IMPACT CAPITAL AFRICA

The basic requirements for starting raising finance

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Is it time to raise finance?

Figuring when (and if) to raise finance is a big step for every entrepreneur – and a big challenge

Do you (really) need finance?

TIMING
Timing is different for every business

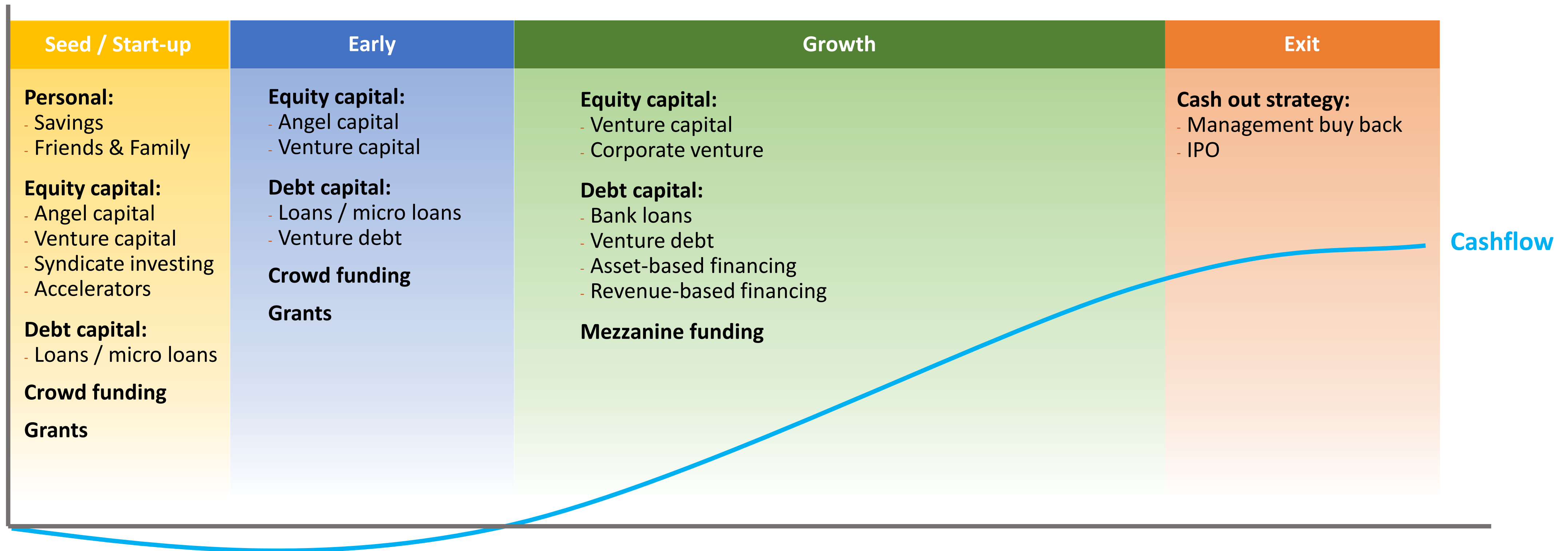
IS IT REALLY NEEDED?
Many success start-ups bootstrap throughout the first phase of the business

NEED
Need depends on things like the business model, how capital intense is it?

Raise funding to build out & test their idea

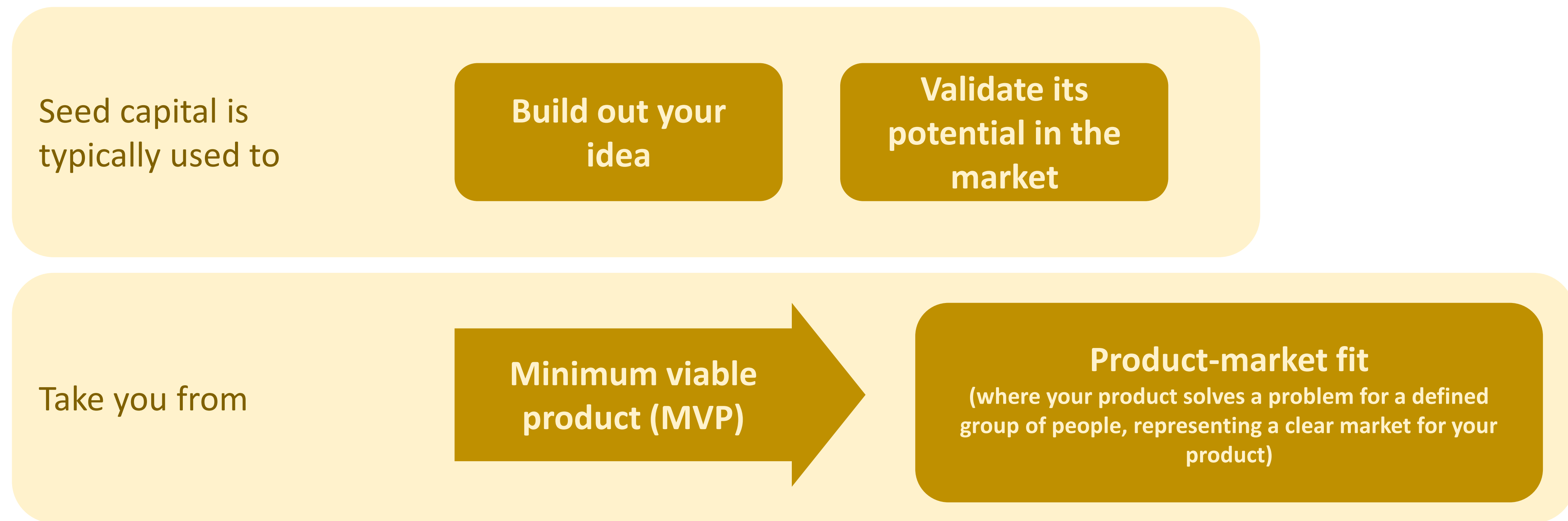
Where are you in your investment journey?

