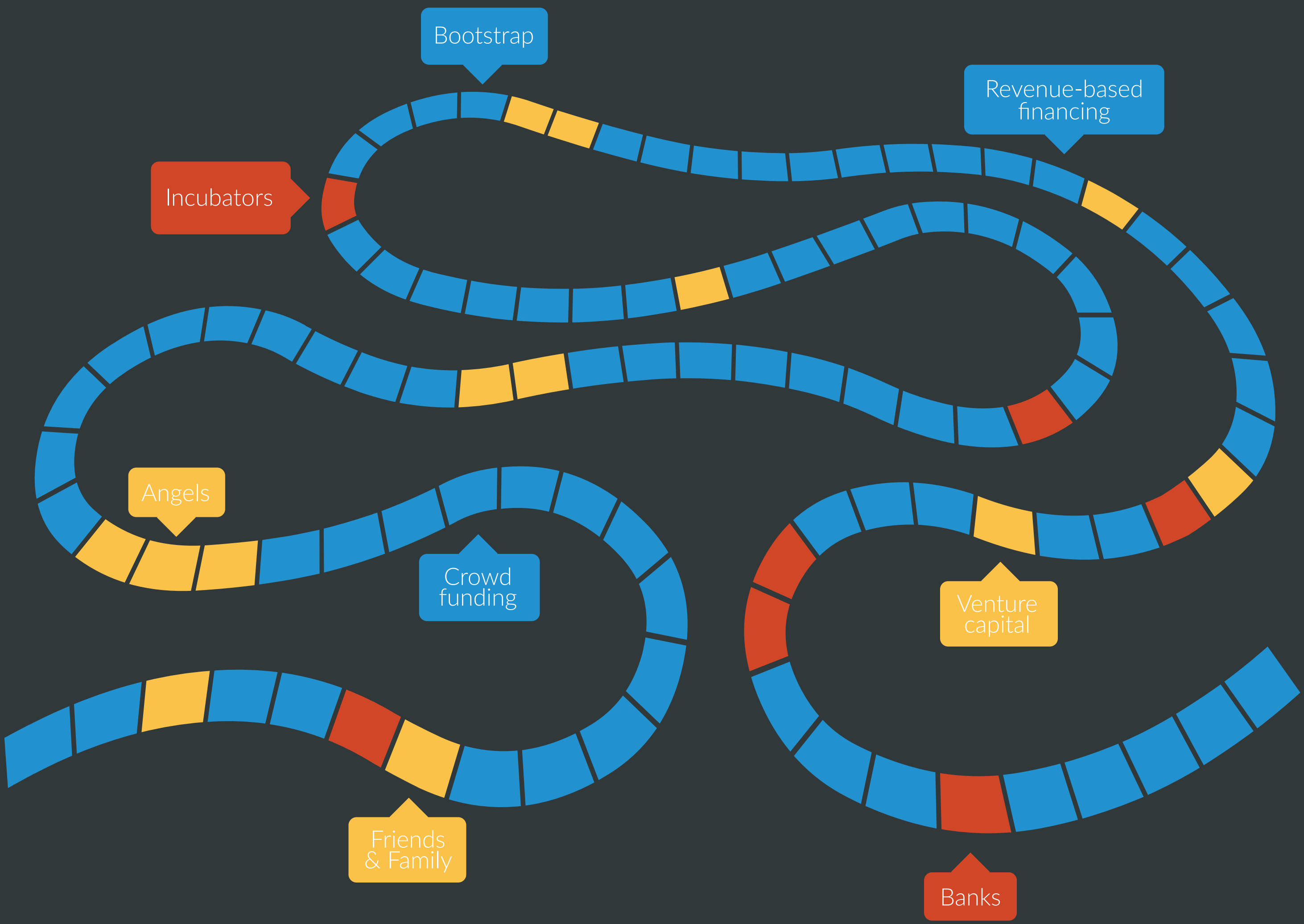

HOW TO CHOOSE

The Best Funding Path For Your Startup

lighter capital

Summary

Building a business from the ground up is almost always going to require an injection of outside capital to spur it toward its full potential. Today, more than ever, entrepreneurs have a wide range of different options they can pursue in funding their business. So that's the good news. The important — not necessarily bad — news is that the funding path you choose will fundamentally impact and shape the future trajectory of your business, and ultimately determine how much value you can expect to extract in the long term.

This paper will help you figure out what funding path makes the most sense for you and your business. By asking yourself some key questions you can evaluate what funding options work for you and when. The type and growth stage of your business will often determine the range of options available to you, but having an idea, up front, of the kind of path you want to travel is important for three reasons:

1. You will know what the trade-offs, risks and pay-offs are and you can adjust your business, personal and financial realities to account for them.
2. You can make sure the business is in the shape most attractive to the type of investors you are pursuing at each stage.
3. You will avoid wasting time chasing down sources of funding that either are not available to you or don't really suit you — time better spent focused on other aspects of your business.

