Swiss Finance Partners Group

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Our Guide to Start Up Financing

2019

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Our Guide to
Financing options for startups in Europe

Startup financing at the early stage has changed dramatically over the past few years. Five years ago the vast majority of startups had to rely on FFFs and business angels to provide the capital necessary to launch their startups, but these are no longer the only options available to entrepreneurs and investors. Options like equity Crowd Funding, syndicate investing, accelerators or P2P lending companies are now able to provide funding to startups at the early stage, allowing them to find their product-market fit before calling on the doors of traditional Venture Capital firms or professional business angel groups.

And the trend above is clearly tied to how we view things at our company.

At Swiss Finance Partners AG we clearly believe in two things: that Europe is becoming a true hub of global entrepreneurship and that investing in startups is quickly changing, as more players enter the space and new financing vehicles are created and adopted. Here are some of the funding options available today to startup founders, CEOs and also to investors.

The startup funding market is changing rapidly

It's no secret that startups are staying private longer than before. In many technology markets capital is abundant at all stages of financing and private investors (Venture Capitalists, Private Equity funds, etc) are providing the money necessary to keep those companies running before hitting the public markets. Something that was not possible 5 to 10 years ago.

According to CrunchBase, 88 out of the 100 largest and most recent venture capital rounds in the US were issued within the past five years, which shows the amount of capital in the market and its availability to technology companies that deserve it. Although there's no reliable data available for the European market, it's not hard to think that the situation will end up being similar.

There's still a lack of European Venture Capital funds able to back companies raising more than €40-100 million at once, but as more firms join the market and more US-based funds start investing overseas, the situation might shift towards the scenario that is now clearly visible in the US.

This doesn't mean there's no space for alternative funding vehicles

The above is a reality. But it's also true that more and more we're seeing new and alternative vehicles of funding for startups at an early stage. A few years ago most startups would start with capital provided by FFF (Family, fools & friends) and/or business angels who had had previous exits and small VC firms.

However, these days the options available to entrepreneurs are greater.

- Depending on the nature of your startup there are Crowd Funding platforms like Kickstarter or Indiegogo that have attracted the attention of many hardware and creative startups.
- For those that want to give back to investors a portion of their companies there are Equity Crowd Funding platforms, which can be instrumented via different investment platforms such as Seedrs or FundedByMe
- Syndicate Funding: the business model chosen by Startupxplore and also by other startups such as AngelList, which doesn't operate in Europe yet. The idea of a syndicate is to let angel investors syndicate deals with each other, which means that certain angels can lead investments in early stage startups and allow other angels and individual investors to join in.
- P2P lending platforms: credits from banks are fewer than ever before and the traditional banking industry is being disrupted by technology startups. Lately there's been a surge in P2P lending platforms that provide loans to SMEs at lower interest rates than most market conditions, helping investors and startups at the same time.

- For those willing to accept public money there are a lot of local and continental institutions willing to co-invest with VC firms with a good track record, like the European Investment Fund.
- And then there's also new VC firms that have adjusted to the new times we live in and are evolving the traditional way of investing.

Financing alternatives for startups: Boostrapping, Angel Syndicate Funding or Crowd Funding

European startups have a wide variety of financing options, from traditional Venture Capital firms to new alternatives such as syndicates, Crowd Funding or even P2P lending platforms. As we've mentioned in the past, these alternatives are more or less useful depending on the stage a startup finds itself in.

In this Guide we want to focus on three specific financing options:

- **Syndicates,**
- **Crowd Funding**
- **Boostrapping.**

These alternatives are very different from each other, but all three could be of interest to early stage startups.

Bootstrapping: I don't want investors' money

Many entrepreneurs consider fundraising as a milestone, especially at an early stage. Mistakenly, they think that raising money from business angels, accelerators or Venture Capital funds is a must to get started and scale. This is not totally true.

Some startups are able to create a business from day one, making money and having real revenues. These revenues can then be invested in the growth of the company, avoiding having to give a stake of the business to external investors. This is what bootstrapping is all about.