Different investment instruments are more useful at different times in the life cycle of a business. This is true for 'traditional' and impact investments.



Early stage funding: Seed capital

SEED CAPITAL: the first money you'll get into your business beyond your own (and usually tricky to get). It's the first time you'll likely have to convince someone you don't know to invest in your company. Seed capital is typically equity, so you are selling a share in your business early on!



Different types of early stage / Seed stage investors

There are many potential investors in a seed funding situation, Most common are:

- **Friends & Family**

- **Angel Investors**: An angel is a high-net-worth individual who provides financial backing for small startups or entrepreneurs, typically in exchange for ownership equity in the company.

- **Venture Capital:** VC's provide equity financing that is provided by venture capital firms or funds to startups, early-stage, and emerging companies that have been deemed to have high growth potential or which have demonstrated high growth

Some of the most commonly asked questions

Start with the WHY?

Some of the most commonly-asked questions are:

- What's your unique selling point?
- What is your cash burn rate/runway?
- What is your ambition for the business?
- What is your personal motivation for running the business?
- What is the quality and experience of the team you have built?
- How will you use the proceeds of your fundraising?
- What are your gross margins?

Seed: What do you need to start raising?

Typically, the right time to consider raising seed investment is when:

- You have a minimum viable product (MVP):
  - a version of your product with enough features to incite customer/user feedback
  - This does not have to be a working prototype, but it must demonstrate that you have refined your idea and show how it solves problems for other people
- A level of customer traction is proven:
  - Evidence that you have an existing base of paying customers
  - Demonstrable and repeatable formula for obtaining paying customers
- You have a robust business model and plan:
  - A core description of growth plans and traction
  - An understanding of your market and competition competitor profiles
  - Key milestones your business is looking to achieve

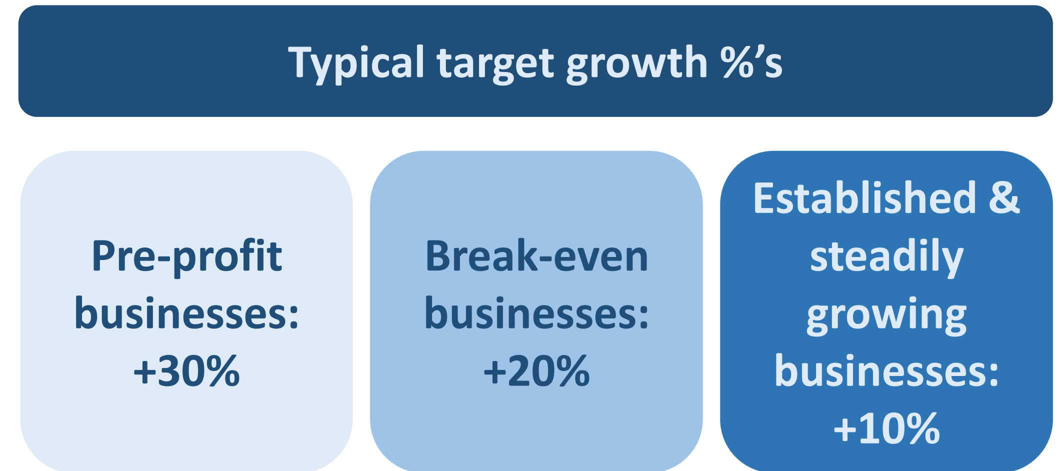
Growth capital (Series A/B)

Growth capital (Series A/B): **(also called expansion capital) is used to expand or restructure operations, enter new markets or finance a significant acquisition without a change of control of the business.**

Growth: What do you need to start raising?

Typically, the right time to consider raising growth investment is when you have:

- Demonstrated your business's ability to grow with:
  - Clear, defined demand
  - Consistent (or accelerating) growth
- A proven, clearly defined business model
- Residual value in your business. This is:
  - Value that can be extracted in a downside scenario
  - Ideally equal to or over the value of capital
- Transparent Information, governance and corporate structure, including:
  - A mature management team
  - Straightforward corporate governance
  - A clean corporate structure



Are you ready for fundraising?