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The 7 most important questions to ask before you make a decision

So how do you decide which funding options to use and what path to follow? Your answer will depend on what kind of company you are building and what matters most to you. Do you want to keep full control of your company or are you willing to add investors to your Board of Directors? Are you trying to minimize dilution or are do you prefer giving away equity over taking on debt?

No one can predict exactly how a company will grow and what twists and turns will impact its future trajectory. But what you can do is start with a path that makes most sense to you based on a good understanding of the trade-offs, risks and pay-offs that come with different funding options.

The chart below shows what we consider to be the seven most important questions to answer when deciding what funding options and path will give you the financial and personal outcomes you are looking for.

SEVEN IMPORTANT QUESTIONS TO ASK WHEN CREATING YOUR FUNDING STRATEGY

1 What funding path best suits *your* business growth strategy?

2 How much capital do you need?

3 How much equity are you willing to give up?

4 What are you willing to risk to fund your business?

5 How do you want to repay the money?

6 Do you want guidance in growing your business?

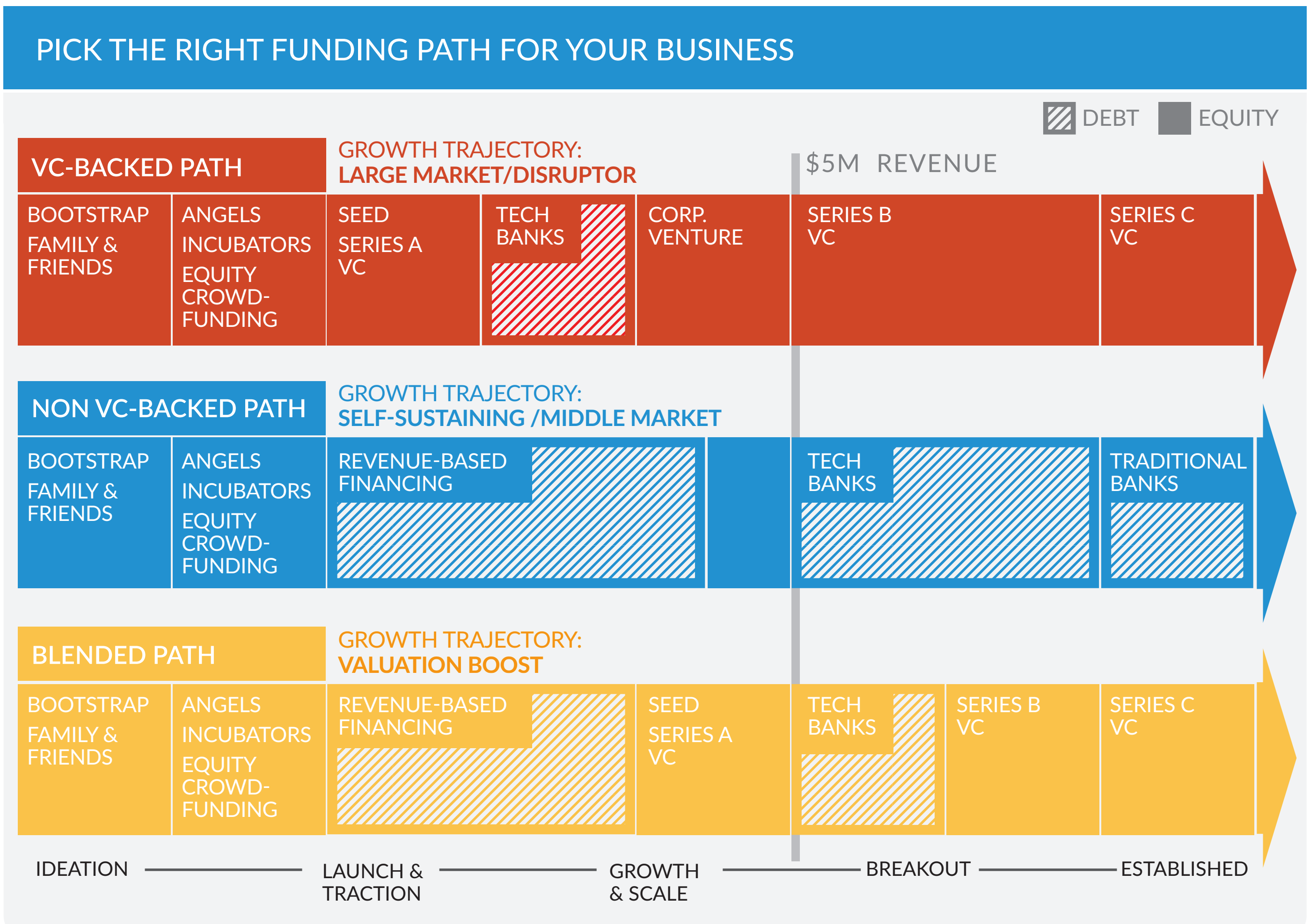
7 How long can you spend raising funds?