The term bootstrapping was first used in a business context in the US in the 19th century, and it usually refers to starting a self-sustaining company without external input. The technology revolution that we have witnessed in the past few decades has allowed certain startups and companies to boostrap themselves and grow with no external funding.

The advantages are clear to the entrepreneur:

- Full control of the company.
- No stake -small or large- of the company has to be given to investors, which means that founders and employees can have a better sense of ownership.
- Spending is limited by the company's business, avoiding high burn rates that can be encouraged by abundant capital.
- No time is spent on looking for funding, thus being able to devote more time to the business itself.
- Company will be customer-focused from day one.

And there are also some disadvantages:

- Not all kinds of companies can be bootstrapped. Some need large sums of capital to start.
- Founders might use their own money and personal assets to start the business, thus increasing their own personal risk.
- Institutional money can help accelerate growth in ways that boostrapping can't.

It's important to note that the fact that a startup chooses bootstrapping over other financing alternatives at a certain stage doesn't mean they can't change in the long term. GitHub is a clear example of a bootstrapped company that, after a few years of operating independently, raised money from Venture Capital firms to accelerate growth. Other examples of successful bootstrapped companies are for instance : Mailchimp, WooThemes, AppSumo or Basecamp (formerly known as 37 Signals).

Crowd Funding: the power of the masses

At an early stage, Crowd Funding can be an interesting and viable fundraising alternative for startups. When it comes to Crowd Funding, it's worth noting that there are different types:

- Reward-based Crowd Funding: the main examples are platforms such as Kickstarter or Indiegogo. Selected entrepreneurs can pitch their products or services on these sites, offering users the chance of participating in the evolution of those products by providing capital. In exchange, users will get something material in return. No equity is exchanged between backers and entrepreneurs.
- Donation-based Crowd Funding: the same as above but backers don't necessarily need to receive anything in return.
- Equity Crowd Funding: this type of Crowd Funding is significantly different from the rest. Basically, it allows entrepreneurs and startups to pitch their businesses on platforms that will connect them to investors. These investors can then put money in those startups and get equity in return, becoming an alternative to family, fools and friends or even traditional business angels.
- P2P lending platforms: in this case startups can borrow money from investors or individuals that have the necessary resources to provide such capital.

All forms of Crowd Funding have something in common: they rely on the power of the masses -big crowds of investors, users, etc- to finance their operations. Interestingly, in the past few months Crowd Funding has been in the crosshairs of many European legislators who are trying to regulate the industry to "protect investors".

Angel Syndicate Funding: you lead and I back you

Last but not least, there's Syndicate funding. A syndicate is a financing option that allows investors (backers) to co-invest with relevant investors (leaders). The idea is that leaders with notable deal flow and significant know-how of specific industries let backers invest with them in the startups they choose.

The benefits for all parts involved are clear:

- Leaders can invest more money per deal, reaching certain startups that might have higher minimum commitments. They also get paid a carry in return for their 'leadership'.
- Backers have access to deal flow and startups they wouldn't have otherwise.
- Startups get more capital than usual and don't have to deal with numerous and different investors. The leader takes care of the fundraising process and they're responsible for managing its relationship with his or her backers.

Syndicate funding is often done via online platforms that connect startups and investors. US-based Angel List was one of the first companies in the world to do this and for instance Startupxplore is also focused on providing this kind of services to the European ecosystem.

As we havve mentioned, financing alternatives for early stage startups are vast and diverse. Each can be a better or worse fit depending on the nature of the startup and its objectives. In the case of syndicates, we believe its importance will only increase in years to come and we want to be right in the middle of this startup financing revolution.

Key differences between startup Syndicate Funding and equity Crowd Funding

At Swiss Finance Partners AG we are firm believers in the impact that syndicate funding can have in the overall startup investing landscape

Syndicate funding is not the only new way of startup investing to appear over the past few years. Equity Crowd Funding or even P2P lending platforms are also viable ways for startups to raise capital, especially at the early stage.

