ANGEL INVESTMENT
NETWORK

AIN Guide to the World of Fundraising

ANGEL INVESTMENT NETWORK

AIN’s Guide to the World of Raising Funding

With this guide we hope to explain to you the types of finance available, which one is most suitable for your business and how to access it. We will also be explaining what investors are looking for in your business plans and how to improve yours. We hope you’ll find our guide useful.

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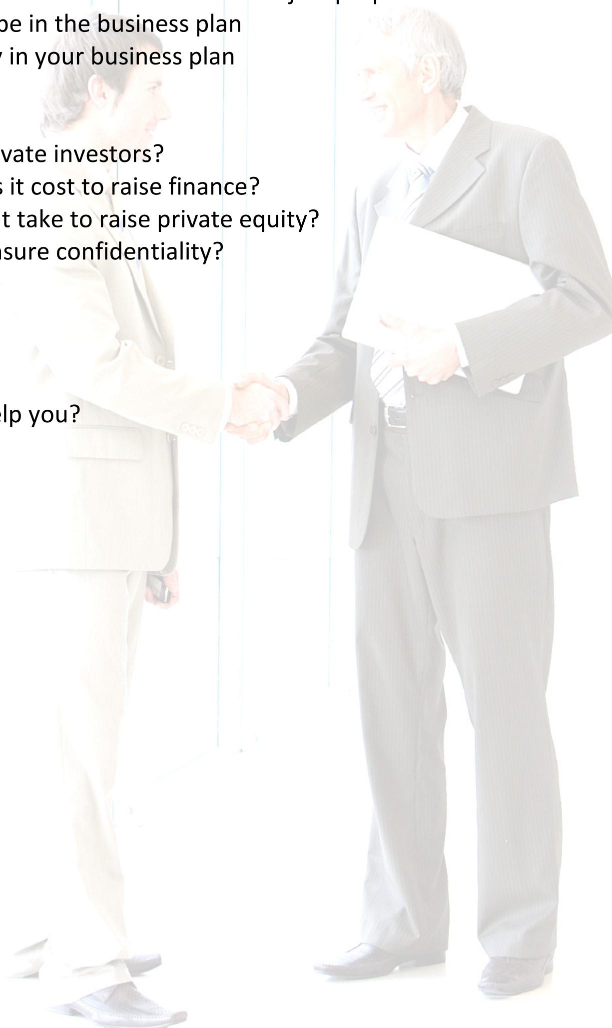

Finance

It is important to ensure the funding structure you choose suits your business. There are two types of finance: debt and equity.

Debt finance is usually secured on business assets or the personal assets of shareholders and/or directors. The difference for the chargee is his right of priority to receive repayment of the monies due, should the company be wound up. i.e. a bank has the power to place a business into administration or bankruptcy if it defaults on debt interest or repayments or its prospects decline. This right to appoint a receiver is not available to an equity investor.

There may come a time in the development of a business when a company cannot borrow any more debt, maybe due to a lack of security. It is then that the company may consider raising equity.

Equity capital is risk capital, with investors bearing the risk of losing their money if the company is unsuccessful or not as successful as projected. However should the business exceed expectations they will benefit through participation in increasing levels of profits and on the eventual sale of their stake.

The different types of finance available

Below we have listed and explained in detail the most prevalent forms of finance available to you. These can be used individually or combined and are grouped into the two sections mentioned above - equity and debt.

Equity

- **Private Investors:**

Private investors are also known as an angel investor. They are an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity, typically investing between £25,000 and £100,000 per deal. A small but increasing number of angel investors organize themselves into angel groups or angel networks to share research and pool their investment capital, whereby the deal size can be greater. They have various and differing investment criteria and can bring a lot more to the table than just money i.e. business experience and industry contacts. Most will want to benefit from tax relief under the Enterprise Investment Scheme (EIS).

- **Seed Funds:**

'Seed fund' is term that can be applied to any finance raised at the outset of a new venture to allow for development. Many seed funds are affiliated to the technology transfer offices of universities and focus on areas such as technology invention and innovation. At this early stage the risks involved in investment may be too high for venture capital investment. This is not a great concern, as there are other sources of finance at this early stage.

