walking the aisles of Staples, a little-known retail store his firm had bet $1.5 million on so far, and picking up office supplies. Then he waited in line at the check-out counter -- for far too long. To Romney, then CEO of Bain Capital, a superstore with low prices was a good idea, but there were big problems*."

Venture Capitalists see their job as driving the entrepreneur to greater heights. They are not usually gentle about it!

They also describe the difficulty of setting a value for the company -and how the founder always thinks it is much higher than the venture capitalist does!

> *"It was a very difficult and painful process,'' Romney would recall while testifying on Stemberg's behalf. "We found Tom difficult to deal with from a negotiating standpoint." …….*
> *Stemberg and his lawyer were driving a tough bargain, trying to keep "a very large portion" of the company for the founder, while Bain and the other investors were "of course thinking we should take a large portion of the company."*
>
> *"It was very clearly our intent to [reward] Tom handsomely if the company did spectacularly well. On the other hand, we did not want Tom to receive any reward*

13 http://www.bostonglobe.com/business/2012/10/30/mitt-romney-testimony-staples-founder-tom-stemberg-divorce-case-reveals-rocky-early-years-company/G4vuYcyxtUGBQeQyO2b4jI/story.html

> *if he were to turn out to be not an effective chief executive officer," Romney said in his testimony.*
>
> *Indeed, such contentious face-offs are common, said Todd Dagres, a Boston venture capitalist whose deals have included Akamai Technologies and Twitter. "The one thing that is an absolute rule is, the most successful entrepreneurs I've dealt with have been the most challenging,'' said Dagres of Spark Capital. "Based on how successful Staples and Stemberg were, and Mitt has been, I would be shocked to learn if it was anything different."*

It always comes down to this point: The entrepreneur thinks he/she has creating something incredibly valuable. The venture capitalist hopes this is correct but approaches the situation with more skepticism. Besides, if the entrepreneur IS correct, then the VCs want to make sure they capture as much of the wealth created as they can! In the end, it comes down to making a deal that fairly recognizes the potential value created while providing adequate reward to the investors taking the risks. The only way to do that is through negotiation. It is not a science.

Venture Capital -Staging of financing

Venture capital usually comes into a new venture at various stages of the ventures development. Some invest early, some later, and others near the end. The stages are often referred to by names:

- Seed Funding -Seed funding occurs very early and often helps to create the prototype or do the feasibility analysis.
- Series A or Start-up funding -If feasibility and prototyping are complete, a business model is adopted, and a management team is in place, one may need funding to begin operation/production even before any, or many, customers have been found.
- Series B or First Stage Funding -In the first stage the company is operating and has customers but needs to expand its operations or production.
- Series C or Second Stage Funding -In the second stage the company is further along in production and operation, but needs further expansion of capability.
- Mezzanine Funding -This is often the final stage in bringing the company to the point of doing an IPO or being acquired. Mezzanine funding is often a combination of debt and equity and is sometimes used to displace earlier equity investors.
- Buyout funding -Funding that allows the acquisition of one company by another.

Investopedia provides a nice description of the stages of venture funding[14].

[14] https://www.investopedia.com/articles/personal-finance/102015/series-b-c-funding-what-it-all-means-and-how-it-works.asp

Specialization-

Venture Capitalists often specialize

- By industry
- By development stage
- By Geographically localized investing
- Syndication –Venture Capitalists often team up with other firms to
- Share the risk on investments that are inherently risky.
- Better investment decision
- Diversify portfolio

Debt Financing

Historically, commercial banks have not been viewed as practical sources of financing for start-up firms. Banks are interested in firms that have a strong cash flow, low leverage, audited financials, good management, and a healthy balance sheet. When banks do provide loans to new ventures they often demand that the founders provide personal guarantees –exposing their families and personal finances to potential liability.

Banks like to say "No." Can one get a Bank to Say "Yes"?

Things a bank will say:

- Our bank doesn't make small business loans
- I don't know enough about you or your business
- You haven't told me why you need the money
- Your numbers don't support your loan request
- You don't have enough collateral
- Your business does not support the loan on its own

You will need to provide good answers to these questions to convince the bank to make the loan. You are also likely to have to secure the loan with your own personal property or other personal guarantees.

