TEN
CAPITAL GROUP

eGuide

HOW TO USE CROWDFUNDING IN YOUR FUNDRAISE

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PART I: Mastering the Basics Before the Crowdfund

Standard of Practice for Entrepreneurs Seeking Funding

For those who seek funding here are some best practices to consider during your efforts:

Develop a relationship with investors early on.

Make sure you talk with investors and start developing relationships now. By building a relationship now and keeping the investor informed of your progress, the entrepreneur will be in a better position when it comes time to raise the funding.

Have ready the executive summary, slide deck, and business plan with financials.

Have the core documents – executive summary (one-page only), slide deck, and business fully developed. As the entrepreneur meets prospective investors, he can use the relevant docs for each meeting.

Publish a periodical email newsletter for interested investors.

If possible, send weekly emails to show progress in sales, product plans, and other milestones. This shows the company's ability to execute.

Find a lead angel to develop a terms sheet and start the funding round.

By finding a lead angel and creating a terms sheet, the entrepreneur removes the most significant barrier to fundraising – the negotiation process.

Make the deal terms "investor friendly."

Every deal must be negotiated. By making the terms “investor friendly” through reasonable pre-money valuations, preferences, and other terms, the faster the process goes.

Push all due diligence docs to a password-protected, so interested angels can perform due diligence more easily.

The due diligence phase can be sped up by having all the critical docs already available in one, accessible, place. This knocks down the hurdle of trying to send 600 MB worth of documents through the email system which is time-consuming.

Continue the quarterly email newsletter after funding, so investors stay with you.

Keep investors up to date even after the funds are raised since investors can help in other ways. Some investors bring a Rolodex of contacts while others bring experience and coaching. By keeping them informed of your progress and challenges, they may be able to help. This practice is also useful for when it comes time for follow-on fundraising.

Look Beyond Local Funding

There's an ongoing dialog between entrepreneurs and investors about the lack of funding in Texas. Entrepreneurs feel that funding is scarce in Texas compared to other parts of the country. However, investors counter that they would invest more often if the deals were better prepared.

The solution is to change the way fundraising is handled and **expand your search**. Ideally, there should be a national focus on your fundraise from day one.

The world of angel investing is going vertical. The chance that an angel investor interested in your business being local is shrinking. To reach an investor interested in your type of deal it's important to look **nationwide**.

Crowdfunding is how you do that. Angels investors can now find you'll be able to reach angel investors from a broader area.

It's helpful to have some support from your local area, but from day one entrepreneurs should have a national perspective on their fundraise.

Network to Attract Your Angels

Across the board, angel groups are seeing a resurgence in membership and deal flow. Indeed, the Central Texas Angel Network is witnessing a surge in membership and deals the need to network to find funding ever-growing.

Keep in mind, each angel group has its own unique characteristics. For example, Dallas is focused on retail, Houston on energy and biotech with a leaning toward **“old money”** and Austin leans towards more eclectic deals with risk.

Each angel group has its personality and should be taken into account when looking for funding. An angel should bring more than just dollars to the table; it should also bring contacts and expertise as well.

In submitting deals to the Central Texas Angel Network, we look for investment by the founder – to ensure **“skin in the game.”** On software deals, we also look for market validation. It’s hard to talk about business models when you don’t have any customers. There has to be some vetting of the business model to get traction with investors. The costs of acquiring/supporting a customer as well as the revenue from that customer are necessary to know before seeking an angel.

Most angel groups seek deals that are raising at least $200K. We rarely see deals like this. Most are seeking at least $500K. The audience asked about **“baby angels”** in so far as are there people who will invest in deals that are lifestyle businesses? While there are not official groups for this type of investor, there are individuals who like these deals. It’s all about networking and always be ready to answer these five questions when meeting potential investors:

1. **What is your value proposition?**

   Points out what your company provides and why people want it.

2. **Will customers pay for the solution?**

   investors want to know if customers will pay for your solution.

3. Who is on the team?

For many investors, the final decision comes down to believing in the team.

4. Why is now the right time?

Let investors know why now is the right time to start your business.

5. What is your exit?

Investors what to know how they will get their money back.

Networking and the Investor Journey

Most investors are found through the networking process, and even more importantly those relationships are nurtured through good networking practices.

Before you fundraise, you should begin the networking process. When you identify an investor be sure to keep them informed of your progress. As you make progress send out a short email (monthly or quarterly) with an update of accomplishments and goals.

