# WHAT IS RAISING CAPITAL?

Written by Cameron Irby

Scalar

# TABLE OF CONTENTS

Raising capital is when an investor or a lender gives a business funds to assist with starting, growing, and managing day-to-day operations.

Some entrepreneurs consider raising capital to be a burden, but most consider it a necessity. Regardless of their stance on the matter, raising capital is an essential step for entrepreneurs, founders, business owners, or anyone looking to start a company.

A business owner might look at different fundraising methods to service different capital needs. Typically, there are two forms of fundraising: equity and debt financing.

Through various client engagements while working at Scalar, we've identified a few of the more prominent methods of raising capital:

**Equity Financing**
(e.g., venture capital, angel, friends and family)

**Debt Financing**
(e.g., personal and bank loans, lines of credit)

**Convertible Debt**

**SAFE Notes**

# EQUITY FINANCING

For those ambitious entrepreneurs in search of millions in upfront capital to push their piece of technology or product to market, equity financing might be the best option.

In short, equity financing is selling a portion of a business in the form of stock to investors in exchange for funds in order to operate and grow the business. This form of financing has been made popular on ABC's show Shark Tank, on which entrepreneurs seeking to raise capital pitch their business to a group of sharks (investors), generally as follows:


Unlike a credit line from which you can draw funds when needed, raising capital through equity financing is typically done in rounds. These begin with an angel round and/or series seed, then proceed to Series A, B, C, and beyond when additional funding is needed. In early rounds, companies look to family and friends and angel investors to lead the round. Angel investors are usually wealthy individuals who invest in startups at the ground floor. As a company grows and matures, if additional funding is needed, the company will then look at taking venture capital. This is when companies can raise tens, if not hundreds, of millions of

To understand exactly how this can play out, let's consider a hypothetical scenario. Company A is a new software company that improves robots' comprehension to exceed that of humans. Company A has an incredible piece of tech and a brilliant team of data scientists but no money to grow their business. So Company A begins discussions with investors and looks to raise an initial seed round. The investors have determined the company's fair market value to be $15M. With the goal of raising $3M, Company A is faced with the challenge of selling off 16%


If you're interested in learning more about equity financing, check out my colleague's article about understanding term sheets when raising money.

# DEBT FINANCING

If you are a business owner not looking to be diluted, then you might explore other options of raising capital, like acquiring debt. Aside from maxing out personal credit cards, companies can raise debt through personal and bank loans, lines of credit, bonds, or convertible notes to service their fundraising efforts.

### Interest Burden

Unlike an equity sale, raising debt comes with the interest burden overarching the company's financial statements. Since these creditors are not investing in the business, but rather providing capital with the expectation for it to be repaid with interest, it is important to make sure the company is generating sufficient revenues to support the repayment and interest obligation before settling for a conventional loan.

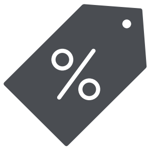
### Investors vs. Lenders

Another important step is understanding the difference between investors and lenders. Investors buy stock in companies, with the expectation that the business will sell, go public, or at least produce healthy dividends down the road. By allowing others to invest, you give up ownership in your business, but investors can provide resources besides just capital, such as networks, mentorship, and business advice. Since investors have skin in the game, they'll want the business to succeed just as much as you do. Lenders give companies money upfront as well, with the expectation to be paid back with interest in a timely manner, but they typically don't provide any other resources.

## CONVERTIBLE DEBT: BRIDGING THE GAP

Many early-stage startups, from my experience, raise what's known as convertible debt. This mechanism was created to bridge the gap between debt and equity financing. Convertible debt is exactly what it might sound like. Initially, it functions as traditional debt; however, it has the option to be converted into the company's equity in the future.

Depending on how the agreement is written, convertible debt has certain provisions, or triggers, that determine when the debt can be converted into equity. Consulting with outside counsel before signing a definitive agreement is always recommended.




20% Discount to Future Round


Fixed Conversion Price


Valuation Cap

# SAFE NOTES: WHAT'S SAFE IN THAT?

Another popular alternative is referred to as a SAFE note. SAFE is an acronym that stands for Simple Agreement for Future Equity. It functions similarly to convertible debt (less the interest). Nonetheless, a SAFE note is where an investor gives upfront capital now in exchange for equity in the future upon reaching certain triggers, such as closing a round of financing (simple, right?). It was created by the popular startup incubator Y Combinator as a way to fund the businesses that successfully graduate from their program. Using SAFE notes is a great way to generate initial funding, except similar to using convertible notes, it is important


Simple Agreement
for Future Equity

# CONCLUSION

There's a variety of different methods to raising capital, and understanding the pros and cons of each form of funding is an important step before making a decision. If you're an entrepreneur, a business owner, or anyone who wants to start a business, feel free to reach out to Scalar to see how we can assist in making this process easier.