However, lately we have noticed that some people tend to mix equity Crowd Funding with syndicate funding but we believe that there are significant and relevant differences between both models. In this guide we will try to explain those differences and describe a bit more -and better- how syndicates work.

Syndicate Funding and Equity Crowd Funding: two interesting, but different, beasts

As we have previously discussed, equity Crowd Funding and syndicate funding have emerged as interesting funding alternatives for startups looking to raise capital at the early stage.

Equity Crowd Funding is a form of Crowd Funding that is vastly different from *reward-based Crowd Funding*. Equity Crowd Funding platforms allow startups to create campaigns to showcase themselves to professional investors. These investors, after analyzing the startup's financial information and data, can invest in such companies, getting equity in return or a percentage of future sales, revenue or profit.

Syndicate funding platforms, on the other hand, add value by putting together three elements: a startup, a lead investor and backers.

We have already explained how syndicate funding works, but it's worth highlighting the importance and advantages for these three entities.

- Leaders can invest more money per deal, reaching certain startups that might have higher minimum commitments. They also get paid a carry in return for their leadership, following and help provided to the startup.
- Backers have access to deal flow and startups they wouldn't have otherwise. Plus, they also get to learn from the very best investors in the industry.
- Startups get more capital than usual and don't have to deal with numerous and different investors. The leader takes care of the fundraising process and they're responsible for managing its relationship with his or her backers.

Equity Crowd Funding platforms allow accredited investors -and in some cases and countries, non-accredited investors as well- to invest in startups that the platforms themselves have chosen. Investors can independently decide to invest in the startups and, if a minimum investment size is reached, the deal is closed between the pool of investors, the equity Crowd Funding platform and the startup.

In return investors will get equity in return or a percentage of the startup's future profits, while the platform charges a commission based on the fundraise or future exit.

The main issue we see with this form of investing is that it tries to apply some aspects from reward-based Crowd Funding systems to a field that is vastly different:

- Knowledge: in traditional Crowd Funding backers know the product or service they are backing (via videos, photos, etc). Startups are harder to understand and, in a lot of cases, they're selling their own vision of the future. Valuing that vision of the future with no previous investing experience is hard.
- Time: in reward-based Crowd Funding you wait months, not years, to get a return. However, returns in startup investing are much more different and can take years (in some cases a decade) to happen.
- Risk: in traditional Crowd Funding you commit low sums of money in something that's somewhat tangible, thus lowering risk levels. In equity Crowd Funding investors usually commit more capital with very low success rates but potentially very high rewards (one or two out of every ten investments might provide a return, if that).

At Swiss Finance Partners AG we have analyzed all of the above and we firmly believe that syndicate funding -by following a co-investment model where there's a lead investor- helps diminish investment risks.

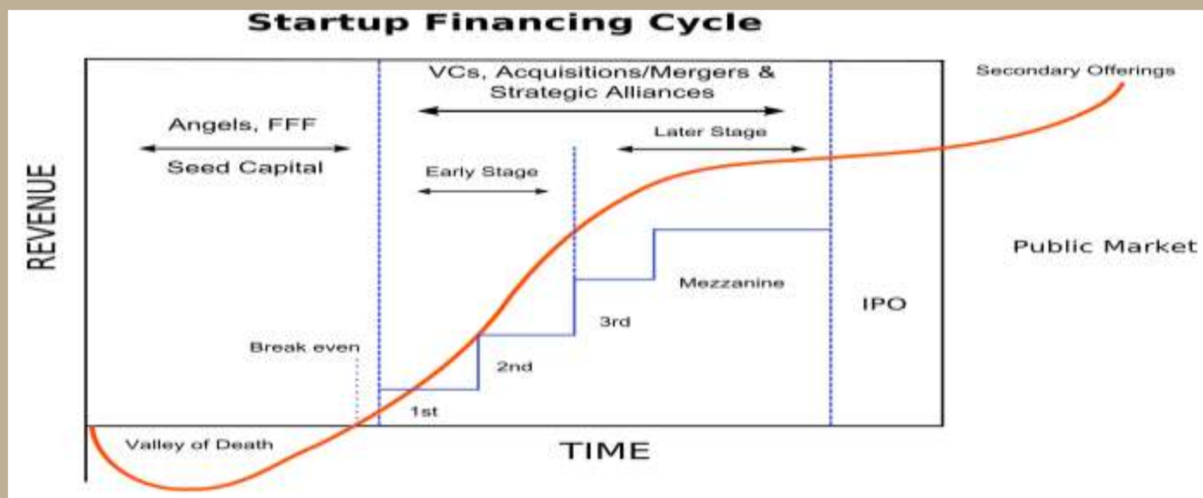
Why? Because backers are investing with the help of a lead investor that understands and knows much better the market and the startup than the average person. In addition, this lead investor tends to have access to better investment opportunities (deal flow).