When I founded ILinc, I was indeed able to convince a bank to give us loans, but I had to make personal guarantees. I was living dangerously!

A personal story of the funding of ILinc

When I became President of the University of Massachusetts it was in the aftermath of a battle between my predecessor, William Bulger and Governor Mitt Romney. The Governor invited me over to his office for a meeting to establish a good initial working relationship. The meeting was very cordial and went quite well. Near the end of the meeting, he asked me "*Jack, I think this is a very high stress job. Do you think you are up to enduring that kind* *of stress*?" "*Well Governor, when I was CEO of ILinc in the early years, we were bootstrapping the company with no venture capital. We had orders come in and those took time to collect. In the meantime, I had salaries and other expenses that had to be paid. I took my accounts receivable to the bank and negotiated a loan against those in order to pay our bills. As long as the receivables were paid, I would be able to pay off the loans, but if they were not, I would never have been able to pay the loans and my personal possessions would have been in jeopardy. I don't think my wife and four children understood that if I could not pay the loans we were going to lose everything –including our kid's college funds*." "*That is stress! The stress of being President cannot compare to that*" I said.

SBA Guaranteed Loans

One of the best places to get loans as a small business is from the federal government through the Small Business Administration (SBA) and the SBA Guaranteed Loan Program – (https://www.sba.gov/). Approximately 50% of the 9,000 banks in the U.S. participate in the SBA Guaranteed Loan Program. The program operates through these private-sector lenders who provide loans that are guaranteed by the SBA. The SBA can guarantee as much as 85% on loans up to $150,000 and 75% on loans over $150,000. The most notable SBA program available to small businesses is titled the 7(A) Loan Guaranty Program[15].

Government Grants: SBIR and STTR Programs

https://www.sba.gov/blogs/getting-know-sbirsttr-programs-11-agencies-one-playlist
The Small Business Innovation Research (SBIR)[16] and the Small Business Technology Transfer (STTR)[17] programs are two important sources of early-stage funding for technology firms[18].

These programs provide cash grants to entrepreneurs who are working on projects in specific areas. The main difference between the SBIR and the STTR programs is that the STTR program requires the participation of researchers working at universities or other research institutions.

"*The Small Business Innovation Research (SBIR) program is a highly competitive program that encourages domestic small businesses to engage in Federal Research/Research and Development (R/R&D) that has the potential for commercialization. Through a competitive awards-based program, SBIR enables small businesses to explore their technological potential and provides the incentive to profit from its commercialization. By including qualified small businesses in the nation's R&D arena, high-tech innovation is stimulated and*

[15] https://www.sba.gov/7a-loan-program
[16] SBIR: http://sbir.gov/about/about-sbir
[17] STTR: http://sbir.gov/about/about-sttr
[18] https://www.sba.gov/blogs/getting-know-sbirsttr-programs-11-agencies-one-playlist

the United States gains entrepreneurial spirit as it meets its specific research and development needs[19]."

"The mission of the SBIR program is to support scientific excellence and technological innovation through the investment of Federal research funds in critical American priorities to build a strong national economy.
The program's goals are four-fold:

- Stimulate technological innovation
- Meet Federal research and development needs.
- Foster and encourage participation in innovation and entrepreneurship by socially and economically disadvantaged persons.
- Increase private-sector commercialization of innovations derived from Federal research and development funding."

The SBIR Program is structured in three phases:

1. Phase I. The objective of Phase I is to establish the technical merit, feasibility, and commercial potential of the proposed R/R&D efforts and to determine the quality of performance of the small business awardee organization prior to providing further Federal support in Phase II. SBIR Phase I awards normally do not exceed $150,000 total costs for 6 months.
2. Phase II. The objective of Phase II is to continue the R/R&D efforts initiated in Phase I. Funding is based on the results achieved in Phase I and the scientific and technical merit and commercial potential of the project proposed in Phase II. Only Phase I awardees are eligible for a Phase II award. SBIR Phase II awards normally do not exceed $1,000,000 total costs for 2 years.
3. Phase III. The objective of Phase III, where appropriate, is for the small business to pursue commercialization objectives resulting from the Phase I/II R/R&D activities. The SBIR program does not fund Phase III. Some Federal agencies, Phase III may involve follow-on non-SBIR funded R&D or production contracts for products, processes or services intended for use by the U.S. Government.

