



FINANCING SMALL BUSINESSES: FROM VENTURE CAPITAL TO CROWDFUNDING

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Abstract:

Startups and small businesses are facing many challenges in terms of financing their activities. These types of companies do not have the possibility to access capital market or to make IPO or to borrow money from banks like big, mature or well-known companies (who were at their beginnings startups or small businesses). They have to find different sources for financing their ideas/products/services that are in many cases very risky, hazardous or to ambitious. But, fortunately, the financing alternative for these companies have evolved during the last post crisis years. They have possibility to find some investors that are willing to invest in a non-name company by accessing crowdfunding platforms, impress angel investors, or attracting venture capital. All that in order to develop their business and to become a unicorn or to have a great exit.

Key words: small businesses, startup, venture capital, angel investors, crowdfunding, unicorns

1. Introduction

During the last three decades the financing alternatives have evolved and changed considering financial and economic crisis (Block and Sander, 2009), particularities, size, geographic location/relocation (De Prijcket et al., 2017) or field of activities for every sector/industry/company. Nowadays, the financing sources are more tailored and give the opportunity for many companies, especially start-ups and SMEs, to develop their business. Even so, just a few are able to become “unicorns” or to have a great exist through IPO or M&A (Ryan, 2012), while the majority are going to fail (Devace et al., 2016).

2. What is venture capital?

Many specialists have argued that venture capital plays an important role in spurring innovation and growth (Kortum and Lerner, 2001; Bernstein, Giroud and

Townsend, 2016; Nanda, Samila and Sorenson, 2017), productivity growth (Croce, Marti and Murtinu, 2013), and professionalization of firms' internal organization (Hellmann and Puri, 2002).

At the beginning venture capital "has developed as an important intermediary in financial markets, providing capital to firms that might otherwise have difficulty attracting financing" (Gompers and Lerner, 2001). According to Sahlman (1990), *venture capital* represents "a professionally managed pool of capital that is invested in equity-linked securities of private ventures at various stages in their development". Later, Gompers (1995) stating that "the staging of capital infusions allows venture capitalists to gather information and monitor the progress of firms, maintaining the option to periodically abandon projects".

The firms that need venture capital are usually start-ups or SMEs driven by uncertainty and risk. That is why investors look to invest in companies that are well managed, have a fully-developed business plan and are poised for sustainable growth (WEF, 2016) and more, after the investment is made, are actively involved in the management of the ventures they fund.

From all financing sources venture capital is one of the most tailored financing models for these kind of companies (Cumming, Grilli and Murtinu, 2017) at international level, especially in developed countries.

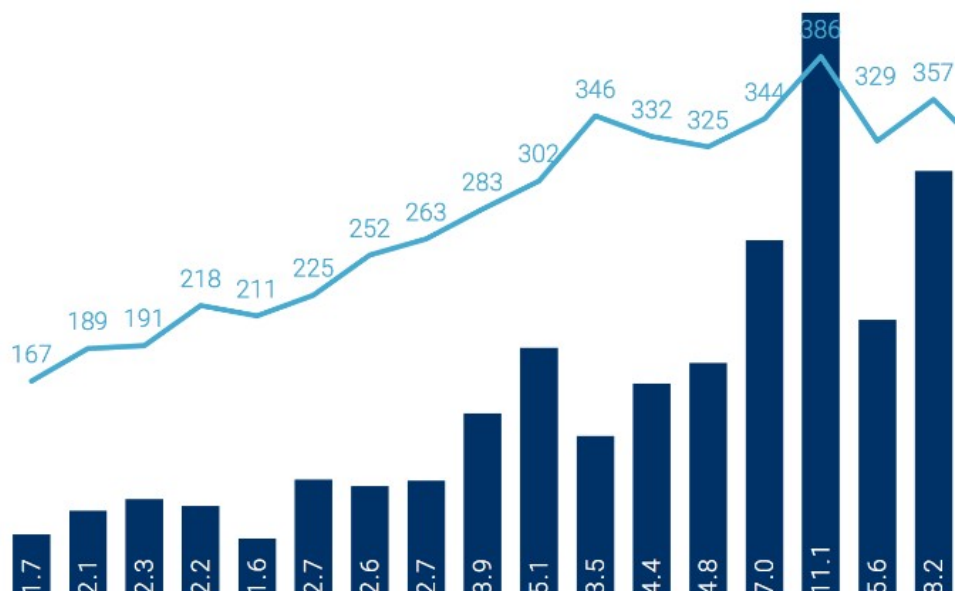


Figure 1: Global corporate venture capitalists financing trend

Source: CBInsights, Global Corporate venture capital Report (2016)