Answering this question means you have done the following:

i. Considered your company's health from every angle
ii. Researched your industry and market
iii. Profiled your competitors
iv. Defined your product
v. Prepared your financial projections
vi. Determined how much capital you need
vii. Defined whether it is debt or equity finance

All of this needs to be clearly represented in your key investor documentation, including your:

- **Pitch deck**
- **Business Plan**
- **Investor memorandum**
- **Financial model**

ANNEX

Different types of Seed funding – Convertible Debt

- In a traditional seed financing of convertible debt, a startup borrows money from an investor. The borrowed debt automatically converts to equity at a later time. Typically, the conversion date is the closing of a Series A preferred stock financing. At this time, instead of receiving its invested money back, with interest, the investor receives shares of preferred stock.

Advantages	Disadvantages
Delays valuation and leaves it flexible to meet the needs of subsequent investors	Requires repayment of the loan, with interest, if the startup does not raise a Series A round before the maturity date (usually within 12-18 months)
Interest payments do not typically need to be paid in cash each month	Complicates calculations of interest payments and schedules, because there are numerous investors with notes of different start times
Provides a quicker and cheaper financing option than issuing equity, because it can close in weeks instead of months	The noteholders may force the company into bankruptcy if the startup cannot repay the loan and is in default under the note (unless the startup renegotiates with investors to extend the loan)
Allows for note proceeds to be used to increase the value of the startup, because ownership dilution is deferred	The interest that accrues until an equity conversion means slightly more dilution for all shareholders
Ease and speed in drafting agreements	Undermines the startup's business standing for considerations of lines of credit and big partnerships because of large amounts of debt on its books
LLC's can use it.	

Different types of Seed funding – Convertible Equity

- In a convertible equity financing, a startup issues a convertible security in return for investment. Similar to convertible debt financing, convertible equity investment converts to equity at a later time – i.e., atthe closing of a preferred round of equity financing. Since it is equity and not debt, it does not have convertible debt financing's characteristics of repayment at maturity and interest. Thus, there is a possibility that the equity never converts to preferred stock, and there is nothing in the terms that requires the investment to be repaid to the investor.

Advantages	Disadvantages
Potentially provides a lower capital gains tax benefit for investors, since, as equity, it is likely classified as qualified small business stock	Is complex to structure (high legal bills and long time to close)
Does not have to be repaid	Usually involves giving some level of board control to investors
Does not accumulate interest	
Gives certainty of valuation to a startup	If valuation is too low, there is a risk for diluting founders' stake. If it is too high, it can impact interest from next round investors who do not like to price down rounds from the round before, to avoid legal risks from diluted shareholders
Delays valuation discussion	

Different types of Seed funding – S.A.F.E note

- Another type of convertible equity financing that is commonly used for seed investments is the Simple Agreement for Future Equity

Advantages	Disadvantages
Does not have a maturity date (which provides flexibility) nor does it accrue interest (which saves a little equity dilution in the future when it converts). There is also no need to spend resources extending such things as maturity dates or interest rates	Creates more dilution for issuers than intended, by delaying valuation, often several times, thus negatively impacting future valuation and the startup's financial viability
The documents are very short - 5 pages, with little to negotiate aside from the valuation cap	Can create undue negotiating tension between CEOs/founders and new investors at conversion, when the founders and other common stockholders see the actual dilution
Removes the deadline, so a startup can take cash on an as-needed basis from each investor without creating a new looming deadline	May force a down round as the only option for a Series B lead investor due to dilution
Converts at the next capital raise with a fixed valuation, regardless of the round's size, thus reducing the possibility that the investor's investment will have an overinflated increase in value between the issuance and conversion due to the discount or valuation cap	May not be advisable for use with LLC's; SAFEs are generally treated as non-compensatory partnership options (NCPO's) in LLC's and tax treatment of NCPO's can be uncertain. The holder is subject to pass-through tax treatment in LLC upon the conversion of the SAFE.

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Do you (really) need finance?

For every business, the right time to raise capital will be very unique to them as their business plan and the product they offer

- Not every start-up needs to raise funding: many successful start-ups will bootstrap to create growth with little or no external capital
- But… most high growth start-ups need money to get things moving:
    - By capitalising on their idea (a seed round), or
    - Grow into an established company quickly (growth round)

Without funding, many start-ups seeking high growth will fail, requiring too much capital to keep up with the market and their competitors.

Put simply: Capital allows Growth.

What do you need to start raising seed capital?

Typically, the right time to consider raising seed investment is once the following three conditions are met:

MVP

- Minimal Viable Product
- You have a product or service you can sell. It doesn't need to be perfect or address all the needs but it needs to be a product that you can use to demonstrate it solves a problem for or addresses a need of your customers

Traction

- A level of customer traction is proven – evidence that you have an existing base of customers
- Demonstrate you can find customers that want to buy your product or service, ideally in a way that is easy to replicate.

"Business" plan

- There is a plan in place that describes your vision, potential market, competition and key milestones you want to achieve
- Can be simple, few pages but needs to provide sufficient information on where you want to take the business and how you want to get there.