Sources of seed funding:

- Family and Friends - Do you know someone who can afford some capital to invest in your idea? The benefit of this may be little or no interest or equity loss.
- Grants - Government or benefactor grants can be a very good source of seed fund, as frequently you are not required to pay them back.
- The Prince's Trust - Nearly 5000 young people received help between £250 and £5000 setting up their own business in 2000. www.princes-trust.org.uk
- Banks
- Nesta - The National Endowment for Science, Technology and The Arts. An organisation that awards fellowships for great business ideas. They can invest up to £250,000 (initial investment up to £150,000) in innovative start-ups. www.nesta.org.uk

- **Investment Funds and Syndicates**:

Business angel syndicates offer a half way solution between individual investors and venture capital. You'll have access to more money but potentially a lower equity stake. They offer individual investors more leverage to invest in larger businesses and wield more collective power. There are many investor syndicates to choose from, where individuals may invest anything between £20,000 to several million of their own money with a syndicate who will then suggest investments based on their investor profile, attitude to risk and return expectations. The complexities of seeking funding from a syndicate mean of course that you will more often than not have more than one investor. How the advantage is they are likely to be made up of individual investors who have a broad range of skills who may be willing to offer advice as well as funding.

- **Regional Venture Capital Firms (RVCFs):**

A relatively new initiative, these commercially-focussed regional funds, supported by the DTI, provide risk capital to small businesses meeting their investment criteria. They only invest in a few dozen per year. Each of the nine regions of England has its own RVCF. All RVCFs have similar rules: they must invest in SMEs in their region, they must be the first institutional investor, their initial investments are limited to £330,000 and they can follow on after 6 months or more with a further £330,000. Each fund can also invest in a company at subsequent rounds to prevent dilution.

- Covers the 32 London Boroughs and the City of London. http://www.thecapitalfund.co.uk/
- South East Growth Fund http://www.segrowthfund.co.uk/
- East of England Fund http://www.createpartners.com/
- South West Regional Venture Capital Fund http://www.southwestventuresfund.co.uk/
- Advantage Growth Fund (WM) http://www.midven.com
- East Midlands Regional Venture Capital Fund http://www.catapult-vm.co.uk/criteria.shtml
- Yorkshire and Humber Fund http://www.yhef.co.uk/
- Capital North East http://www.nel.co.uk/insight/
- North West Fund http://www.nwef.co.uk/

- **Community Development Venture Funds:**

CDV Funds will finance and support entrepreneurs in under-invested communities in the UK who would not otherwise have the opportunity to create and develop competitive enterprises, to the benefit not just of themselves, but of their employees and others in their community. They are funded by the DTI and the private sector, and are transparent for tax purposes.

- **Corporate Venturing:**

The term 'corporate venturing' covers a range of mutually beneficial relationships between companies. They are commonly formed between a larger company and a smaller independent one, usually in a related line of business. The larger company may invest in the smaller company, and so provide an alternative or supplementary source of finance. The benefits to this include making available particular skills or knowledge i.e. by knowing immediate what you are talking about whereas some investors may struggle to understand the technology, perhaps in technical or management areas, which a smaller company would otherwise not have access to, provide access to established marketing and distribution channels, or complementary technologies.

This relationship is often beneficial for larger companies as it allows them to develop and broaden their business without acquiring other companies, and a way for small companies to grow faster than they otherwise would. A typical outcome would be the development of a new product or process, perhaps involving an exclusive licensing deal between the two companies.

However in the United Kingdom (UK) it is quite limited, being found mainly in areas such as biotechnology, telecommunications and information technology. The Corporate Venturing Scheme (CVS) is intended to encourage corporate venturing involving equity investment in the UK.

- **Venture Capital Firms:**

A fund raising technique for companies who are willing to exchange equity in the company in return for money to grow or expand the business. Venture capital firms often want a high rate of return (20%+) and will finance the business with $500,000 to millions. A venture capitalist differs from an angel investor in terms of wanting greater control of company and quicker return on investment.

- **Venture Capital Trusts (VCTs):**

A VCT is a company whose shares trade on the London stock market, just like Lloyds TSB or BT. However, rather than banking or telecoms, a VCT aims to make money by investing in other companies. These are typically very small companies which are looking for further investment to develop their business.

A VCT is distinguished from other investment trusts in that the manager is not just looking to provide capital but also advice. This could be knowledge of a particular sector or hands on experience of actually running a company. By working closely together the chosen firms should be able to expand more quickly, increasing their value and potentially providing better returns for investors. Then, normally between three and seven years after investment, the VCT manager will look to float or sell the business, take a profit and

move on. Generally, any profit is paid out to the VCT investors as a tax-free lump sum and the original capital is reinvested in the next opportunity.

