

# Raising business capital and funding innovation

Raising capital is one of the most important aspects of starting and building a successful business. While there are a variety of sources that may supply your business with the essential funds to develop and grow, it is critical to understand the expectations and requirements of investors.

Before approaching anyone for funding for your business, you should determine how much money is needed to support a range of business functions, from ongoing operations to growth objectives. This requires a comprehensive understanding of the capital requirements of the business, such as purchasing new equipment, hiring new employees and expanding office space, and how capital will help the company follow its business plan and achieve short and long-term goals.

There are a number of different sources of business capital, such as private investors, financial institutions, venture capitalists and government grants. Which source you choose can depend on where your company is in the business life cycle. Some are more popular for businesses that are in the start-up phase or progressing into the growth phase.

## Private sources

Business owners often approach individuals for money – from friends, relatives, a spouse or partner, business contacts, employees and private or “angel” investors. When approaching any of these private sources, there are certain considerations that one should keep in mind.

Crowdfunding has become an additional source of funding for certain businesses. Each crowdfunding platform is different, so it is important to read the fine print. Crowd-funding raises

funds for a business from many people, called crowd funders. Crowd funders aren’t technically investors as they don’t receive ownership in the business and don’t expect a financial return on their money. Instead, crowd funders expect to get a “gift” from your company as an acknowledgement of their contribution. This is typically in the form of product or services offered by the business.

Individuals who are willing to invest in your business are rarely “silent” and may offer management or policy assistance, to provide contacts or to help with special assignments. Private investors tend to value equity – the right to participate in the future of your business. It is worth noting that the financial gain may be balanced by a certain loss of ownership. Individual investments often come with a highly personal relationship with the investor. If you are setting up a partnership, consider supplementing areas of weakness in the business with individual investors that have strong and complementary experiences.

A written shareholder or partnership (operating) agreement is essential when raising capital from financial backers or partners. This agreement will stipulate the rights and obligations of the shareholders or partners of the private company and will also include “buy-sell” provisions. It is important to review all agreements with your legal counsel.



## Financial institutions

Although U.S. banks are primarily concerned with short and long-term lending, they also often provide other financing options such as leasing, mortgages, factoring and support services such as payroll, letters of credit, credit references, and more.

To secure funding from financial institutions, a financial proposal and business plan are most often required. The bank will review facts and figures from statements, records and projections. They need to be sure of the stability of your company and the commitment of the owners.

They will look at your past and present performance, future potential, the amount you have invested, the amount you have left (equity and retained earnings) and the way you run the company. The bank will want proof of your ability to service the debt – that is, to pay the interest and retire the loan on time. They may require security or collateral that can

involve the pledging of accounts receivable or inventory, and a personal guarantee of principal. Term loans often require fixed or tangible assets as security.

It is important to keep lines of communication open. Tell your business banking professional in advance if there's bad news coming – the bank's confidence in you will remain strong if you're straightforward. Prepare and share a cash flow budget, and keep your banker in the loop each month, even when you're not borrowing. To establish a credit record, borrow from your bank early in your business cycle.

Use your banking professional as a valuable contact. Your banking professional can be a key partner to your business' success. They could offer support to your business beyond financing, such as cash management solutions that improve or create cash flow as an alternative to an operating line.

Your banking professional may also be aware of local economic conditions and suggest potential opportunities in other areas.

They can introduce you to prospective customers and suppliers and help you with credit checks. Your banking professional can be your best business friend. Discuss future financing needs with your banking professional and take the time to nurture a good business relationship.

## Venture capital

Venture capital firms will invest directly in a company if they believe that a business will be profitable and show substantial growth. Almost all deals are based on equity or some form of subordinated debt with conversion or option rights. (This means that in case of bankruptcy, their loans rank behind all other secured creditors but ahead of other shareholder loans.)

Venture capital companies expect high returns and usually want substantial minority positions – 20% to 40% of shares, or even full control of start-ups. They expect management shareholders to be fully committed financially, providing an efficient, balanced management team.

Venture capital companies can help in several ways, including planning and policy, finance and control, and arranging mergers and acquisitions or an IPO (initial public offering). They will likely require a seat on the board, to attend regular board meetings, monthly statements, life insurance for the owner, involvement in the budgeting process, and a buy-sell agreement covering your shares and their shares. Most venture investments usually require more funds to be invested later as the company progresses. Ensure the venture capital company has a good reputation and is well financed.

