DUALE, OVIA & ALEX-ADEDIPE

Fundraising Toolkit for Startups

A. Introduction

Startups need adequate capital to sustain operations during their early stages. Typically, founders rely on personal funds, contributions from family and friends, bank loans, and angel investments to kickstart their ventures. However, this initial capital is often insufficient in the long term, necessitating a strategic approach to attract further investment and ensure sustainable cash flow.

In today's #TMTThursday series, we explore the concept of fundraise from end-to-end, highlighting the steps and other practical considerations required to engage in fundraising activities.

B. Steps to Fundraise

Determine the Startup Runway & Amount to Raise

Runway refers to the timeframe which a startup has until it exhausts its available funds. This duration is determined by the rate at which the startup spends its cash. It is important to estimate a runway for the startup, since early startups do not have predictable revenues and costs. If a startup does not have enough runway, it risks going out of business before it understand/reach the market it is looking to serve.

Ideally, a startup should raise as much money as it needs to reach profitability, or at least to get to their next "fund-able" milestone, which is usually 12 to 24 months later. A good way to determine the optimal amount to raise in a first round is to decide how many months of operation to fund. The requested funds should be tied to a credible plan.

Identify and Connect to Potential Investors

Research and identify potential investors using online databases, industry publications and networking events. Ensure that investors are interested in the business sector and fund startups. Then create a list of names, contact information and investment focus. The best funds to pitch are those that just raised fresh capital and are looking for new cohort of startups to invest in.

Prepare a Pitch

Prepare a compelling pitch deck that showcases the potential of the business or the solution created by the startup and explains you are the right team/structure to make a success of it. The pitch should provide financial projections including revenue, expenses, and cash flow projections for the runway.

Prepare a Cap Table

A cap table set outs the startup's ownership structure. The cap table highlights the equity stakes being offered to investors, previous investments in the startup and the principal shareholders of the startup.

Due Diligence Process

Due diligence comes up when the startup has attracted real investor interest. It starts with the preparation of a virtual data room (VDR). A VDR is a secure digital repository in which the startup compiles key confidential documents and information to share with potential investors in a structured and transparent way. Investors closely examine information in the VDR for the purpose of (i) determining the corporate, financial, intellectual property, and regulatory good standing of the startup, among others; and (ii) ensuring that it is a good investment opportunity.

Closing the Funding Round

To close out the funding round, key steps include: negotiation of the terms of the investment; review of the investment documents by legal counsel, consummation of the terms of the investment documents including obtaining corporate consents and registrations, etc.; formalization of the investor-shareholder relationship (where necessary); and receipt of funds.

Post-investment Integration/Relationship with Investors

After the investment is secured, the startup must maintain strong and positive relationship with its investors. This step includes provision of regular updates/access to information as agreed in the investment documents, execution of the business plan; and implementation of the startup's vision and mission.

C. Funding Options for Startups

Founders need to decide which funding option presents the best fit for their startups. Available options include:

1. Debt Capital

This is involves obtaining loans to fund the startup. Debt capital allow founders to retain equity stakes in the startup and imposes an obligation of repayment. Loans are repayable with interest.

2. Equity Capital

Equity capital involves trading equity stakes of the startup to investors. Investors in this case become shareholders and may own a certain percentage of share in the startup. Examples of equity finance include:

i. Incubators and Accelerators

Incubators are programmes/organisations that provide resources and mentorship that offer a nurturing environment for startup founders to build on their ideas and turning them into a working product. Accelerators are similar to incubators, but are typically time-limited and more intensive. Most startups develop their minimum viable product (MVP) at this stage.

ii. Angel Investment

Angel investors provide initial seed capital for startups businesses, usually in exchange for ownership equity in the company. Angel investors typically enter into a simple agreement for future equity (SAFE) with the startup. A SAFE is an agreement between a startup and an investor to invest in the startup with the hope of a valuable return in the future when the funds invested will be converted to equity stakes. It offers investors a stake in the company when the startup raise capital at a pre-determined valuation.

iii. Venture Capitalists

Venture capitalists provide startups with funds needed to grow and expand their business. They invest in startups with high growth potential, with capital provided by large companies, investment firms, high net worth individuals and institutional investors. A venture capitalist is a private equity investor that provides companies with high growth potential in exchange for an equity stake.

iv. Crowdfunding

Startups may take advantage of crowdfunding to raise funds through a large number of people. Crowdfunding may be rewards-based, equity-based, and debt-based.

3. Hybrid Capital

This takes the elements of equity and debt financing. Example of hybrid finance include convertible loan notes. Convertible loan notes are short-term debt instrument that can be converted into equity. Convertibles notes are often used by seed investors who invest in startups.

4. Grants

Startups may be provided with grants by government organisations, non-governmental organisations/foundations, development finance institutions, etc., to support the development of the new business or solution. Grants are typically non-repayable funding.

D. Conclusion

Securing capital and managing runway effectively are vital for startups survival and growth. Understanding runway and its determinants, such as funding, burn rate, revenue, competition, and economic conditions, enables startup to make informed decisions on runway management. As a pre-requisite to fundraising, founders need a compelling pitch deck, a well-researched plan, an understanding of the proposed funding method, a structured cap table, a well-structured VDR and legal & financial counsel. Addressing these ensures a strategic approach to fundraising, maximizing chances for success in the competitive market.