Securing Funds for Your startup Business

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The views expressed here are those of the presenter and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System
Overview

• Discuss successful strategies for building or obtaining equity
• Discuss debt financing alternatives
Some definitions

- **Equity**: money raised in exchange for a share of ownership in the company. Ownership is represented by owning shares of stock outright or having the right to convert other financial instruments into stock of that private company.

- **Debt**: funds borrowed that must be repaid over a period of time, usually with interest. The lender does not gain an ownership interest in the business and debt obligations are typically limited to repaying the loan with interest. Loans are often secured by some or all of the assets of the company.
Firm Continuum and sources of finance

**DEBT**
- Principal Family & Friends

**STARTUPS**
- SMALLER FIRMS

**EQUITY**
- Principal Family & Friends
Model for financing startups in some communities - ROSCA

Table 1
ROSCA system based on five participants with monthly payments of $100

<table>
<thead>
<tr>
<th>Members</th>
<th>Contributions by Month (in dollars)</th>
<th>Total Paid</th>
<th>Difference in Amount Received Less Paid = Net Gain (Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>( r_1 )   ( r_2 )   ( r_3 )</td>
<td>( r_4 )</td>
<td>( r_5 )</td>
</tr>
<tr>
<td>P1 (Organizer)</td>
<td>100          100          100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>P2</td>
<td>100           100          100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>P3</td>
<td>100           100          100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>P4</td>
<td>100           100          100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>P5</td>
<td>100           100          100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Total Received</td>
<td>500           500          500</td>
<td>500</td>
<td>500</td>
</tr>
</tbody>
</table>

Note: Shaded cells represent the period in which the participants received the pot.
Source: This table contains exemplary data provided by the author and uses a table format similar to one used by Shirley Ardener in “The Comparative Study of Rotating Credit Associations” (Ardener, 1964, p. 214).
Continuum

DEBT
- Family & Friends
- Credit cards
- Microloans

STARTUPS
- Family & Friends
- Angel investors

EQUITY
- Family & Friends
- Angel investors

high net worth individual investors who seek high returns through private investments in start-up companies
### 2003 Survey of small business finances

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Credit Card</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Personal</td>
</tr>
<tr>
<td><strong>All firms</strong></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>46.7</td>
</tr>
<tr>
<td>1998</td>
<td>46</td>
</tr>
<tr>
<td><strong>Number of employees</strong></td>
<td></td>
</tr>
<tr>
<td>0-1</td>
<td>48.6</td>
</tr>
<tr>
<td>2-4</td>
<td>48.1</td>
</tr>
<tr>
<td>100-499</td>
<td>32.2</td>
</tr>
<tr>
<td><strong>Organizational form</strong></td>
<td></td>
</tr>
<tr>
<td>Proprietorship</td>
<td>52.3</td>
</tr>
<tr>
<td>S corporation</td>
<td>43.6</td>
</tr>
<tr>
<td><strong>Years under current ownership</strong></td>
<td></td>
</tr>
<tr>
<td>0-4</td>
<td>45.2</td>
</tr>
<tr>
<td>25 or more</td>
<td>46.6</td>
</tr>
</tbody>
</table>
Microloans

- Provided through intermediaries (usually non-profit microenterprise development organizations)
- Provides loans up to $35,000 to start up and existing businesses
- Very flexible source of financing (more lenient on requirements such as collateral and credit)
- Interest rates typically between 8-15%
- Maximum term is 6 years
Angels

• Seek companies with high growth potentials, strong management teams, and solid business plans to aid the angels in assessing the company’s value.
• Typically invest in ventures involved in industries or technologies with which they are personally familiar.
• Often co-invest with trusted friends and business associates (angel network).
• Because of their business experience, many angels invest more than their money. They also seek active involvement in the business, such as consulting and mentoring the entrepreneur.
Angel investments compared to venture capital investments

2005 Angel Investment
source: UNH CVR

$$23B$$
$$49,500$$ deals
Mostly early stage

2005 VC Investment
source: NVCA/PWC/VE

Mostly later stage
$$3,008$$ deals
$$22B$$

761 Early Stage
184 Seed
Small Business Loans Under $100K (Source: SBA annual reports)
About 80 funds in operation in the US today
CDVC

- CDVC funds invest in businesses in low-income areas around the world. CDVC funds help businesses to flourish in areas that are in need of economic growth. Their investments create financial returns for investors as well as social returns in the form of good jobs that pay living wages and allow people to rise out of poverty and begin to build wealth.

- Manufacturing has made up 49% of all CDVC investments to date, with services, retail trade, and software development, following at 17, 7, and 6% respectively.
### DEBT
- **Family & Friends**
- **Credit cards**
- **Microloans**
- **Bank/guaranteed loans**
- **Public Debt/CP/MF/TC**

### STARTUPS & SMALLER FIRMS
- **Family & Friends**
- **Angel investors**
- **Development VC**
- **VC/PP/PE**

### MATURE GROWTH FIRMS
Growth/more mature firms

- **Debt**
  - Public debt
  - Commercial paper
  - Trade credit
  - Mezzanine financing

- **Equity**
  - Venture capital
  - Private placement
  - Public equity
Questions??

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