The key to networking is making contact and keeping those contacts with you on the journey.

Speaking of the journey, here are some key characteristics of a lead investor that should be on this journey with you:

- ☐ **Provides a substantial sum of capital of at least $100K.**
- ☐ **Provides advice based on their experience in the industry. They should be expert problem solvers.**
- ☐ **Is your leading advocate. By going first, he's putting his reputation on the line.**
- ☐ **They bring a strong reputation that attracts others to your deal.**
- ☐ **Performs the initial due diligence. Al investors should be performing their own due diligence, but most will use the lead investor's work as the basis for their decision.**

Raise Funding at Every Stage

Crowdfunding can be used to raise funding throughout the life of a business. When the idea of a new business strikes, and there's nothing built yet, run a donations campaign. Ask family and friends to donate $10K collectively without payment. The value of this step is that it establishes a network to support your business.

The next step is to use a Rewards/Prepay campaign to pre-sell 50 units of your product. The goal is to start building your customer network and if you can't presell 50 units, then you have a product problem that needs to be solved before progressing. The funding you raise should be enough to build the first version of your product.

With a successful rewards campaign in place, you can move towards turning those customers into investors using the Texas Intrastate crowdfunding campaign since Texas Intrastate law gives anyone the ability to invest in your business. Keep in mind, while funding helps, building your network is the vital point in this process. If all 50 of your Prepay customers invested in your company, you now have 50 brand ambassadors supporting your business which is not trivial support by any means.

With support from your customers, and now investors in your business, you can approach angel investors and start to raise funding to grow the business. Angels typically invest $250 to $2M to build a working operation. When you approach at the angel investors, they are expecting you to have a product at some stage of usage in addition to revenue. The previous steps give you the ability to do that.

If you find yourself having trouble raising funding, it may mean that you skipped some key steps. You should go back and fill in the gaps of building your support network and your customer base before proceeding.

Why Startups Fail

The most common reason why startups fail to raise funding is that they don't budget the time or financial resources to do it. The four components of a startup are product, team, customers, and funding. Startups budget time and money for the first three, but many miss the fourth one: funding.

Fundraising typically doesn't require many financial resources up front, but it does take some. For example, pitching to angel groups requires application fees. While the cost is not great, a budget of zero dollars makes it harder.

The primary cost of raising funding is time. It's a nearly full-time job for three to six months in many cases. Closing investors are not unlike closing a customer and it takes several interactions. For a new company with a new product, it is seldom one visit and you're done because you have to go back and show how the product is improving. Getting the first customer is the hardest, and as you gain more users, it does get easier. The same is true with investing from investors.

So, if you're starting to raise funding, review your time and financial budget and make sure you are prepared for it.

PART II: Understanding the Pitch

5 Things Investors Love to hear in a Pitch

Investors hear pitches continually throughout the year. There are so many that one's eyes can glaze over. From time to time, an entrepreneur will make a pitch and the investor's eyes light up. It's because investors are listening for a few key things that show you have a real business with real growth. The rest is filler. Every entrepreneur has a story— many are interesting, some are not. But for investing purposes, there have to be **5 key elements** to capture their interest. Here they are:

1. **Real traction—** entrepreneurs who have sales and show it are head and shoulders above the rest. Most talk about the traction they will have in the FUTURE but not what they have today. In an investors mind, this equates to "No Traction".

2. **Real pain point—** the entrepreneur has found a real pain point in the market and is filling it. Someone once said customers pay for the pain to go away— they don't pay for nuisances or inconveniences.

3. **Real team—** they have someone building it and someone selling it, and those team members know what they are doing.

4. **Real product—** the product works and is non-trivial to build. It's more than just spin marketing.

5. **Real growth prospects—** the market opportunity has strong growth potential and is not going to run out of steam in a year or two.

Those are the elements that light up the investor room if you really have it.

The Online Pitch

Increasingly investor communication is going online. Your initial pitch will most likely come through an email, so it's essential to be effective in pitching investors this way. Most email is now read on a mobile device, so it has to pique his interest before he jumps to the next one. Here are some tips on crafting an effective pitch online:

1. Investors will always look at the subject line so make good use of it by giving a description of the topic such as, **"Introducing StartupX to Greyline Capital."**

2. Address the email to the **individual investor** (Jim, Bob, Mary, etc.) and not the generic (Investor, All, To Whom it May Concern).