QUESTION 1

What funding path best suits *your* business growth strategy?

The growth trajectory you envision for your business should have a major influence on your funding strategy. You should know what you want the business to look like in one, five, and 10 years before you make decisions on what type of funding makes sense.

As the diagram below shows if you are expecting to be a major player in a $1billon market, a predominantly VC-backed funding path will make more sense. If your growth potential is more constrained or you think you can reach your market share goals under your own steam, then a non-VC or blended funding path that relies more on debt funding maybe a better outcome, because it allows you to retain more control and value in the long term.



The 6 remaining questions we help you answer in this paper will address some specific implications of going with one particular source of funding over another. Just remember to keep in mind what your overall funding path should be. These paths are not set in stone, but will keep you focused on what's important for you and your company.

GROWTH TRAJECTORY: **LARGE MARKET/ DISRUPTOR**

Funding Path:
VC BACKED PATH

For companies:

- Targeting large $1billion plus markets generating a minimum 10x return.
- Requiring periodic, large infusions of capital to get off the ground and capitalize on an opportunity.

What to expect

- Requires a significant investment of time to connect with and attract investors.
- Expect to cede a significant portion of equity and control.
- For those looking to make an exit via sale or IPO.

GROWTH TRAJECTORY: **SELF-SUSTAINING/ MIDDLE MARKET**

Funding Path:
NON VC BACKED PATH

For companies:

- Generating growing, predictable revenues and strong margins.
- Seeking smaller capital amounts periodically to boost growth.

What to expect

- Access smaller amounts of capital as needed to fund early growth activities via revenue-based financing.
- Once through the $5m revenue milestone, further debt to fund larger expansion is more accessible.
- On this path the entrepreneur retains equity and control.

GROWTH TRAJECTORY: **VALUATION BOOST**

Funding Path:
BLENDED PATH

For companies:

- That can get to scale on their own.
- That will require a large equity infusion to reach a market leadership position.

What to expect

- Access smaller amounts of capital as needed to fund early growth activities via revenue-based financing.
- By using a debt option, (such as RBF) to fund early growth a company can improve its valuation.
- A better valuation strengthens the entrepreneur's position when negotiating the equity split with outside investors.

Funding paths are not set in stone, but will keep you focused on what's important for you and your company.

More on venture capital, banks and revenue-based financing

Different types of investors are seeking different types of outcomes and so they value different company growth characteristics.

Traditional banks are not as impressed as entrepreneurs think by exponential growth rates. What they are looking for are established companies with slow but steady profits and strong annual revenues. **Specialist technology banks** are more savvy when it comes to understanding the nature of growing software businesses but they usually will only consider financing after an initial VC round.

Venture capitalists are looking for companies that can make it really big, really fast. Hockey-stick growth is one of the factors for determining whether a company has breakout potential. High-growth companies are more likely to attract venture capital but success is anything but a certainty. Additionally, expect steep competition for a very limited number of venture investments.

A **revenue-based lender**, such as Lighter Capital, looks to fund early stage technology companies that are seeking smaller capital infusions to fund sales and marketing or product development. While companies need to be generating revenue, they don't have to be profitable – they just need to show a good diversity of customers and good growth potential.

QUESTION 2

How much capital do you need?

Securing as much financing as you possibly can is a common approach — and an understandable impulse. With more capital on hand, you'll be able to jump on new opportunities that arise so you can swiftly respond to market shifts. This can be of huge value to your company, since launching your product more quickly than your competitors, for example, often means grabbing more market share, which can boost revenues and raise the valuation of your company. But equally, having too much capital can put stress on your business and lead to a loss of focus and misalignment to strategy.

How do you determine how much you need?

A well-thought-out business plan and capital-raising strategy can help you figure out how much capital you need. Your business plan should tell you what your growth milestones are in 6 months, 1 year, and 3 years. Then figure out what you need to do and how much it will cost you to go from one milestone to the next.

Securing as much financing as you possibly can is a common approach — and an understandable impulse.

Some of the pitfalls of raising too much money include:

The more you raise, the more you need to return to investors

This may seem obvious, but it's a point that's easy to overlook in the euphoria of finding someone willing to give you a big cash infusion: The more you borrow or raise, the more you will owe—either in interest or sacrificed equity and control. And the more you borrow or raise, the longer it will take you to pay it back or extract value.

