TOPIC 6. How to finance my Entrepreneurial or Self-Employment Project

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Introduction

Access to finance is a key driver in the creation, survival and growth of innovative new ventures. Lack of finance typically prevents new ventures from investing in innovative projects, improving their productivity, financing their growth, covering working capital requirement and meeting market demand.

The importance of different types of finance varies across the stages of business development. During the seed and start-up stages, technology-driven high-growth SMEs can obtain equity financing from entrepreneurs or from family and friends. In earlier stages, self-financing is particularly important since innovative entrepreneurs cannot overcome information asymmetry and therefore rarely find any lender or investors, even for potentially profitable projects. Subsequently, financing may be supplemented by seed capital investment from informal private investors (e.g. business angels) and, in a few cases, by seed financing funds and venture capitalists. In the expansion stage, SMEs generally require increasing amounts of equity to maintain R&D and to expand marketing and sales activities, amounts that are typically only available through other sources, such as initial public offerings on stock exchanges.

In this topic you can find information regarding financing a new entrepreneurial idea, both in the traditional way and using alternative sources, basic ideas to have in mind while looking for the right financing and some instruments you can use, as well as information on where you can get support during your quest for the right financing plan.

This topic aims to help you in getting an idea on where and how you can seek financing and who can help you when you have decided to put your business ideas in motion.

What are you going to find here?

- Text Materials; PDF
- Presentation; ppt
- Practical Activities

Crowdlending and Crowdfunding. What are they and how they work?

What is Crowdfunding and how they work?[1][2]

Until recently, financing a business involved asking a few people for big sums of money. Crowdfunding is turning this idea on its head, using the internet to help entrepreneurs talk to thousands – if not millions – of potential funders that each contributes a small amount.

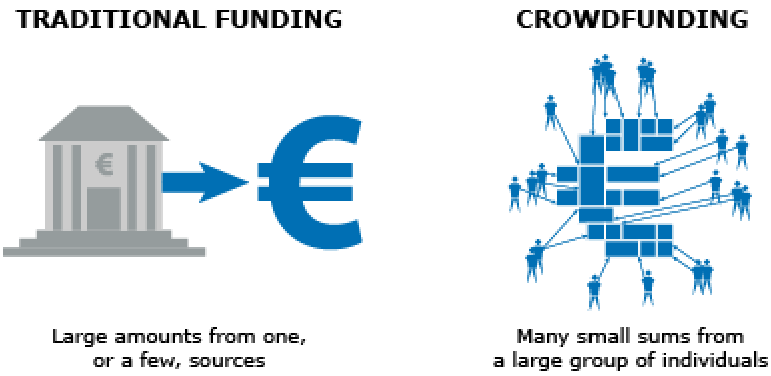
The idea is the latest in funding innovations. It means small business owners that are being turned down by High Street banks now have an opportunity to appeal directly to small investors. Equally, whereas investing in small businesses was previously the domain of the very rich, this new concept means anyone can reap the benefits of investing in fledgling start-ups.

Companies requiring huge amounts of start-up capital may continue to be funded in more traditional ways - venture capitalists, for example, are likely to carry on plugging the funding gap.

However, in the immediate term, crowdfunding is poised to alter the entrepreneurial ecosystem significantly - just like angel investing, venture capital, and private equity before it.

According to European Commission's Guide on *Crowdfunding "Crowdfunding is a way of raising money to finance projects and businesses. It enables fundraisers to* ***collect money from a large number of people via online platforms****."*

[1] http://www.thisismoney.co.uk/money/smallbusiness/article-2333399/Crowdfunding-does-work.html
[2] https://ec.europa.eu/growth/tools-databases/crowdfunding-guide/what-is/explained_en



Crowdfunding is most often used by startup companies or growing businesses as a way of accessing alternative funds. It is an innovative way of sourcing funding for new projects, businesses or ideas.

It can also be a way of cultivating a community around your offering. By using the power of the online community, you can also gain **useful market insights and access to new customers.**

How does crowdfunding work?

Crowdfunding platforms are websites that enable interaction between fundraisers and the crowd. Financial pledges can be made and collected through the crowdfunding platform.

Fundraisers are usually charged a fee by crowdfunding platforms if the fundraising campaign has been successful. In return, **crowdfunding platforms are expected to provide a secure and easy to use service.**

Many platforms operate an all-or-nothing funding model. This means that if you reach your target you get the money and if you don’t, everybody gets their money back – no hard feelings and no financial loss.

There are a number of crowdfunding types which are explained below. This Topicprovides unbiased advice to help you understand the three most common types of crowdfunding used by profit-making SMEs and startups: **peer-to-peer, equity and rewards crowdfunding.**

Main types of crowdfunding

Peer-to-peer lending; The crowd lends money to a company with the understanding that the money will be repaid with interest. It is very similar to traditional borrowing from a bank, except that you borrow from lots of investors.

