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A Guide to Raising Capital for Your Business

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When starting a business, it goes without saying that you need capital. Capital is what gets your business not only registered, but makes it commercially viable. Here at LawPath, we help businesses get started everyday. Whether it be registering your business, hiring employees or acquiring capital, we want businesses to start on the best foot possible.

In this guide, we'll discuss all the ways you can raise capital for your business and ways to maximise your business's chances of success.

Raising capital requires hard work, but hopefully this guide will make it little bit easier.

Why do I need capital?

Turning an idea into a profit doesn't always come cheap. In the early stages, it'll likely be necessary for you to raise money to get your business off the ground.

Starting a business is one thing, but getting it off the ground requires monetary investment as well as time. Some costs in the early stages include purchasing or leasing equipment, renting a premises and marketing. Although 97% of businesses in Australia are small businesses, more than 60% of them shut their doors within the first 3 years of operating. It's not surprising that a significant reason for this is that small businesses can find it hard to grow when there is little investment. Raising capital for your business allows it to not only stay afloat, but grow into its own machine as well.

Having access to capital allows you to work on your business, hire new staff, rent a space and do all the things necessary to turn your venture into a lucrative business. Growth needs to be nurtured, and that's where investments are vital in the early stages.

This guide will take you through the considerations you need to make when raising capital, how capital works, and tips on budgeting for your business.

Planning how you will use capital

You need to plan how you will raise funds carefully. It can be exciting to get a significant sum of money injected into your business, but if it's not allocated carefully, it can get eaten up very quickly. Firstly, calculate your current operating costs. Combining this with your growth projections will help you get an idea of how much money you want to raise.

Once you've come up with the amount you want to raise, plan how you will allocate it to the following:

- Research
- Technology
- Wages for staff
- Administration
- Rental costs
- Marketing

After you have discerned where the money should be allocated, you can map out a budget. Things to be mindful of include your current operating costs, costs to continue, and costs to take your business further.

A good way of breaking it down can be by estimating your costs to set up on your first day or trading, and then calculate recurrent costs on a monthly basis. These costs can include facilities, assets, materials and professional fees paid to lawyers or accountants. To calculate how much funding you need to continue growing, weigh your projected sales against your expenditure. When making these calculations, it's always safest to underestimate your sales and overestimate your operational costs. A Small Business Lawyer can also help you discern how you can balance your operational costs with sufficient funding to grow your business.

Capital raising options

Self-funding (Bootstrapping)

In the early stages, it may be necessary to self-fund your idea until it's tangible enough for others to invest in. Injecting your own money into the business will show other potential investors that you believe in it and that you're willing to risk your financial security for it. A great example where self-funding has paid off is the company, Tough Mudder. When Tough Mudder was starting out, the founder poured $7,000 of his own money into getting the business of the ground. The company now brings in $100 million a year in revenue. Investing in your own idea can be necessary in the early stages, and it will also allow you to have a significant degree of autonomy over your business.

Personal loans or investments

Similar to how investing your own money will show potential investors how serious you are about your business, getting a loan or investment from family or friends will have a similar effect. You can either have this structured as a loan or investment, but it's important to be careful when mixing your business with your personal relationships.

Why would I obtain a personal loan?

There are many advantages to loaning money from someone you have a personal relationship with. Mainly, that a private loan means that you and the lender can negotiate the terms yourself and you may not have to provide security for the loan. This means there will likely be more flexible interest rates and your credit history won't be a relevant factor or affected later on by the loan.

But tread with caution...

If you choose to borrow this money, ensure that you have the terms set out in a Loan Agreement and don't make any promises that you can't keep. A significant risk that comes along with personal loans is the chance that it could lead to a breakdown in your relationship with this person. However, you can minimise this risk by having the terms of the loan clearly set out. Another incentive may be to have the loan serve as an investment. You can then give the lender an interest in the business by allocating shares to them and completing a Shareholders Agreement.

Professional loans or investments

You can also take out a loan from a financial institution. However, be sure to understand your obligations under the loan and the consequences if you default on it. It has become a popular practice for business owners to loan funds through peer to peer (P2P) lending. P2P lending matches up lenders (or investors) with business owners through an online marketplace.

Similar to crowdfunding, the onus is on you to write a convincing 'pitch' which will tell lenders why they should loan to your business. Below we've put together a comparison chart of the different characteristics of traditional and P2P lending.

Traditional Lending	P2P Lending
You will need to provide your credit history	Your credit history won't be checked
You may have to provide security (e.g. car, property)	You won't have to provide security
You won't need to pitch your business idea	You will need to have a compelling business pitch
Can have high interest rates	Tends to have a lower interest rate
Can take a few weeks to process	Can be processed straight away

Government grants

There are a number of grants (see the list here) which the government may provide to a startup to assist with project costs. For example, the CSIRO Kickstart Grant offers startups matched funding of up to $50,000. Businesses normally need to meet certain requirements to be eligible, for example, they need to have been in operation for less than 3 years.