On top of that, syndicate funding platforms also offer the opportunity of following the investment and the startup.

It's important to note that with this post we're not trying to claim that no startup or investor should fundraise via equity Crowd Funding platforms. But we think there are significant differences between both systems and we wanted to highlight them.

If you're still interested in knowing more about syndicate funding, here are a few interesting and relevant links:

- Financing options for startups looking for funding in Europe.
- Understanding differences in startup financing stages.
- Financing alternatives for startups: Boostrapping, Angel Syndicate Funding or Crowd Funding.



Understanding differences in startup financing stages

The startup funding landscape has changed significantly over the past few years in Europe. While five to ten years ago the options available to startups were few, lately we've witnessed an important surge in Venture Capital available for startups at all stages. From seed to growth, from Series A to Series C.

This increase in capital has been accompanied by the creation and development of alternative financing vehicles such as Crowd Funding, investment syndicates and new and fresh Venture Capital firms that bring different approaches to the market. With this post we'll analyze what types of fundraising vehicles are being used at the different stages of a startup's life.

Startup financing at the early stage

Pre-seed capital

You have an idea, maybe a working prototype and are looking for funding that will allow you to focus on your project full time. Pre-seed capital tends to cover the first stage in the life of a startup and is often compromised of three main sources of financing:

FFF (Fools, friends and family): the three classical Fs that we use have explained and provided with their very own FFF profile.

Business angels: previous startup founders who have had exits and decide to invest the money in other startups (or their own) or investors that despite not having a tech-related background decide to back companies in the space, given their potential growth and current market situation. Contrary to Venture Capital firms, business angels often invest their own money and at one of the most riskiest stages for startups, thus their importance in every single startup market.

Accelerators: five years ago there were barely any startup accelerator programs in Europe (with the exception of Seedcamp and a few others), but these days there's an accelerator in every single big European city. These organizations provide capital, mentorship and office space to teams in exchange for 5 to 10% of equity. TechStars, Startup Sauna, Plug and Play Valencia / Berlin, SeedRocket or the aforementioned Seedcamp are some of the most popular European accelerators.

Seed capital

Seed capital can be described as the capital necessary to start a company and to try to find product-market fit. European seed rounds range from €250K to €750K or €1 million. The main providers of capital at these stage are business angels, super angels and early stage Venture Capital firms. However, in recent years more players have joined the game in Europe and are, in theory, improving the ecosystem.

Crowd Funding: there are two types of Crowd Funding that are closely tied to startup investing. For hardware startups and creative projects there's what's often called 'Eeward-based Crowd Funding', where sites like Kickstarter and Indiegogo are global leaders. Users can back the projects they like and get something material in return (physical or digital products and services), receiving no equity from the teams or companies providing such goods.

The other kind of crowdfunding that's relevant for startups is Equity Crowd Funding. As the name indicates, in this instance backers (investors) of the companies get equity in return, thus becoming shareholders of the companies and being able to participate in the future returns the startups might be able to provide to investors. This type of investing is often carried by platforms that serve as aggregators, choosing startups and

inviting backers to invest in them through the platform, which get to charge a fee per deal closed.