As regarding the venture capital analysis, CBInsight have published in 2016 the Global Corporate Venture Capital Report. According to the Report and based on

Figure 1 Q3 from 2016 has reached the maxim level in period 2012-2016, with a total investment of 11.1B USD and 386 deals.

3. How the venture capital works?

In order to finance their ideas, the start-ups or SMEs have to convince the investors that they have developed successful and sustainable businesses. First step is to attract *angel investors* that are usually wealthy people, willing to provide funds in earlier stage of business development because the presence of angels should improve chances of eventual venture capital financing (Madill et al., 2005). A growing body of research has emphasized the major role of angel investors in this early stage (Ibrahim, 2008; Hsu et al., 2014, Hellmann and Thiele, 2015). Also, Hellmann and Thiele (2015) have wondered if angels and venture capitalist are friends or foes because they rely upon each other's in earlier stages, but at the later stages the venture capitalist no longer need the angels.

Furthermore, Hsu et al (2014) found that strategic readiness for funding and affective passion matter more to angel investors, while economic potential matters more to venture capitalists. For both, the specific human capital of entrepreneurs is placed on the same position.

Table 1. Venture capital cycle (adapted by Gompers and Lerner, 2004)

Company Development	Idea	Start-up	Development	Growth	Maturity
Investment Stages	Seed \$0 to as much as possible	Angel Investment Up to \$1M	Early Stage Venture Capital \$1 - \$7M	Later Stage Venture Capital \$5M+	Exit Return on capital/ IPO/M&A/ Bankruptcy

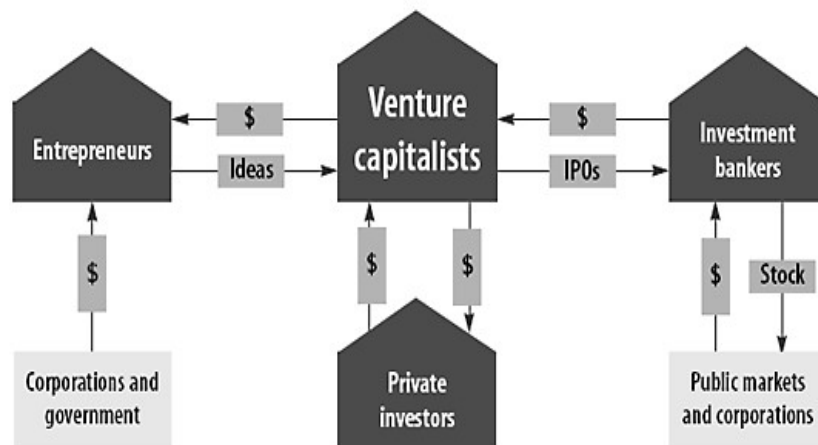


Figure 2: How the venture capital industry works

Source: Zider, 1998.

4. Crowdfunding platforms

Nowadays, a great challenge is to connect entrepreneurs with good ideas (but no money) with investors who have money but are looking for good ideas (Kaplan and Lerner, 2010).

In order to bring the idea to life, entrepreneurs have to present her to the potential investors, prior to the venture capitalist or private equity. Considering the information technology, a lot of platforms have been developed that interconnect entrepreneurs with investors.

Crowdfunding is a new concept that has been defined by many specialists (Mollick, 2014; Belleflamme et al. 2014; Agrawal et al. 2014; Geber et al. 2012; Ahlers et al. 2015). Crowdfunding is a new way to finance new venture and has an important role on the revitalization of the early stage risk capital market (Harrison, 2013). According to Mollick (2014), crowdfunding allows entrepreneurs to fund their efforts by receiving relatively small contributions from a relatively large number of individuals using the internet, without standard financial intermediaries, instead of soliciting a small group of sophisticated investors (Belleflamme et al. 2014).