"Small Business Technology Transfer (STTR) is another program that expands funding opportunities in the federal innovation research and development (R&D) arena. Central to the program is expansion of the public/private sector partnership to include the joint venture opportunities for small businesses and nonprofit research institutions. The unique feature of the STTR program is the requirement for the small business to formally collaborate with a research institution in Phase I and Phase II. STTR's most important role is to bridge the gap between performance of basic science and commercialization of resulting innovations." "*The mission of the STTR program is to support scientific excellence and technological innovation through the investment of Federal research funds in critical American priorities to build a strong national economy*."

[19] http://sbir.gov/about/about-sbir

The programs' goals are to:

- Stimulate technological innovation
- Foster technology transfer through cooperative R&D between small businesses and research institutions;
- Increase private sector commercialization of innovations derived from federal R&D.

The STTR Program is structured in three phases

1. Phase I. The objective of Phase I is to establish the technical merit, feasibility, and commercial potential of the proposed R/R&D efforts and to determine the quality of performance of the small businesses prior to providing further Federal support in Phase II. STTR Phase I awards normally do not exceed $100,000 total costs for 1 year.
2. Phase II. The objective of Phase II is to continue the R/R&D efforts initiated in Phase I. Funding is based on the results achieved in Phase I and the scientific and technical merit and commercial potential of the Phase II project proposed. Only Phase I awardees are eligible for a Phase II award. STTR Phase II awards normally do not exceed $750,000 total costs for 2 years.
3. Phase III. The objective of Phase III, where appropriate, is for the small business to pursue commercialization objectives resulting from the Phase I/II R/R&D activities. The STTR program does not fund Phase III. In some Federal agencies, Phase III may involve follow-on non-STTR funded R&D or production contracts for products, processes or services intended for use by the U.S. Government.

Raising funding by doing an IPO

Exiting through an IPO or being acquired is often the way a new venture allows the investors to exit the investment while raising funding for the company by selling equity to the public. Doing an initial public offer (IPO) is often the most desired way to profit from starting a new venture –often called 'going public.". If the company desires to raise capital in another round of stock sales this is termed a secondary offering.

A new venture will hire an investment bank to help with the enormously complicated process of either an IPO or acquisition. In 2002, in the aftermath of the collapse of the technology stock markets, the Sarbanes-Oxley Act was passed that set stringent (and expensive) requirements for public corporations. For an IPO the investment bank will act as an underwriter or agent for the proposed stock offering. The next step is the creation of a preliminary prospectus while the Securities and Exchange Commission (SEC) is investigating the offering. Once the SEC approves, then a final prospectus is issued. The new venture's leaders will usually then launch a series of presentations, often called the "**road show**" to potential investors in various locations. The road show must be available as a video to anyone with an interest.

You can see many example roadshows at http://www.retailroadshow.com/wp/index.asp

The Facebook IPO

The Facebook IPO[20] on May 18 2012 was a case study in large IPO offerings and what can go wrong[21]! A share price of $38 valued the company at $104 billion, the largest valuation ever (at that date) for a newly public company. During the roadshow, the leaders had to confess that Facebook was suffering from pressure on earnings due to the mobile platform, and this spooked investors and reduced the demand. The price fell precipitously over the following year but has since recovered to more than twice the offering price. Although the IPO was a failure, the long-term progress of the company has been good.

Two other interesting IPOs had opposite results. Twitter has struggled, and the stock has fallen steadily. Alibaba, on the other hand, has continued to advance.