There are a wide variety of equity Crowd Funding platforms in Europe, but the most popular are Seedrs, Companisto and FundedByMe. It's interesting to highlight that equity crowdfunding regulation varies from country to country within Europe, which can be a hurdle for investors and startups interested in raising money this way.

Syndicate investing: the idea of a syndicate is to let angel investors syndicate deals with each other. This means that angels with good track records can lead investments in early stage startups and allow other angels to co-invest, providing additional capital to the financing rounds. The advantage for the three parts involved are simple to understand:

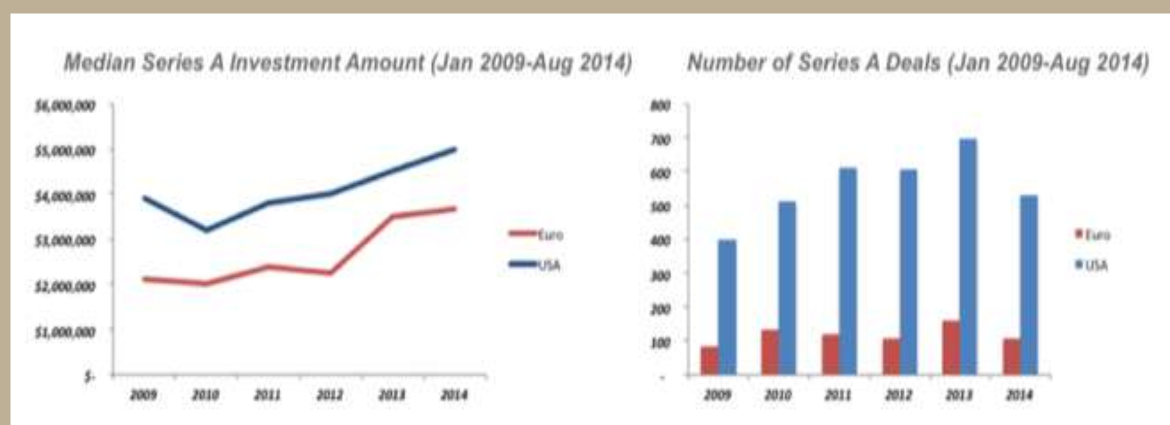
- Lead angel investors get to choose the startups they want to invest in and don't have to face the burden of providing all the capital.
- Angels that join in don't have to select the startups if they trust the criteria of the lead angel investors.
- Startups can get more money than usual, faster.

Angel syndicate platforms such as Startupxplore and AngelList charge a fee per deal closed and create platforms where startup investors and companies can meet each other.

Startup financing at the growth stage

Series A

Startups that get to this stage have usually figured out their product, the size of the market and need capital to scale, improve distribution systems or establish a business model if they don't have one yet.



Typical European Series A rounds range from €2 to €5 million, according to a report from Stephen Piron, and are led by traditional Venture Capital firms that end up owning between 15 and 30% of the invested startups. Series A and previous stages are the riskier for investors, given the doubts surrounding the startups, their products and their teams.

Although it might seem that Series A deals in Europe are abundant, it's worth mentioning that "only 6% of European companies managed to secure an A round" since 2009.

Series B

As Elad Gil explains in his blog post about startup financing, Series B are "all about scaling". Successful startups at this stage tend to have an established user base and a business model that is working.

Series B in Europe usually start at €6 million and can be as high as €8 to €10 million. As highlighted in the aforementioned report, "Series B deals in Europe remained flat from 2009 to 2014 while they grew 37% in the US". In other words, Series B deals are not as common in Europe as in the US and tend to be led or include the participation of US-based VC firms.

Series C and following rounds

When companies reach this stage they're fully mature. Business model is working - whether the company is profitable or not-, user base is expanding and acquisitions might be in the crosshairs of the executives leading these companies.

Financing rounds at these stages tend to range from tens to hundred of millions. A clear difference between Series C and other rounds, besides the amount being invested, is that at this point private equity firms and investment banks tend to be the lead investors, with the participation of large Venture Capital firms. From this stage on the outcome tends to be an IPO or to get acquired by a much bigger company.

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