There are also significant tax write-offs for investors. Investors who invest in an Early Stage Innovation Company (ESIC) can receive a non-refundable carry forward tax offset of 20% of the amount paid for their investment. The Government strongly supports early stage business, and it's no surprise that investment has grown exponentially over the past few years.

Crowdfunding

Crowdfunding is a great way to not only raise money for your business, but also get the word out there to the millions of people who visit crowdfunding sites. To do this, you will have to pitch your idea on an online platform, and if users are interested, they can pledge funding. In preparing your pitch, be sure to research the competition and set a realistic target for how much capital you want to be raised.

Why would I obtain a personal loan?

Crowdfunding is easily accessible, inexpensive and a great way to market your business. Putting your idea out there can have benefits beyond raising capital - think of it also as a free marketing opportunity.

Some other benefits are:

- You can raise capital without having to give up equity
- It will keep your investors in the one place
- You can raise a lot of money (the average amount for a successful campaign is $7,000)
- It will create momentum for your business
- You can get to know your target market

Pitfalls

Crowdfunding is a platform accessible by everyone. This means that it's competitive, and to be successful your pitch needs to stand out. Many entrepreneurs who have successfully crowdfunded their businesses already had a network of investors and professionals in their industry. With this in mind, you will have to go the extra mile and work at drawing people into your crowdfunding pitch. There may be extra costs involved in promoting your campaign and getting the pitch designed so it will attract the right people.

Angel Investors

Angel investors will invest significant sums of money in ideas they believe in. However, Angel Investors also expect returns on their investment, and you will need to present a convincing pitch to win them over.

Here's a breakdown of what an Angel Investor can offer:

- Significant capital in the range of $25,000 to $250,000
- The investor will have knowledge and experience and can provide helpful guidance
- They will likely provide capital in exchange for equity in the business

However, Angel Investors tend to also be investors in other small companies, meaning sometimes their attention is divided. You will also need to be transparent with the investor, and change your processes so that they're included in the decision-making process.

Venture Capitalists (VCs)

Venture Capitalists are usually larger firms that invest in smaller companies in return for equity, or a stake in the company. In this sense, Venture Capitalists have a significant say in how the company operates, but also provide business advice. Venture Capitalists are different from Angel Investors as they tend to be larger companies and firms, not individuals. They also tend to invest higher amounts of money, but this can be in exchange for a larger role in the business.

Funding rounds for Venture Capitalists are normally categorised by the following:

- Seed funding
- Series A funding
- Series B funding
- Series C funding

Seed Funding

Also known as 'seed money', seed funding happens in the early stages of a business. This money is normally put towards early costs, such as development of products or research. Seed funding is used to get the company off the ground and can involve self-funding, angel investors and personal loans from friends and family.

Series A

After seed funding, a Series A round raises more money from a wider pool of investors. At this stage, capital is invested towards growing the business through increased marketing and promotion. This is normally the stage where venture capitalists become involved, and shares are distributed to them. Funding will last the company 6 to 18 months. In this period, the company needs to spend its resources on growing the company.

Series B

Series B, as a continuation of Series A will see your business raise more funds and continue to grow the company. By this stage your business will have a solid team and customer base. In securing funding for this round, there will be more focus on the company's projections rather than just its potential. Series B is seen as the point where a lot of businesses struggle to raise funds.

This is because investors tends to prefer investing in Series A, where the company is just starting out and the capital risk isn't high, or Series C where the company is sufficiently established that it's a relatively safe investment. Due to this, Series B is a crucial stage of funding where investors consider the viability of the business into the future.

Series C

By the time Series C funding comes around, your business will be established, with a key plan to ensure success for the future. At this time, the business will likely be considering expansion, whether that be by going international, or looking at acquiring other businesses. Larger investment firms and hedge funds tend to invest at this stage.

When pitching to a Venture Capitalist, remember:

- Be flexible and understand that external investors will want to have a say in the company
- Be realistic and don't overvalue your company. Investors see this all the time and know when an idea or figures look too good to be true
- Be ambitious and believe in your business
- Be opoen to advice and guidance that experienced investors can provide

Scaling your business

Scaling your business is a necessary part of ensuring its success in the future. This process involves keeping your operational costs low whilst growing your business sustainably.

Here's some important things to remember when the time comes to scale your business:

- Be ambitious and don't be afraid of growth
- Automate your systems where you can
- Continue building your network
- Understand your competition
- Think long-term

Scaling your business requires you to take stock of your business, how its grown so far, and where you see it going in the future. If you don't scale it correctly, your business may run out of capital or may stagnate if you don't have the structures in place to support the growth of your business.

Preparing your pitch

Raising capital for your business means that you'll need to convince others why they should invest their money into your venture. Whether you're pitching to an online community or to specific investors, a winning pitch needs to cover the following:

Why

Explain why there is a need for a business like yours. You can introduce it by explaining the problems or gaps that exist in the current market and how this reflects a deeper consumer need and the purpose your venture serves. This will provide a context as to where your business comes in and why it has the potential to be so valuable.