## Incubators and accelerators

Incubators are programs that are offered to start-up companies. These programs offer business support (i.e., operating space) and the opportunity to work alongside other start-up companies with the potential for growth. There is also usually some measure of mentoring from retired business leaders. Connecting with an incubator is a very competitive market, but successful participation can be very advantageous. Incubators are usually composed of successful entrepreneurs who will offer advice and access to advisors of other successful start-ups.

A business accelerator, on the other hand, is a program that gives developing companies access to mentorship, investors

and other support that help them become stable, self-sufficient businesses. Companies that use business accelerators are typically start-ups that have moved beyond the earliest stages of getting established.

## Governments

Federal and state governments have loan, guarantee or grant programs for creating jobs, increasing capacity, and creating or upgrading technology.

When seeking government financing, you may need to show you can't get the funds elsewhere. Try to tailor your needs to the program and ask for help from the program officers.

## Improving and growing your business with innovation

Many business owners raise capital to foster innovation in their company. Innovation may help to gain market share, introduce new products and to become more profitable. To drive your business forward profitably, additional capital may be required to implement innovation.

### Business owners can fund innovation from a variety of sources:

- Ongoing cash flow
- Business loans from commercial or private sources
- Government grants
- The business owner's own resources, or financial support from family and friends

There is a network of accelerators, incubators and hubs that allows entrepreneurs to work with experienced mentors in supportive environments and can also assist in attracting funding. For example, Y Combinator, a community of over 4,000 founders, supports many businesses each year with a small amount of money (\$150,000). Combinator and alumni continue to help founders for the life of their company. SCORE is the largest U.S. network of volunteer, expert business mentors and is dedicated to helping small businesses get off the ground, grow, and achieve their goals. It is a resource partner for the Small Business Administration and assistance in finding that support coaching, mentoring and training across the country can be found on SCORE's website.

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# Seek out and take advantage of all that is out there to help you build your business

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## Conclusion

Seek out and take advantage of all that is out there to help you build your business. Not only sources of funding, but also the invaluable knowledge and learning from experienced business owners that have been there before. Speak with your BMO financial professional to learn more about your options for raising capital and how it can work for you and your business.

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# Women and innovation

Innovation is a widely used term that is often misunderstood. It does not necessarily mean inventing new items and does not always have to depend on technology. Peter Drucker, author of *Innovation and Entrepreneurship: Practice and Principles*, says that “innovation is the act that endows resources with a new capacity to create wealth.” In other words, innovation should be a never-ending process of challenging how resources and methods are used to create new opportunities.

Innovation requires business leadership, motivation, a desire to improve and a supportive family including associates and employees. According to a survey commissioned by BMO Wealth Management, the top three reasons why small business owners implement innovation are to meet client needs (69%), maintain growth and sustainability of the business (61%) and create a better product or service (60%). The survey findings showed that women tended to be more client-centric, while men were more likely to focus on creating better products or services.<sup>1</sup>

In addition, the survey identified gender-specific trends and barriers within innovation that affect entrepreneurs. More women were unaware of the support available to foster business growth and innovation. Gaps in financial knowledge often limit women from reaching their entrepreneurial potential. Mentorship programs and incubators, often praised as an important component of entrepreneurial success, tend to be tech-oriented and less prevalent in service sectors where female entrepreneurs dominate. Women are under-represented among mentors and advisors, limiting

the ability of female entrepreneurs to find a supportive environment or raise capital. Lastly, women continue to face double standards and other social barriers in their work and personal lives, such as household and caregiving duties.

With these barriers come a potential for change. Policy changes, including the provision of equitable grant funding and better maternity benefits, should be considered by the government. Financial institutions should work harder to address and eliminate unconscious bias and improve support for female entrepreneurs. Additionally, better educational resources should be provided to grow the awareness of financing options.

BMO is making great strides as an innovator in empowering women to reach their potential as a business owner. We're committed to providing women with access to services, tools and resources to help them manage their money and grow their businesses. How we help? We continue to provide personal wealth and entrepreneurship education workshops. Our networking events have connected women of different backgrounds and industries to help them grow professionally.

Also, **BMO Celebrating Women** has raised the profile of 91 women in communities across North America by honoring them for their achievements in a variety of community building and entrepreneurial ventures.

BMO is dedicated to breaking down the financial barriers that female entrepreneurs face and we want to support them in as many ways as we can. We offer banking services, tools, case studies, and resources, both online and in branch, to support business owners at every step of their entrepreneurial journey.

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<sup>1</sup> Innovation – Creating wealth through business improvements., BMO Wealth Insights, BMO Wealth Management, May 2018.

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