Equity crowdfunding; Sale of a stake in a business to a number of investors in return for investment. The idea is similar to how common stock is bought or sold on a stock exchange, or to a venture capital.

Rewards-based crowdfunding; Individuals donate to a project or business with expectations of receiving in return a non-financial reward, such as goods or services, at a later stage in exchange of their contribution.

Donation-based crowdfunding; Individuals donate small amounts to meet the larger funding aim of a specific charitable project while receiving no financial or material return.

Profit-sharing / revenue-sharing; Businesses can share future profits or revenues with the crowd in return for funding now.

Debt-securities crowdfunding; Individuals invest in a debt security issued by the company, such as a bond.

Hybrid models; Offer businesses the opportunity to combine elements of more than one crowdfunding type.

Crowdfunding is a fairly new sector that is still developing. While it is an exciting prospect for many - and gives small businesses access to funding opportunities like never before - it can be a confusing arena for most people because it is presented in such a wide spectrum of ways.

Investments or donations are usually made through online platforms, which then coordinate and administer the fundraising.

Projects will range from those helping to finance community-based projects for no financial return (but a fuzzy, warm feeling inside), to sophisticated portfolio-picking, purely for monetary gain

What is Crowdlending and how they work?[3]

Crowdlending is a way of connecting individuals (the crowd) who have funds ready to invest with businesses wishing to borrow money through a web based auction platform. A business will apply for a loan offering competitive business finance where, if successful, it will go to one of our seven-day auctions. Our lending community will lend directly to the business with each loan being made up of several loan parts all owned by individual investors.

Crowdlending is sometimes called P2P, P2P Lending, Marketplace Lending or P2P Loans. Despite the different names the meaning is the same – crowdlending is where private individuals or institutions lend to projects that require funding, without any bank involvement. In exchange, they receive a return on their investment, hence the name P2P, which means peer-to-peer.

Crowdlending should not to be confused with crowdfunding, which is mainly concerned withraising equity for start-ups. In contrast crowdlending is geared towards established small and medium-sized businesses (SMEs) and is debt-based, not equity-based. This means SMEs don’t have to give up a share of their business to finance growth and can bypass the banks, which have become more reluctant to lend to smaller companies since the global financial crisis.

Crowdlending platforms like MytripleA, bring together private individuals looking to make a profit and companies seeking finance, through an online marketplace. Despite the huge success of these platforms there is lots of misunderstanding surrounding P2P Lending.

[3]https://www.fundingknight.com/news/weekly-digest-week-24/

Crowdlending and Crowdfunding Platforms at EU and National Level[4]

Here you can check out some Crowdlending and Crowdfunding Platforms from several EU countries:

Austria; Respekt.net; Conda.eu; 1000x1000.at; Greenrocket.com

Spain; Verkami and Lanzanos; Goteo; Libros.com

Greece; JumpStart Greece; GIVE & FUND

Slovenia; Gremo na Kickstarter!

Bulgaria; Kickstarter; Indiegogo; Look&Fin

International platforms; Kickstarter; Indiegogo; Look&Fin

Guidelines to get good financing conditions

Most businesses in Europe rely on bank loans for their external financing. Borrowing can be difficult for small and medium-sized enterprises (SMEs) however, particularly if they lack collateral or if they do not have a long enough track record or credit history. Between 400,000 and 700,000 SMEs are unable to obtain a loan from the formal financial system[5].

If you are looking to get bank financing, there are a few things you should keep in mind for getting good financing conditions[6]:

1. When applying for a business loan, it's essential to prepare a detailed business plan and fully inform the lender about your proposed venture. This information helps the lender to provide you with the right type of finance and advice.

2. Deciding that your business needs a loan is only the first step. There are a number of things to consider before you approach a lender:

[4] https://www.sbs.ox.ac.uk/sites/default/files/Entrepreneurship_Centre/Docs/OxEPR2/current-state-crowdfunding-europe-2016.pdf
[5] https://ec.europa.eu/growth/access-to-finance/funding-policies/loans-guarantees_en
[6] http://www.business.vic.gov.au/money-profit-and-accounting/raising-funds-for-your-business/small-business-and-commercial-loans

- how much do you need to borrow?
- what type of loan will you need?
- how long will you need it for?
- can the business afford to repay the loan, interest and any one-off or ongoing fees that come with the loan
- what security can you offer the lender and how this affects the interest rate offered.

3. If you need to access the funds on a semi regular basis to help with cash flow to keep the business operating while waiting for your customers to pay for goods, 'at call' loans such as an overdraft or line of credit are designed for this purpose. However, if you need the funds to buy a new business or equipment to expand your existing business you will need the funds 'upfront'. This is also known as a ‘fully drawn advance’ and provides you with the entire loan amount all at once.

4. Loans provided upfront will need a portion of the loan plus interest paid back at regular intervals. The repayment amount will depend on the term or length of the loan. To determine the loan term suitable for your business you will need to calculate how much you can afford to service the loan. Be aware that the longer the loan term the more total interest you will pay. Loans that are at call have no fixed terms.