You can start honing down on your 'why' by thinking back to when you first had your business idea. Where did it come from? Why did you feel there was a need for it? If you were a customer, how would your business benefit you?

Understanding the 'why' of your business will help you plan the rest of your pitch and will be the key ingredient that wins customers and investors over.

How

Run through how your business will work. Explain how this is different from other competitors and why you believe you have found a better way. This can be from a specific technology you have invented, a product you sell, or a service you provide. The key here is to both explain how your business works whilst keeping it connected to the 'why' of your business. Being able to explain the how of your business will make your idea tangible in the eyes of investors.

What

Finish your pitch with a summary of the product or service you provide and how you will make this available to your customers. By this time, your audience will already understand how the values of your business directly correlate to that of your customers. The 'what' of your pitch needs to wrap everything up neatly and compel the investors to want to invest in your idea.

When making your pitch, remember to:

- Put yourself in the shoes of your audience
- Keep your pitch engaging
- Avoid using industry 'buzzwords' and keep the message simple and effective
- Be confident - if they see that you truly believe in the business, why shouldn't they?
- Keep your pitch succinct and to the point
- Think of the reasons why someone wouldn't invest - then address those by emphasising the reasons to invest in your business
- Don't rehearse it as a speech, but have a good idea of the why, how and what of your pitch
- Be willing and able to answer any questions your potential investors may have

What a successful pitch deck looks like

In 2009, Airbnb presented a hugely successful pitch deck to investors, from which they raised $600,000 in funding. Some of the reasons the pitch was so successful was how it showed investors the gap in the travel and accommodation market which Airbnb could fill.

Their pitch included:

1. A vibrant, simple and eye-catching **cover** slide.
2. A concise explanation of **'problems'** with travel and accommodation, with keywords highlighted.
3. A **'solution'** slide which presented the ways the product or service can solve these problems. This slide focused on the benefits of Airbnb.
4. A slide comparing other companies in the industry. Airbnb presented the **number** of users for Craigslist and Couchsurfing. This demonstrated that there was potential in the market for a company like Airbnb.
5. **Market size** - this slide presented other numbers in the travel industry, such as the number of trips booked worldwide in a single year.
6. **Product** - Airbnb showed how their product works in three easy steps. Explaining the function of a product can be done through the use of infographics or even an explainer video. The simpler, the more effective.
7. **Business model** - investors want to know how the business will profit. This slide explained that Airbnb takes a 10% commission on each booking. This can also be used to calculate growth and revenue.
8. **Growth strategy** - This slide showed how Airbnb planned to grow their business through partnerships and become ubiquitous in the market.

9. **Competition** - This slide showed the other competing businesses in the market. Through a diagram showing cost effectiveness and convenience, Airbnb showed why they are different and have a wider appeal to consumers.

10. **Advantages** - This slide showed what benefits Airbnb could provide that other businesses in the market couldn't. This included ease of use and the incentive for people to become 'hosts' and rent out their home.

11. **Team slide** - This slide introduced the team who are the visionaries of Airbnb. The slide only showed the founding team of Airbnb and how their roles work together.

12. **Testimonials** - Businesses are nothing without their customers. Airbnb's testimonials slide showed the positive experiences customers had and would continue to have using the platform.

13. **Financing** - this slide provided the answer to one of the most important questions investors will have - how will funding help grow the business? This slide explained how $600,000 would help them reach 80,000 transactions on their platform.

Airbnb is a company that had $2.6 billion of revenue in 2017. This example shows that in making a successful pitch, keep it informative, solution-focused and simple and investors won't be able to stay away.

Turning capital into growth

So where do funds need to be allocated in order to grow a new business? The answer depends on what the business does, their industry, their growth ambitions and the amount of capital invested.

Company growth is normally focused on the following areas:

- New staff and hiring experts
- Advancing your technology
- Fixing current issues or setbacks
- Marketing/advertising
- Establishing and increasing your online presence
- Administration costs

Distributing capital raised in these areas is particular to what your company does and where you see it heading in the future. Once you've been successful in raising capital for your business, you need to ensure it's spent effectively. Careful planning and accurate growth projections will ensure that money is spent where it's needed.

Concluding Remarks

Raising capital for your business can seem like a Sisyphean task, but once you're aware of the avenues available to you, you can take steps to make it happen. Start by asking what it is you want out of an investment. If you want shared responsibility, you may want to issue shares to investors.

If you want to promote and market your business, an online platform could raise money and also bring awareness to your brand. Also remember not to limit yourself - the more ways you attempt to raise capital increases your chances of success. It's true that often you have to spend money to make money, but it's just as important that you do it the right way.

How Lawpath can help?

Unsure where to start? Contact a Lawpath consultant on 1800 529 728 to learn more about customising legal documents and obtaining a fixed-fee quote from Australia's largest legal marketplace.

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