These companies make VCT investing very exciting. The VCT invests at an early stage in its development. This means that the VCTs are aimed at wealthier investors who can afford to take a long-term view and accept falls in the value of their investment.

- **Incubators:**

Business incubation provides a nurturing, instructive and supportive environment for entrepreneurs during the critical stages of starting up a new business. The goal of incubators is to increase the chance that a start-up will succeed, and shorten the time and reduce the cost of establishing and growing its business. www.ukbi.co.uk

- **Enterprise Capital Funds (ECFs):**

Enterprise Capital Funds (ECFs) are part of the UK Governments continued efforts in its crusade to address the “Equity Gap” for growth companies seeking up to £2m in equity capital.

ECFs are privately managed funds that leverage private investment with public funds. The Government invests up to £2 for every £1 of private investment. Government money is provided at rates of interest similar to those applicable to other government bonds and attracts a profit share. ECFs offer a potential mechanism for groups of high net worth and sophisticated private investors to take the first steps towards formalising existing loose networks.

- **Stock markets:**

There are a number of small & mid-cap stock exchanges know as the junior stockmarkets i.e. AIM, PLUS and Sharemark. They all offer a simple, low cost, flexible stockmarket for small companies. The formalities are fewer than those of their larger counterparts and have a flexible approach to regulation and a streamlined admission process which make them the ideal market for smaller growing companies seeking to develop their business in a supportive environment.

Debt

- **Small Firms Loan Guarantee Scheme (SFLGS):**

The DTI's Small Firms Loan Guarantee Scheme provides a government guarantee for loans by approved lendors. Where you have insufficient security to satisfy the bank to qualify for a bank loan. The guarantee generally covers 70% of the outstanding loan. This rises to 85% for established businesses trading for two years or more. Loans can be for amounts between £5,000 and £100,000 (£250,000 for established businesses) and over a period of two to ten years. Loans are available for most business purposes although there are some exclusions.

- **Local Investment Funds (LIF):**

LIF was set up in 1995 to provide loans to social and community enterprises who have been unable to secure funds from traditional sources. By providing loan finance, LIF enables community organisations i.e. to move from grant dependency and towards self-sufficiency.

- **Grants and Awards:**

There are thousands of grants schemes there are out there. They can however generally be put into one of three categories the European Commission, National government which has several departments and agencies, which hand out the money based on their own criteria and objectives. There are also a number of locally based agencies and organisations which have been established specifically to support and encourage enterprise at local level. i.e. Business Link www.businesslink.org The vast majority of schemes apply without major restrictions but on those that do eligibility tends to fall into three main categories – location, size and industry. The National Lottery and UK Grant Making Trusts also provide awards to good causes. There are 5 'good causes' that lottery distributors separately focus on. These are sport, art, heritage, charities and health, education and environment. These are some of the distributors Community Fund, New Opportunities Fund, Arts Council England, Heritage Lottery Fund, Sport England, UK Sport, Millennium Commission, UnLtd: Foundation for Social Entrepreneurs, Film Council, Nesta (National Endowment for Science, Technology and the Arts), Football Foundation, The Foundation for Youth Music, and Awards for All.

- **Bank Loans:**

Bank Loans may be secured or unsecured. A secured loan is a loan in which the borrower pledges some asset (e.g. a car or property) as collateral for the loan. They can then take repossession of the secured asset possible in the event of default.

Unsecured loans are monetary loans that are not secured against the borrower's assets. These may be available from financial institutions under many different guises or marketing packages such as credit card debt, personal loans, bank overdrafts, credit facilities or lines of credit corporate bonds

The interest rates applicable to these different forms may vary depending on the lender and the borrower. These may or may not be regulated by law. In the United Kingdom, when applied to individuals, these may come under the Consumer Credit Act 1974.

- **Mezzanine Debt:**

A hybrid of debt and equity financing that is is typically used to finance the expansion of existing companies. Mezzanine financing is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies.

Since mezzanine financing is usually provided to the borrower very quickly with little due diligence on the part of the lender and little or no collateral on the part of the borrower, this type of financing is aggressively priced with the lender seeking a return in the 20-30% range.