5. There can be fees which can make a loan less attractive than it first seems. These include one-off fees such as establishment/application fees, exit/discharge fees and early termination fees or regular fees such as service fees or line/credit advance fees. The Business Loan Finder tool includes the cost of set-up and ongoing fees in the average monthly repayment to give you a better idea of the true cost of the loan.

6. Lenders will ask for a lot of in-depth information about the financial history of the business. It's also important for you to create a convincing and detailed business plan which should include a profit and loss budget and cash flow forecast. The information you use to build your business plan may also be needed by the lender to assess your

project. This includes both the past and future plans for your business, the people working in it and the market itself.

The outcome of your application is strongly influenced by how well your proposal is researched and how well it is presented.

Other sources where I can find financing opportunities.

Startups usually don't have just one source of funding for their small business. Typically, they rely on a patchwork of financing tools to get their businesses off the ground. Some of these financing tools are the following:

The traditional ones

- Bank loan
- Friends and family

New financing tools

- Venture capital
- Business angels
- Seed capital
- Crowdfunding
- EU, National o Regional financing projects

Let's see these new financing tools in a glance:

Venture capital[7]

Venture capital is the term used when investors buy part of a company. A venture capitalist places money in a company that is high risk and has the possibility of high growth. The investment is usually for a period of five to seven years, after which, the investor will expect a return on his money either by the sale of the company or by

[7] TANEO S.A., New Economy Development Fund S.A.

offering to sell shares in the company to the public. There are three different types of venture capital investment: early stage, expansion, and acquisition financing. When investing venture capital, the investor may want receive a percentage of the company's equity and may also wish to have a position on the director's board. An investor who agrees to place capital in a company is looking to make a healthy return, so he can demand repayment by the sale of the company, asking for his funds back or renegotiating the original deal.

Business angels

An **angel investor** (also known as a **business angel**, **informal investor**, **angel funder**, **private investor**, or **seed investor**) is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. A small but increasing number of angel investors invest online through equity crowdfunding or organize themselves into **angel groups** or **angel networks** to share research and pool their investment capital, as well as to provide advice to their portfolio companies.[8][9]

Angels typically invest their own funds, unlike venture capitalists who manage the pooled money of others in a professionally managed fund.[10]

Seed capital

Seed capital lives up its namesake in the sense that it's the capital needed to "seed" a business. Seed funding may come from various sources such as family members, friends, banks, or angel investors. More often than not, this is the very first source of funding that an entrepreneur receives for his or her idea. Therefore, it's a critical element in launching a successful startup business. The main differences between seed capital and venture capital are the size of the company and the size of the financing: seed capital is usually for small businesses and ranges in the tens of thousands to

[8] "A Guide to Angel Investors".Entrepreneur.
[9] "National Venture Capital Association".Nvca.org. 2012-11-20.Retrieved 2012-12-01.
[10] Joe Hadzima. "All Financing Sources Are Not Equal". Boston Business Journal.

hundreds of thousands, while venture capital is required for larger businesses and often range into millions.

Crowdfunding

We have already described how crowdfunding works in previous chapter.

EU, National of Regional financing projects

You can find specific Funding Programmes managed by public bodies that support the creation of companies, development of innovative projects or simply support first stages of self-employment or entrepeneurship. Please, go to your own local contact point and ask for them.

Chambers of Commerce are usually a very good support in this field.Your local Chamber of Commerce can provide with valuable information regarding financing projects or other sources of financing for a new enterprise

Complementary reading

Crowdlending and Financial Inclusion Evidence from EU Countries

http://www.unwe.bg/uploads/Alternatives/I_B_2016_Issue4_en-3.pdf

Crowfunding_European Commission

https://ec.europa.eu/info/business-economy-euro/growth-and-investment/financing-investment/crowdfunding_en

Commission proposal for a regulation on European crowdfunding services providers

https://ec.europa.eu/info/publications/180308-proposal-crowdfunding_en

Top 15 Crowdfunding Platforms in Europe

https://crowdsourcingweek.com/blog/top-15-crowdfunding-platforms-in-europe/

Study cases

Crowdfunding guide - case study "Isabella's Pastry Shop"[11]

Building solar power into bags

[11] http://ec.europa.eu/DocsRoom/documents/8982/attachments/1/translations

Videos

How to get EU finance

https://www.youtube.com/watch?v=N_24hdG8Z20

Venture capital explained

https://www.youtube.com/watch?v=4UostF_73po

What is Crowdfunding? CrowdFunding planning? What, How, Why and when

https://www.youtube.com/watch?v=8b5-iEnW70k

Επιμελητήριο Αρκαδίας

COORDINA Organización de Empresas y Recursos Humanos, S.L.

CPU - Gospodarska zbornica Slovenije Center za poslovno usposabljanje

FORBA - Forschungs- und Beratungsstelle Arbeitswelt

RCCI - Ruse Chamber of Commerce and Industry

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