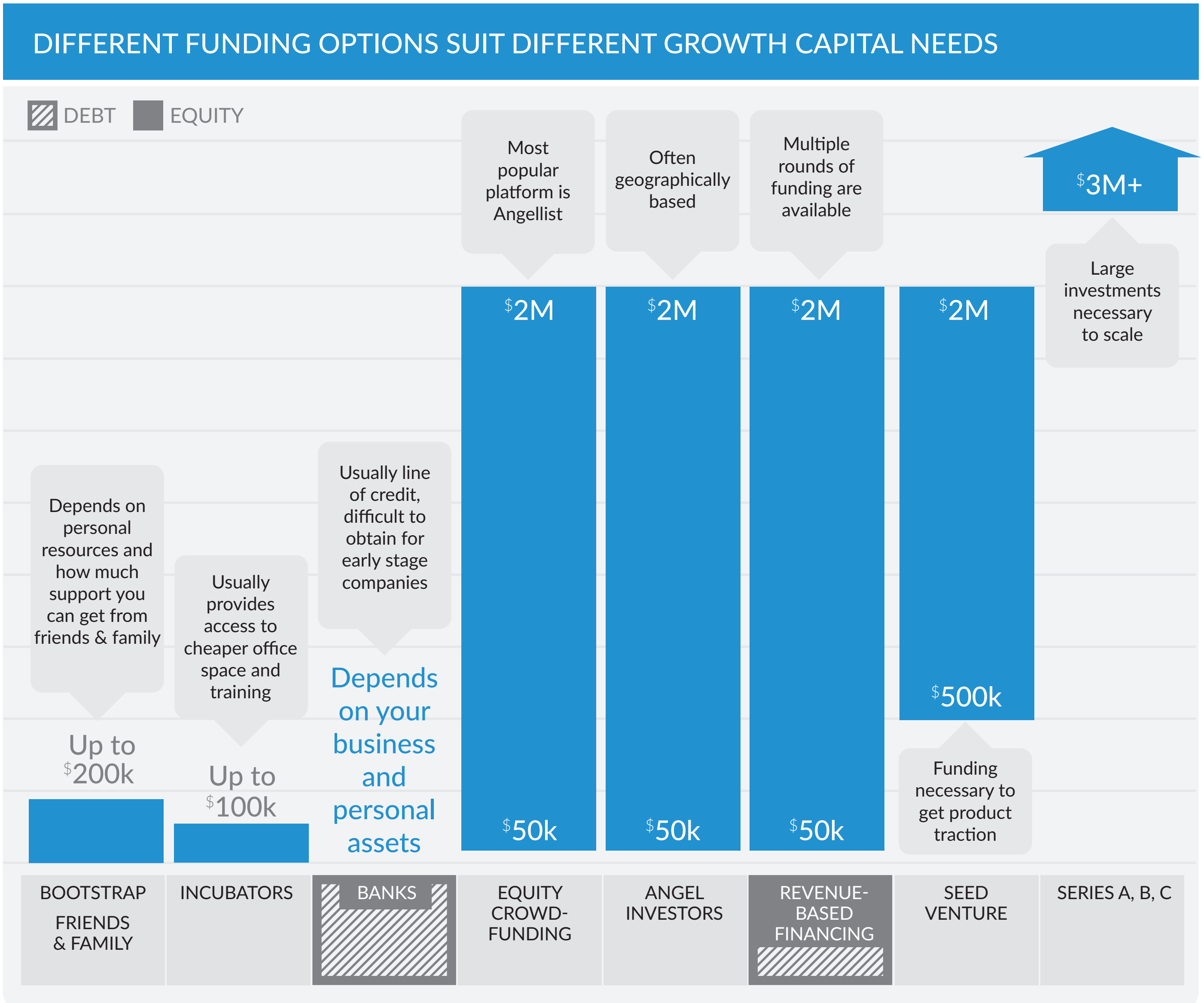
Venture capitalists, for example, invest with expectations of at least at 10x return on investment. This means that if you raise $20 million dollars at a post-investment $50 million valuation, you won't be able to sell until your company has a valuation of at least $500 million.

Easy money can take you off-track

Raising too much money can lead to a lack of focus and may lead to overspending on line items that don't help your company grow. You want to stay focused on the milestones you are trying to reach rather than on discretionary expenses.

You are not ready for growth

When you are looking to expand, make sure you're prepared to handle success. Do you have the capacity to take on an influx of additional customers? Will you be able to continue to provide the outstanding customer service that sets your company apart? Do you have the resources to train new hires? If you're not ready to make a big leap, consider taking a smaller step and limit your investment.