- **Bank Overdraft:**

It is normally secured on current assets, repayable on demand and used for short term working capital fluctuations. The interest cost is normally variable and linked to bank base rate.

- **Factoring / Invoice Discounting:**

Factoring \ Invoice Discounting is a funding option available to companies that provide a product or service on credit terms to their customers. The purpose of the finance is to give you access to immediate funds, without having to wait for the customer to pay the invoice. This is particularly beneficial to those of

you who are in a growth period. It is commonly used by businesses to improve cashflow but can also be used to reduce administration overheads.

The company lending you the money will agree that for all invoices raised you will have available 80-85% of the value of the invoice at your disposal. You do not have to take available amounts. The cost structure is similar to that of an overdraft: you pay a service fee and an agreed percentage above bank base rate, calculated on the amount of funding you require and the length of time your customer takes to pay the invoice.

- **Leasing:**

Leasing is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductable payments. i.e. Hire purchase, finance lease and contract hire.

Which type of finance is appropriate to your business?

Stages of company development and funding needs	Usual Investment amounts required	Finance types which are applicable
Seed capital pre-start - cash required for research or to develop a prototype	Up to £50,000	✓ Business Angels ✓ Seed Funds ✓ Grants and Awards ✓ Investment Funds ✓ Incubators ✓ Corporate Venturing ✓ Bank Debt
Start-up you have researched the market but have no sales yet	Up to £500,000	✓ Business Angels ✓ Seed Funds ✓ Grants and Awards ✓ Investment Funds ✓ Incubators ✓ Corporate Venturing ✓ Bank Debt
Early stage you have generated a few sales and need cash for marketing and operations	Up to £750,000	✓ ALL types of equity finance ✓ Bank Debt
Expansion you are generating revenue but need cash for new products or new markets	£100,000 Upwards	✓ ALL types of equity finance

Raising private equity

Britain is one of the leading centres for private equity in the world, second only the US. Private equity is behind a range of household names such as Boots, Phones4U, Birds Eye, National Grid and Travelodge to list a few. Identifying the potential opportunity to turnaround a business, private equity provides the long-term investment that is suited to companies jeopardised by financial constraints or operational inefficiencies. Besides injecting much-needed capital, private equity stays through thick and thin with the right leadership and the business benefits from the strategic advice and business know-how brought on board.

What are the advantages of private equity?

- Long-term equity finance with no interest charges. There is no sudden requirement to repay and no personal security to provide.
- Investment is committed to the business and the project concerned alone. The investor's interests are closely aligned to those of the entrepreneur in helping to make the business work as this would reflect in the value of their equity.
- The correctly chosen investors can add value to the existing project. If the investor's background is in that field/industry they can give their expertise, contacts and experience. They can also provide invaluable assistance in key decision making, strategies and putting processes in place for policies and procedures.
- Further financing is more readily obtainable as the investors are involved from the very beginning and hence would be interested to provide follow up finance for further expansion and growth. It also easier to raise further bank debt on the back of equity provided by the investor.

What are the disadvantages of private equity?

- Raising equity finance is time consuming and costly. Due diligence usually last from 3-12months and cannot always be successful.
- Once finance is attained it can be costly to pay out monthly dividends, and high annual returns.
- The share held by the owner is diluted.
- Investors often exert control over the business which can impede key strategic and financial issues.
- It can often be hard to find the right partnership between the company and investor. This can effect time it takes to raise the private equity and could also affect the growth of the company if the investor chosen is unsuitable and a hindrance.

Business Plan

What investors are looking to invest in depends on a number of criteria and is often dependent on who you are raising finance from. However they are looking for the same things when reading a business plan. Your job in writing the business plan is to address these questions convincingly and clearly. All the following points are crucial.

What do investors look for?