Twitter –November 7, 2013 -http://www.forbes.com/sites/hershshefrin/2013/11/08/why-twitters-ipo-was-really-a-failure/

Alibaba –Chinese Internet Sales–September 22, 2014 - http://www.forbes.com/sites/ryanmac/2014/09/22/alibaba-claims-title-for-largest-global-ipo-ever-with-extra-share-sales/

The case of Snap, the company that operates SnapChat, continues to be an interesting IPO to follow.
SnapChat - http://www.jackmwilson.net/Entrepreneurship/Cases/Case-Snapchat.pdf

Funding the non-profit organization

Those who are creating a new venture in social entrepreneurship may be considering forming a 501 c(3) non-profit organization as we describe in Chapter 13 on the legal structures for new ventures. In a non-profit organization, there is no way to reward investors or distribute profits. That is termed "self-inurement" and is prohibited. Thus, those who contribute funds to the social enterprise need to take their "profit" in different ways –often by enjoying the feeling of simply contributing to something that they think is important to the world.

Raising funds for a non-profit organization is thus done quite differently than for a for-profit corporation –although some techniques are similar. Usually the largest source of funding is from donations that are given freely because the donor wants to support the organization

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[20] http://en.wikipedia.org/wiki/Initial_public_offering_of_Facebook
[21] http://www.theatlantic.com/business/archive/2013/05/facebook-one-year-later-what-really-happened-in-the-biggest-ipo-flop-ever/275987/

with no expectation of financial return. Other sources of revenue can include subscription to journals that must relate to the non-profit purpose or fees for attendance at meetings. In some ways starting a non-profit is much like starting a for-profit venture. For the organization to be sustainable, it MUST obtain revenues (donations, subscriptions, fees, sales) that exceed its expenses. Non-Profit organizations always need to remember the axiom: "*No margin - no mission*." Many founders of new social ventures do not like this or understand it. For that reason, many such ventures fail to fulfill their mission. I have often been told: "I'm not interested in finances and money, I am only interested in the mission." I then reply that it is very wonderful to be focused on the mission and not to be driven by finances, but if no attention is paid to finances, then there will be no way to sustain the mission.

Because of this need to sustain the mission, many leaders of non-profits spend much of their time helping the organization to raise money. For example: the presidents of universities are often described as "living in a big house and begging for money." The President of the University of Massachusetts does not have any university provided house – let alone a big one. But, like most Presidents, public and private, he or she spends a large share of time in meeting donors and asking for donations.

Many larger non-profits have professional fund-raising personnel working full time to help fund the mission. The Boston Globe article "'*Shark Tank'-style contest may give nonprofits capital*" (March 17, 2015) describes a creative approach[22]. It demonstrates one venture capitalist's idea for funding non-profits though a "Shark Tank" like pitch contest. It also uses the usual venture capital approach of putting the VC on the board or advisory committee to the organizations in which they invest.

In recent years, there have been a variety of innovative ways to raise money for non-profits. Perhaps the most innovative is crowdfunding -of which Kickstarter is a nice example[23]. Kickstarter began with a focus on creative projects such as films, games, music, art, design, and technology. It is an all or nothing approach. You either reach your goal or get nothing.

There are a number of other similar organizations which may have somewhat different programs to focus on:

- Indiegogo –similar to Kickstarter but allows project to receive funds even if the goal is not met.
- PeopleFund.it -British
- SmallKnot –invest in community businesses
- RocketHub –similar to KickStarter
- Gambitious –video gaming
- MedStartr -medical/healthcare

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[22] http://www.bostonglobe.com/business/2015/03/17/boston-venture-capitalist-plans-shark-tank-style-competition-for-nonprofits/fbm31tNPXEuqWui5ZckXLN/story.html?p1=Article_InThisSection_Bottom
[23] http://www.jackmwilson.net/Entrepreneurship/Cases/Case-KickStarter.pdf

- Spot.us -Journalism supporter
- GigFunder – support musicians on tour!

Figure 5 Red Sox 2004 World Series Trophy with J. Wilson

Happy Ending!

This is the World Series trophy won by the Red Sox in 2004 after 86 years of trying and failing. When your new venture gets funding, you may not get a trophy, but you will feel like you won the world series!