DIFFERENT FUNDING OPTIONS SUIT DIFFERENT GROWTH CAPITAL NEEDS
DEBT
EQUITY
Depends on personal resources and how much support you can get from friends & family
Up to $200k
Usually provides access to cheaper office space and training
Up to $100k
Usually line of credit, difficult to obtain for early stage companies
Depends on your business and personal assets
Most popular platform is Angellist
$2M
$50k
Often geographically based
$2M
$50k
Multiple rounds of funding are available
$2M
$50k
$2M
$500k
Funding necessary to get product traction
$3M+
Large investments necessary to scale
BOOTSTRAP
FRIENDS & FAMILY
INCUBATORS
BANKS
EQUITY CROWD-FUNDING
ANGEL INVESTORS
REVENUE-BASED FINANCING
SEED VENTURE
SERIES A, B, C

QUESTION 3

How much equity are you willing to give up?

To build a great company, you need to give up a lot of equity, right? Not necessarily.

If you are looking to remake a market and need millions of dollars to scale, the venture capital path is likely to be the only route to get you the firepower you need. In this scenario, you will likely need to give up 10 to 45% of equity in exchange for the big infusion of capital you require.

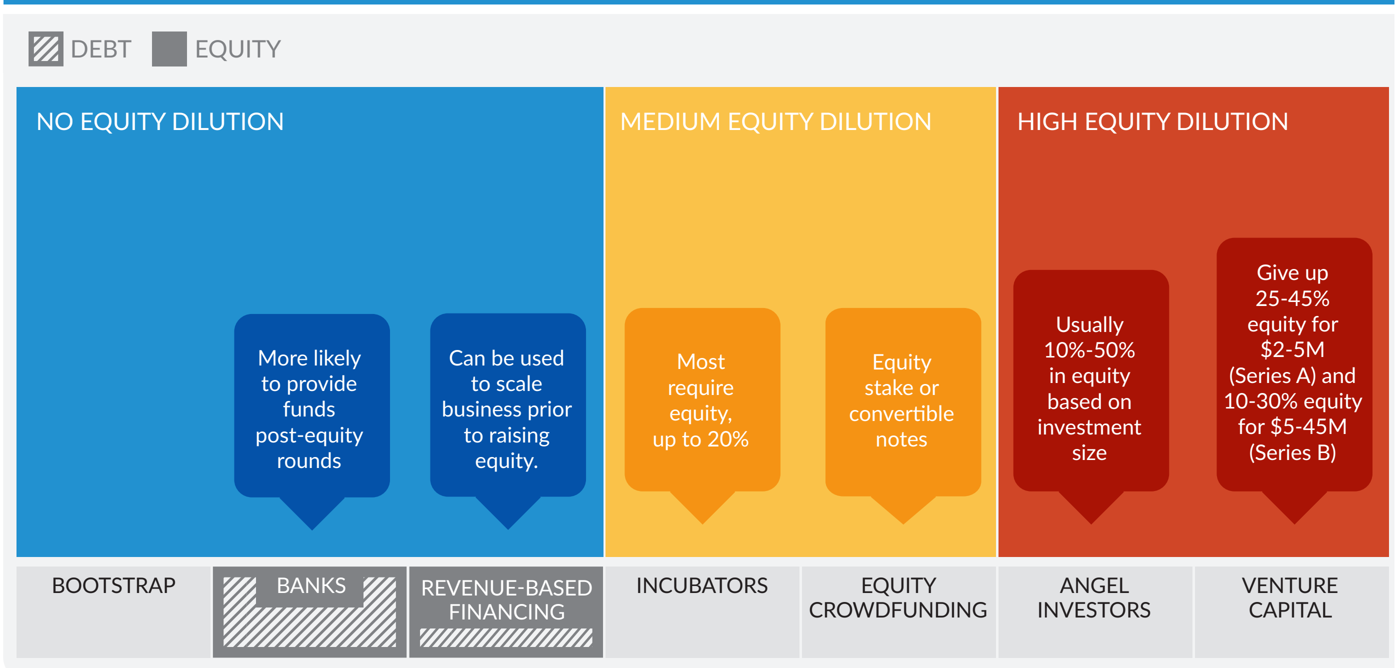
But if you are looking to build a more modest company without a $1 billion dollar exit but with recurring revenues and clear paths to profitability, it might be smarter to first explore debt options that don't dilute equity.

Even if you plan to eventually raise venture capital, you may want to look at debt financing to grow your company first to attract interest from investors. Very few companies succeed in securing venture capital and the more sustainable your revenues and market share, the greater your chances.

Growing your company before pursuing equity financing can also improve your company's valuation, which means you will need to give up less equity for the amount of funding you raise.

Realize that it's not just venture capital that comes at an equity cost. Angel investments are often structured as convertible debt, which is really unpriced equity.