- **Experience and a good management team** - They also want you to be determined and ambitious to achieving your long and short term goals – passion and good business acumen obviously helps!
- **Good relationships** - Being able to work with the investors and that you are committed to the business this can be shown through investing your own money, taking a low salary and being receptive to their input.
- **Open and honesty** - Investors will want to be able to trust you with their money. Also anything you may mislead the investor on will be uncovered during due diligence.
- **Knowledge** - It is important that you have researched the market extensively – both your competitors and your customers. You should be able to be able to answers any questions about your industry with complete understanding and insight. Private investors tend to back businesses which interest them, preferring those in sectors in which they have experience.
- **Realistic Finances** - Investors expect to see a business plan that paints a realistic financial picture of the anticipated growth of the company. If the plan is overly aggressive and not consistent with growth in the industry, your plan may be shelved. Be realistic with your financial projections, and be prepared to explain how you arrived at the numbers. Even if you are a new venture and cannot give specific figures on the performance of your business, quote figures for the industry or your competitors. These real figures carry more weight than your assumed projections and give more reality to your plan.
- **Exit plan** – this is critical to investors so. This allows them to get their money back (hopefully with a healthy return) and exit your company. The exit strategy section of your business should also outline your long-term plans for your business. Venture Capitalists - look for a high return and an exit strategy of approximately 3-7 years. Angel Investor looking for a high return but are more flexible with the terms of the exit strategy. Possible exit strategies to consider i.e. Merger/Acquisition, Buyout by partner in business, Franchise the business, Hand down the business to another family member.
- **Rate of return (ROI)** – Investors are looking for a high return on their capital. Anything below 20% will be on no interest to them as they could earn this from bank interest rates. They usually look for 40-50% annual return which may seem high but it is due to the risks involved.
- **Scalability** - Choosing a market with high growth potential i.e. a business which targets teenage girls who listen to music and has a reasonable chance of capturing 90% of the girls that are online is a huge opportunity. A business which targets net-savvy SAAB mechanics who need prosthetic limbs is not. Or businesses that can be successfully reproduced as a concept form or franchise.
- **Intellectual property** - Having a trademark, copyright or patent can be attractive to the investor, as long as it necessary to act as a clear barrier to entry or secures a competitive advantage.

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The 10 most common reasons Investors reject proposals

1. Poor written and communication skills
2. Untrustworthy
3. Lack of ability to respond well to comments, questions and criticism
4. Too complex
5. Inadequate information i.e. no track record, proof of concept, market awareness
6. Lack of management and business experience
7. Unwillingness for sharing equity and control of the business
8. Inaccurate / unrealistic revenue projections and costs (financial forecasts) and inadequate financial returns
9. Not scalable
10. No clear exit route and sustainability i.e. viable and controllable if founder leaves

What needs to be in your Business Plan

Once a need to raise finance has been identified it is then necessary to prepare a business plan. If you intend to turn around a business or start a new phase of growth, a business plan is an important tool to articulate your ideas while convincing investors and other people to support it. The business plan should be updated regularly to assist in forward planning.

There are many potential contents of a business plan. The European Venture Capital Association suggest the following:

- Profiles of company founders directors and other key managers; make sure you highlight the team member's relevant expertise in the area to show how valuable their contribution is.
- Statistics relating to sales and markets.
- Names of potential customers and anticipated demand.
- Names of, information about and assessment of competitors.
- Financial information required to support specific projects (for example, major capital investment or new product development).
- Research and development information.
- Production process and sources of supply.
- Information on requirements for factory and plant.
- Magazine and newspaper articles about the business and industry.
- Regulations and laws that could affect the business product and process protection (patents, copyrights, trademarks).

The challenge in preparing a business plan is to communicate your ideas clearly and succinctly. The very process of researching and writing the business plan should help clarify ideas and identify gaps in management information about your business, competitors and the market.

What not to say in your Business Plan

- Economy lingo, business jargon and clichés as well as value inflation

Disintermediation, win-win and phrases like "unparalleled in the industry;" "unique and limited opportunity;" or "superb returns with limited capital investment" are nothing but assertions and hype.

- Trying to be all things to all people

Many early-stage companies believe that more is better. They explain how their product can be applied to multiple, diverse markets, or they devise a complex suite of products to bring to a market. Most investors prefer to see a more focused strategy,

- ''The product will sell its self''

Business plans that fail to explain the sales, marketing, and distribution strategy are doomed. The key questions that must be answered are: who will buy it, why, and most importantly, how will you get it to them? You must explain how you have already generated customer interest, obtained pre-orders, or better yet, made actual sales—and describe how you will leverage this experience through a cost-effective go-to-market strategy.

- "We have no competition"

No matter what you may think, you have competitors. Maybe not a direct competitor—in the sense of a company offering an identical solution—but at least a substitute.

- ''Our target market is X million'' or ''Achieving a return of £Xm for the investor after X years''

Complete overestimations or if cannot be guaranteed should not be included on the plan.