3. Show a network connection to the investor such as, **"Our CFO worked at one of your portfolio company— Hotspot App before joining StartupX."**

4. Get to the point of what you do and say it in five to seven words or less, **"We make cybersecurity tools for retail businesses."**

5. Then explain how this is a real business and not just an idea, **"Our core platform is installed in 300 sites and growing by 20 sites per month."**

6. Close with the team**, "Our team has experience from Intel, Microsoft, Google, and the Cyber intelligence arm of the US government."**

7. Finally, close with the ask, **"We're raising $500K to expand the product into the market and would like to give you more details over a coffee next week."**

The more numbers you use to describe the business and the market, the stronger the impact of the presentation. The overall email should be no more than 75 to 100 words. Anything longer will most likely go unread.

PART III: The Keys to Crowdfunding

Crowdfunding Campaigns: The Criteria for Loans in the Future

A crowdfunding campaign can tell one a great deal about a startup or growth company. If a campaign has a clearly defined product, a demand from the market, and funding from backers, then it's probably a strong company. On the other hand, if the campaign doesn't receive any interest from backers, then it's probably going to have a hard time making it in the market.

In fact, lenders could use the results of a crowdfunding campaign to determine if the startup should receive a loan or not. A campaign clearly outlines the core product/service. Market demand can be determined by the fundraise trajectory— how much and how fast the raise take place. Finally, did the startup deliver on their promise from the campaign? The last one determines if the company can execute on a project.

As the business world moves transactions to performance-based models, this is another example of “**prove to me you can do it and then I'll do my part."** In working with investors, I found they over-weigh what they see entrepreneurs do while on their watch and under-weigh whatever the entrepreneur did previously. In the same vein, lenders are trying to determine what the startup can do currently and running a crowdfunding campaign while on their watch is a great way to assess the ability to payback rather than historical credit reports.

Crowdfunding Strategy: Break it Down into a Series of Communities and Campaigns

I talk to entrepreneurs all day about raising funding. I notice that when I ask how much they are raising, they give me their ultimate raise figure. It's the amount they plan to raise over the entire life of the company. Moreover, then they grow frustrated because it seems like an insurmountable number. That's because they think they have to raise it all at once. It's best to break the raise down into multiple campaigns.

With the emergence of crowdfunding, there are now more tools to use for raising funding. These tools include donations, rewards, equity, and more. Each tool takes a different approach to raise funding and leveraging a different community. The **donations** portion focuses on family and friends who will give you funding to help you start. The **rewards** concentrate on customers who want the product. **Equity** focuses on investors who wish to ownership. By leveraging all three one can stair-step their way up the fundraise ladder.

Most crowdfunding campaigns run 30 to 90 days long. After that backers and investors grow tired of seeing the deal and look elsewhere, so it's best to set a goal that can be accomplished in that timeframe. With money raised at each stage, the entrepreneur can go work on the business and move it to the next level and then start another campaign.

2 Key Elements of a Crowdlending Campaign

The key to success is having a compelling presentation and getting the word out to as many people as possible.

Let's start with the presentation. You need to provide a simple, well-organized explanation of your business. The elements that are requested are things you already know– what your business is, how you would use the proceeds of the offering, simple financial information, the people behind your business, and the risks related to the business and the offering. Your potential investors need to know it too, so they can make an educated choice on whether to invest or not invest in your loan.

Securities laws require certain kind of information as well, since mostly what you are doing is issuing **"mini securities"** under the Texas intrastate crowdfunding exemption. All this can get somewhat confusing, but an excellent crowdlending platform should provide you with organized and straightforward instructions.

The second step is to get as many people as possible to take a look at your project. This would be a time-consuming task if you had to make the presentation personally.

But, you don't have to make it personally.

All you need to do is to interest people in taking a look at your project online. Use personal contacts, email lists, daily customer contacts, social media, whatever means will get the simple message to as many people as possible:

> *"You know me and my business. I am raising money to expand. I am conducting an offering at **[Your URL]**."*

Crowdlending vs. Crowdfunding for Small Businesses

Crowdfunding may be useful to get a business concept started, but **Crowdlending** is better for growing it. Crowdlending will help you raise more money faster, once the market demand is established and the business model is proven.

Why?

Simply put, Crowdlending helps you get a loan, not a gift. You pay back the money with interest, rather than provide rewards to supporters.

