New venture financing case

Business, Entrepreneurship

`New venture financing at its core is securing the necessary funding to launch a new business. There are a variety of options for the entrepreneur to secure these funds, and finding the right financing in critical to starting any new business. Investors into a new venture will want to know that there is an acceptable risk/reward threshold for their capital. Therefore, it is important that the entrepreneur alleviate investoranxietyabout the riskiness of the venture.

There are several ways of an entrepreneur can portray the investment so that it is perceived to have less risk to the investor's capital: an entrepreneur can stake his/her own capital in the venture to show the investor that he has a " horse in the race" as well, he/she may promise to pay back themoneyinvested at an earlier stage in business growth rather than a later stage where the business' financial status is less certain, or he/she may give investors some form of control in the company through specified terms, loan covenants, or participation in management.

There are many entrepreneurs, however, who receive no outside funding for their start-up businesses. " Bootstrapping," as it's called, is when an entrepreneur uses his/her own savings, credit, personal loans, or equity available from a home or car mortgage. This is ideal if the entrepreneur has enough capital to start the business, as they retain 100% of ownership and control. Unfortunately, not all entrepreneurs can fund their new venture without outside help.

When starting a new venture, it can be problematic to be burdened with too many liabilities that must be repaid, instead of reinvesting the funds back into the business to stimulate growth. For this reason, equity financing may

be a more prudent path. There is a sector of specialized firms that will provide “ seed capital” for a new venture, when the entrepreneur does not have enough capital to begin the new venture on their own.

This capital is meant to get an idea off the ground and move it from past the “ idea stage,” until the business has advanced to the stage where it can generate sufficient revenues itself. In this regard, they are considered to be “ angels,” although this term can apply to individual investors as well as firms. “ Angels” are typically those who have an excess of capital and contribute capital to new ventures. Angels may want forms of convertible debt, ownership equity, or management positions or control. To approach anyone for financing it is important to have a business plan.

All legal issues regarding stakes and/or ownership should be clearly stated in any business plan, and it may be advantageous to supply a formal offering memorandum to investors. This will legally protect both principals in additional to providing the investors with a well-formulated blueprint for the formation and growth of the new venture. Venture Capital is another source of financing. Venture capital is a pool of equity capital that is professionally managed. Wealth individuals can invest in these funds as limited partners, but usually they are comprised of pension funds and endowments.

The general partners of the venture capital firm manage the funds, and are compensated with a fee as well as a percentage of the gains on the investments of the funds. Target returns on the investment in a venture capital fund are between 50% - 60%, although they can be very volatile. Venture capital usually does not take place during the start-up stage of the business cycle; usually is in the 2nd round financing stage. When exploring

financing options and potential investors, it is paramount to guard any proprietary material associated with the new venture.

Proprietary material is also known as a trade secret, which can be almost anything: a pattern, formula, design, process, or information. Whatever the proprietary information, it gives the entrepreneur a potential competitive advantage over competitors, and is usually not generally know by the public. Protecting proprietary material with confidentiality agreements or non-disclosure agreements is advisable to any entrepreneur. As stated previously, there are different options when selecting financing. Equity ecurities are instruments like common stock and preferred stock, ownership shares in a firm, which derive value from the value of the firm, and are also a claim on a firm’s assets after all senior claims have been satisfied in the event of liquidation. Debt securities can take many forms: bonds, debentures, notes, etc. These debt securities receive higher priority than equity securities, and have the added benefit to the hold of receiving interest payments as well as the principal payment at the maturity of the security. Some debt instruments can be converted into equity securities depending on their construction.

Venture capital firms will often “ syndicate” a large investment: they attempt to entice other firms to take a stake in the investment. This allows venture capital firms to invest in numerous firms, diversifying their portfolios, and decreasing risk. Another form of financing is “ cash flow financing. ” Cash flow financing is typically funded by commercial banks, although it can also be obtained from institutional lenders (insurance firms or pension funds), loan institutions, orfinancecompanies, and is a form of debt financing.

These can either be short-term, long-term, or line-of-credit obligations. Asset-based financing may be more appealing to a start-up business than cash flow financing because start-ups lack an earnings history. In this form of financing, the firm gives the financier a first lien on assets: assets that can be used for these liens include accounts receivable, inventory, equipment, real estate, personally secured loans, letter-of-credit financing, and government secured loans.

Venture leasing, a hybrid financing option, occurs when a piece of equipment must be rented by a new venture for a fixed term. However, since the machine will have depreciated in value by the end of this fixed term, and if the new venture fails, the renter will have a harder time renting a depreciated piece of equipment, venture leasors will want to be able to purchase equity shares of the venture at the current price of financing at some date in the future, in exchange for the additional risk they take in leasing to the new venture.

Of course, once your new venture has begun receiving revenues, financing may be internally generated. Profits can be reinvested into the venture to continue growth. Sources of internally generated financing include retained earnings, credit from suppliers, accounts receivable, a reduction in working capital, and the sale of assets. And while these sources can be a beneficial way of raising capital without the help of outside investors, the venture must be wary of becoming too " lean," or not having any wiggle room financially.

There are a variety of investment possibilities to entrepreneurs in a new venture. Choosing the right one, or combination of financing methods, is critical to the growth and maturity of any venture. Throughout the business

life-cycle, there are different stages at which these different financing methods will be helpful, or even necessary, and knowing which one best suits the venture is a vital part of prosperity.