HOW MUCH EQUITY DO YOU WANT TO SACRIFICE?



QUESTION 4

What are you willing to risk to fund your business?

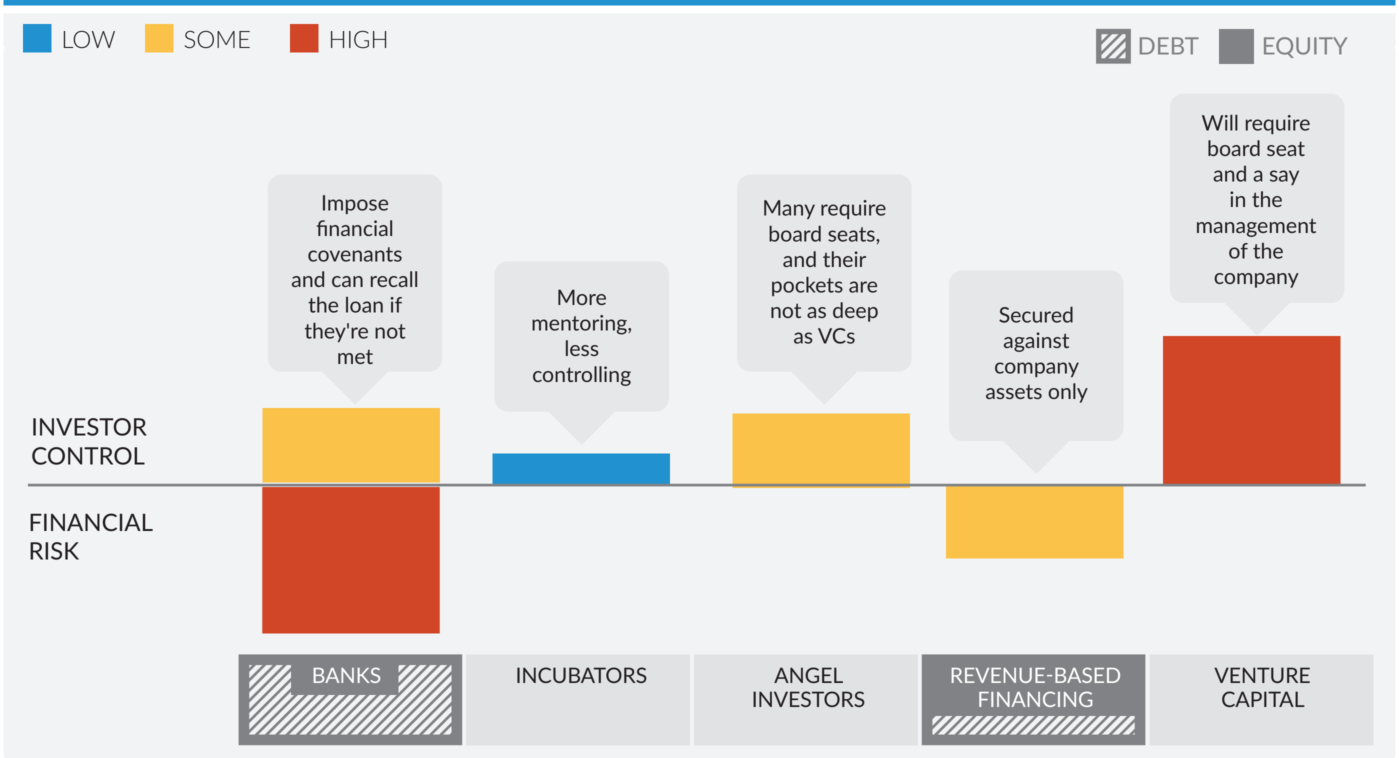
Before you raise capital, you need to decide on what risks you are willing to take. Two big risks are personal financial risk and a loss of control over the management of the company. Often the trade-off between debt and equity funding options will be that debt will have higher financial risk while equity will more than likely require you to give up some, or a great deal of, control.

Personal financial risk

Depending on your personal finances, you may have been able to use some of your own savings to fund the products, services, and staff you need during the early stages of your company's growth. Now that you are looking at outside financing, your personal financial risks may increase even further.

At first glance, a traditional bank loan can seem like the ideal way to further grow your business. Unfortunately, such loans are difficult for entrepreneurs to obtain, especially for software technology companies that don't have physical assets that can be used as collateral. But if you find a bank willing to take a chance, you will almost always need to guarantee the loan not just with your company assets but with your personal assets as well: your house, your IRA, or anything else of substantial value. Without hard assets, your banker's first questions won't be about the company, but about your personal credit score and how much equity you have in your house. Starting your own company is stressful enough without risking your home and retirement fund in the process.