Let's take Jenny for example:

A few years ago, Jenny was the first to offer Italian style espresso in her community. She put down three months of rent on a tiny space and funded the purchase of a second-hand espresso machine by offering free coffee, cookies, and T-shirts in exchange for donations from the first espresso enthusiasts.

Jenney's Coffee Shag was a success. The line in the mornings grew ever longer.

Jenny decided to expand into Jenny's Coffee Shop. However, how much more cookies and coffee can anyone eat and drink?

Jenney launches a Crowdlending campaign instead. She offers to borrow the money, promising to repay it on a schedule and with interest. Now, her friends and customers can help her out and earn interest on their capital, as well as enjoy a shorter line for their morning espresso. It is a **win-win** for everyone.

Where can you crowdfund a loan in Texas?

You have to set up your crowdfunding campaign on a Texas registered crowdfunding portal. There are currently only two registered portals that specialize in debt, and they are entirely different: Lendoor and NextSeed. The first facilitates term loans, and the latter does revenue sharing loans.

Lendoor Explains Bank Loan vs. Crowdfunded Loan

Both loans will get you the funds to grow your business, but the process of securing those funds is very different. The resulting obligation would likely be very different too.

Different Process

For a bank loan expect to spend most of your time on paperwork and collecting documentation, then waiting for a response. Your credit score would almost certainly be checked. For a crowdfunded loan, most of your effort will go into finding the people that will invest in your loan. You would have to spend time preparing your campaign as well. Your credit score will not be checked since your friends and family would be the judge of your creditworthiness, not a credit algorithm.

Different Obligation

A bank loan is typically secured by assets of the company, or by personal assets. It is almost always personally guaranteed by the business owner. A crowdfunded loan is unsecured and without quarantine by the owner. If you can crowdfund a loan, your company will have better financial flexibility.

Loans for Start-Ups?

Banks don't usually lend to startups, especially if you don't have personal or business asset to offer as collateral. If you have a solid business idea and people that believe in you, you could raise the money for your startup even if your only assets are your business plan and your reputation.

Crowdfunded Loans with Benefits

There could be many additional benefits that come with a crowdfunded loan:

- ☐ **Customer loyalty.** Your customers could be literally "invested" in your business' success.

- ☐ **“Word of mouth” advertising.** Investors are naturally great advocates for business.
- ☐ **Buzz factor.** A crowdfunding campaign may increase visibility and create buzz about your company in your community.

Key Points Angel Groups Can Learn from Crowdfunding

Crowdfunding teaches us to place the deal in a mailer and send it out to the investors so when they open it up, the deal is staring them in the face with only a few choices such as **"Invest"** or **"Pass."**

In today's work world, if you don't make it easy for users to interact with your system, they will bail out on you and your program.

The traditional angel world sees the angel meeting as the core of the program. People coming together is how investors and entrepreneurs exchange information.

In crowdfunding, the web portal is the core of the program and is where people come together to find deals, share information, and interact with each other. In most crowdfunding deals, the investor ultimately wants to meet with the team, and that's the benefit of the angel group process.

Combining the angel group's face-to-face format and camaraderie with the efficiency of online funding tools for screening, monitoring, and closing the deal makes for a strong partnership.

Angel groups can improve their process by drawing technologies and formats from crowdfunding as they move into an online world.

Screening

This needs to shift online and in particular to well-formatted mailers through which members can view and vote on deals.

Presentation

This part can be done in person and provides the high touch interaction which is always vital to closing the deal.

Monitoring

This is another crucial step where crowdfunding can help the current angel group process.

Due Diligence

The online tools for researching the deals increases every day. Online databases, comparisons to competitors and other tools are available to help investors decide which deals to pursue.

Closing

Most angel deals are still papered the traditional way with hard copy papers. Crowdfunding brings online tools for completing the transaction without having to sign physical documents but rather using electronic signatures instead.

Deal Syndication

This gives the angel group the ability to take a funded deal and pass it to another group or "crowd" of investors. A strong syndication network raises the value of the angel group as it can bring more dollars to the table and thus attract better deals.

Crowdfunding brings online tools that make the angel funding process more efficient and effective. It can save the angel investors time as well as manage the increasing deal flow.

About TEN Capital

TEN Capital Group provides funding as a service to companies anywhere raising venture capital. Its network of over 5000 accredited investors represents venture capital, angels, family offices, and high networth individuals.

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