- Long winded and encompassing sentences

It is much more beneficial to use a precise and solid choice of words. Write in plain English stick to a tight, simple explanation of your idea. A 20-page plan which clearly lays out your business is far more likely to be read than a 100-page plan. Often entrepreneurs use a 15 slide Power Point presentation.

- Don't give more away than you want to

Be aware of who is reading your information, and never give away more information than you feel comfortable with. Do due diligence on anyone who you are dealing with. If you do need to reveal sensitive information, ask for a Non Disclosure Agreement (NDA) to be signed (See Confidentiality section).

FAQ

Who are the private investors?

There are 3 types of private investors. These are the entrepreneurial and occupational, who are wealthy individuals who are either retired or have sold their business and are looking to bring their skills and experience into a new venture. There are also professional investors who work for large organisations and invest in a portfolio and make high risk / high return investments.

Costs of raising finance?

It is important to be aware of the cost of the money raised. Apart from interest charges and dividends, other costs you may need to consider will relate to third parties, such as lawyers, accountants and fees.

Investment costs

These relate to the costs of the particular investment and are not annual charges. An indication of the types of costs that you might expect is as follows:

- Arrangement fees - normally expressed as a percentage based on the sums invested.
- Due diligence costs - These are fees charged by third party industry, technology and financial experts to conduct due diligence on your proposal from a commercial and financial perspective prior to completion of the proposed investment. These experts may also make useful recommendations to you.
- Legal costs - These are fees charged by lawyers for providing the necessary advice and documentation, and will vary according to the complexity of the deal. These fees are paid out of the investment and relate to work undertaken for you and for investors.
- Negotiation and commitment fees on bank borrowing and Venture Capital investment.
- Success fees - these are usually charged by brokering companies and individuals and can vary from 2-5% of the amount of finance raised through their contacts.
- Advisory fees – These are charged for reviewing, amending your business plan, financial forecasts and to enable you to become investor ready before approaching financial sources. They often charge a one-off fee between £1000 - £10,000.
- Registration fees - These are for introductory services and can vary from £99 to around £2000 for promoting your business to their database of investors.

Ongoing costs

These relate to the ongoing costs of having secured investment.

- Monitoring fees - It is normal for venture capital investors to charge an annual monitoring fee, which is expressed as a percentage of the sum invested.
- Non-executive director fees - Some investors may take a board position and may charge a fee for this role. Remuneration for a non-executive director is negotiated between the non-executive and the company and any fees are paid by the company to the non-executive. We are happy to provide guidance on the normal commercial rates that you should expect to pay.
- Consultancy fees - Some investors will charge consultancy fees.

How long does it take to raise private equity?

Raising finance is often a complex process and rarely does it take less than 3 months. Business management need to assess several alternatives and then negotiate terms which are acceptable to the finance provider. The main negotiating points are often as follows:

- Whether equity investors take a seat on the board
- Votes ascribed to equity investors
- Level of warranties and indemnities provided by the directors
- Financier's fees and costs
- Who bears costs of due diligence

During the finance-raising process, accountants are often called to review the financial aspects of the plan. Their report may be formal or informal, an overview or an extensive review of the company's management information system, forecasting methods and their accuracy, review of latest management accounts including working capital, pension funding and employee contracts etc. This due diligence process is used to highlight any fundamental problems that may exist.

How can you ensure confidentiality?

- **Non-disclosure agreement (NDA)**

This is also known as a confidentiality agreement, confidential disclosure agreement (CDA), proprietary information agreement (PIA), or secrecy agreement, is a legal contract between at least two parties that outlines confidential materials or knowledge the parties wish to share with one another for certain purposes, but wish to restrict access to. It is a contract through which the parties agree not to disclose information covered by the agreement. An NDA creates a confidential relationship between the parties to protect any type of confidential and proprietary information or a trade secret. As such, an NDA protects non-public business information.

NDAs are commonly signed when two companies or individuals are considering doing business and need to understand the processes used in each other's business for the purpose of evaluating the potential

business relationship. NDAs can be "mutual", meaning both parties are restricted in their use of the materials provided, or they can restrict the use of material by a single party.

In rare cases, the contract may state that the existence of the NDA itself cannot be disclosed.

About Us

How can AIN help you?

We are an international online platform connecting business entrepreneurs with angel investors. We are the world's largest online angel investment community. We can connect you directly with private investors, private venture capitalists and business funds.