THE FINANCIAL RISK VERSUS CONTROL TRADE-OFF



Starting your own company is stressful enough without risking your home and retirement fund in the process.

Loss of control

Who's in charge of your company after you raise additional funding? Depending on the source of financing, you may find yourself having to cede some control of the company you have nurtured over the years, especially when you secure large investments. But even funding from family and friends can lead to subtle or direct interference with strategic decision making.

When they make equity investments, angel and venture capital investors want to make sure their money is well spent and that they can influence the success of the company they are betting on. That is reasonable, but before you sign on the dotted line, make sure you understand exactly what you are giving up. How will shared control be structured? Who will get to have a say in major decisions after you secure the financing and what will happen if you disagree? How will preferred stock options allow investors to gain additional influence over the direction of the company?

Bank loans come with fewer strings attached, but financial restrictions can limit your options for what you can do with the investment.

Risks to personal relationships

Finally, there's one more risk to consider: the potential damage to relationships with early supporters who have invested money in your start up, but don't necessarily want to have their money tied up in your company over the long haul. Also, getting more funding to grow further from such investors is often more difficult than you expect. Make sure you have an exit plan for potentially buying out your friends and family without damaging personal relationships.

QUESTION 5

How do you want to repay the money?

The best investments are those you never have to pay back. But most financing is made with an eye on return on investment, which means that you will eventually need to return the investment to the investor—and then some.

Banks require fixed repayments, regardless of how well your company is doing. Fixed interest payments may hamper your ability to run your company, especially if your business is cyclical. You may be stuck making pre-set payments even when revenues are down and money is in short supply.

Revenue-based financing differs from banks in that there is no fixed repayments. They ebb and flow with a companies business revenue based on a percentage of monthly income. If a company grows faster than expected, the loan will be paid off quicker, as monthly income is higher. Equally, if revenue is lower in a particular month, the repayment amount is lower. Also, there is usually no fees or penalties for early repayment.

Angel investors and venture capitalists provide financing with a view to capital appreciation. The investment can come at a hefty price tag. Venture capitalists target a return on investment of 10x. Angel investors, despite their moniker, don't invest in your company for philanthropic reasons either. Their investments can also come at steep cost upon exit.

REPAYING CAPITAL

QUESTION 6

Do you want guidance in growing your business?

One of the advantages of being an entrepreneur is that you make all the decisions that matter. But no one has all the answers, and it can be frustrating to have to make important decisions on the future of your company without getting outside feedback or validation of your ideas.

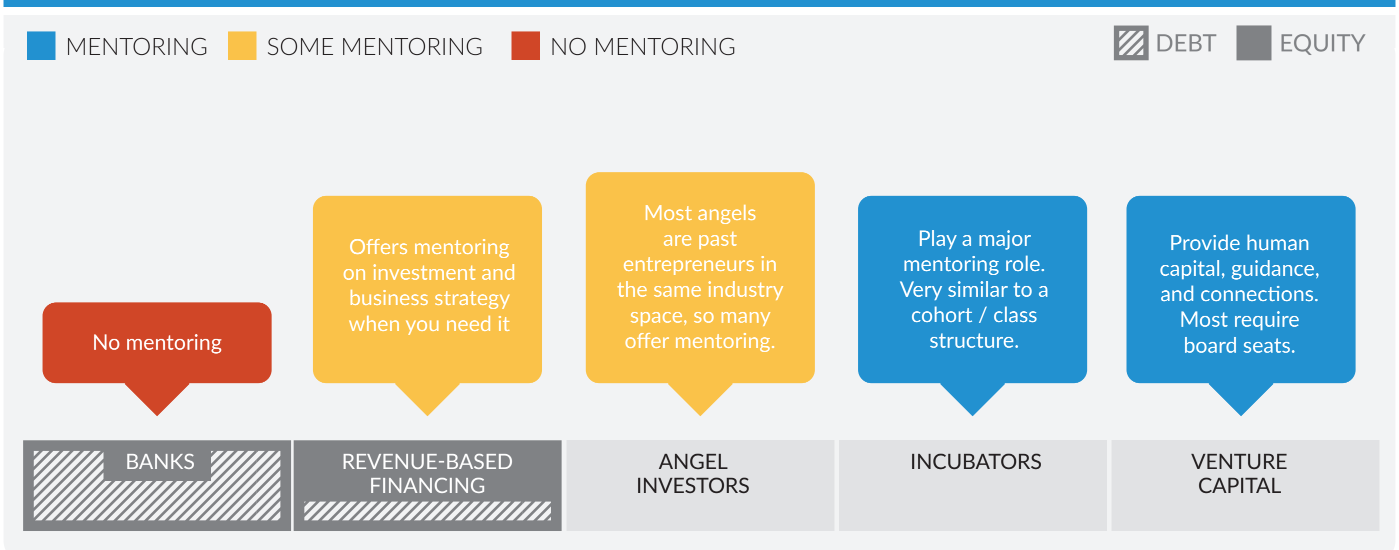
Angel investors and incubators provide mentoring, connections, and hands-on knowledge during the startup stage to entrepreneurs with game-changing ideas.

Once you start seeing revenues, other financing options become available with varying amounts of mentoring.

Venture capitalists can provide a large amount of human capital, guidance, and business connections that can help you grow the business. Even when they provide valuable mentoring, they will also exercise a fair amount of control over your company in return for their investment, so the advice you receive is not always yours to take or leave. When you seek venture capital, you're not just securing financing—you're taking on an active partner with their own interests in mind.

In contrast, banks provide no guidance or mentoring. They have too many clients in their portfolio to assist you with running your business.

MENTORING INCREASES WITH THE LEVEL OF EQUITY SACRIFICE



QUESTION 7

How long can you spend raising funds?

Seeking out sources of funding is an inconvenient but necessary part of any serious initiative to grow your company. Unfortunately, obtaining financing can become a full-time job, significantly disrupting your capacity to run your company.

Before you seek financing, consider how long it will take to raise funds and how much of a distraction it will be. How much time will you spend courting potential investors? How much time will you spend gathering financials and filling out paperwork for a traditional bank loan?

Time spent chasing money is time not spent running your business. Can your business thrive while the CEO is out raising funds for an extended period of time? Will the company culture survive the absence of the founder and chief motivator? Is there an opportunity cost to not being able to respond to market changes?

Entrepreneurs raise capital in order to have a war chest that lets them capitalize on opportunities. But getting that war chest is often a horribly slow, inefficient, and distracting process. You can easily spend six, nine, or 12 months working your personal networks, having coffee meetings, making presentations, and undergoing due diligence in pursuit of an investor—by which time any number of opportunities have whizzed by and disappeared.

When comparing different options for funding your next round of growth, be sure to factor in the time and opportunity cost associated with securing that source of capital.

BE AWARE OF HOW MUCH TIME RAISING MONEY TAKES

Easy guide for early stage revenue-generating companies.

Before making a decision, it can be helpful to line up the funding options you are most seriously considering with the elements that are most important to you.

Below we have created an example chart comparing three options: bank loans, revenue-based financing, and venture capital, to allow for an easy comparison on how they stack up on the seven questions we considered above for early growth stage companies.

DEBT
EQUITY

	BANK LOAN	REVENUE-BASED FINANCING	EQUITY FINANCING
Business growth strategy	Established businesses with hard assets	Early-revenue growth stage	Company with a breakout product in a market of more than $1 billion or more
How much capital do you need?	Depends on your business and personal assets	$50,000–$2M	$500k – $3M+ Depends on round
Equity dilution	No dilution	No dilution	25–45% ownership in exchange for $2–5M Series A rounds. 26–45% in exchange for $2–5M in Series B rounds
Risks	High financial risks on business and personal assets and impose financial covenants	Secured against company assets, not personal assets. Entrepreneur keeps full control	Investors have control via board seat
Repayment	Fixed repayments	Repayments ebb and flow with monthly revenues	Venture capitalists target 10x return on investment
Guidance	No mentoring	Varies. Lighter Capital offers mentoring on investment and business strategy when you need it	Will provide human capital, guidance, and connections to help grow the business
Time spent raising funds	Can take 6 months to get approvals	Can be finalized in 4 weeks	Can take 6 to 12 months

Talk to us

At Lighter Capital, we love to talk to entrepreneurs about how we can help you grow. Whether you need capital raising advice, have a question about a Lighter Capital RevenueLoan®, or are ready to apply for funding, feel free to contact us at anytime.

About Lighter Capital

Lighter Capital is 100% focused on providing early-stage SaaS, software and technology services companies with the long-term capital you need to get your business to the next level.

Want to know how much growth capital you may qualify for? Try our Funding Calculator and find out by answering five simple questions.

Get Started: lightercapital.com/how-it-works/see-if-you-qualify

Apply Now: lightercapital.com/apply

Learn more about Lighter Capital's RevenueLoans®

For tech companies only

Software, SaaS, tech services, digital media or similar online/digital businesses.

Funds when you need it

You don't need to borrow it all up front. We'll provide further loans to you as you grow.

How much can you borrow?

We will lend up to ⅓ of a company's annualized revenue run rate. We lend $50,000 to $2 million per company.

Capital for growth

We fund product development, sales and marketing, new hires, and other growth strategies.

Retain control

We do not take equity, require a board seat or a say in how you run your business.

What you need to qualify

Revenue: $15,000 per month
Gross margins: at least 50%
Profitability: not required

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