Kickstarter is the largest crowdfunding platform to date according to Zvilichovsky, Inbar and Barzilay (2015) and to Kuppaswamy and Bayus (2015). The platform presents over 4.000 live projects from many categories (arts and comics ... technology and theater). But, there are over 100 crowdfunding platforms in the world that cover all fields and all ideas.

5. From start-up to unicorn and exit

A unicorn is a company – a start-up or SMEs – with a total valuation of more than 1B USD. The use of the term for defining this kind of company is attributed to Aileen Lee (Brown and Wiles, 2015).

Unfortunately, only a very small percent of startups or SMEs become unicorns or find a way to successfully exit by IPO or M&A. According to Techcrunch.com, in 2017 the number of unicorn companies is 267 with a total valuation of 920.8B USD and a total amount raised of 176B USD. The most known unicorn exit through IPO is Facebook and the most known unicorn exit by acquisition is WhatsApp.



Company	Last Private Valuation	IPO Valuation	Valuation Change	Market Capitalization	Change Since IPO	Total Pre-IPO Equity Raised	Known Investors
 Facebook TechCrunch Coverage	\$50B Jan 2011	\$104B May 2012	+108%	\$490.03B Nasdaq: FB	+371%	\$2.43B	Peter Thiel Accel Partners Greylock Microsoft Horizons Global Founders Horizons TriplePoint DST Global Goldman Sachs DST Global SoftBank SoftBank Yahoo (R) China Investment Lightspeed Benchmark
 Alibaba TechCrunch Coverage	\$42B Jun 2016	\$238B Sep 2014	+467%	\$430.6B NYSE: BABA	+81%	\$4.81B	

Figure 4: Top 3 Exited Unicorns by IPO

Source: <https://techcrunch.com/unicorn-leaderboard/exited/>


Company	Last Private Valuation	Acquisition Valuation	Valuation Change	Acquired By	Total Equity Raised	kn
 Uber China TechCrunch Coverage	\$9B Jan 2016	\$7B Aug 2016	-22%	Didi Chuxing	\$2B	Ut Ba Ba
 Stem CentRx	\$5B Sep 2015	\$5.8B Apr 2016	+16%	AbbVie	\$474M	An Fo Fic
 Legendary	\$3B	\$3.5B				Ro UE

Figure 5: Top 3 Exited Unicorns by M&A

Source: <https://techcrunch.com/unicorn-leaderboard/exited/>

Acquired	Announced price	Acquirer
WhatsApp	\$18,025M	Facebook
Nest Labs	\$3,200M	Alphabet
Zulily	\$2,067M	Liberty Intern
Oculus	\$1,993M	Facebook
Instagram	\$1,000M	Facebook
Sprout Pharmaceuticals	\$1,000M	Valeant Pharm
Twitch	\$970M	Amazon
Seragon Pharmaceuticals	\$725M	Genentech
Aragon Pharmaceuticals	\$650M	Johnson & Jc
Dropcam	\$517M	Nest Labs
Civitas Therapeutics	\$516M	Acorda Ther
Skybox Imaging	\$500M	Alphabet
Maker Studios	\$500M	Walt Disney C
Precision Dermatology	\$475M	Valeant Pharm
SteelBrick	\$360M	Salesforce.co
Tapad	\$360M	Telenor
Elastica	\$280M	Blue Coat Sy
Paydiant	\$280M	PayPal
Topera	\$250M	Abbott Labor
Lumena Pharmaceuticals	\$246M	Shire
Scioderm	\$229M	Amicus Ther
Tendyne Holdings	\$225M	Abbott Labor
Labrys Biologics	\$200M	Teva Pharma
Incline Therapeutics	\$185M	The Medicine

Figure 3. The most important acquisitions of unicorns

Source: Bloomberg and Crunchbase.com

6. Conclusions

The present study examines the financing opportunities for startups or SMEs by describing the venture capital cycle, the relationship between entrepreneurs and investors, and the accessibility of crowdfunding platforms. The reality shows that not all the ideas/projects become successful businesses and not all successful businesses become unicorns or have a great exit by IPO or M&A. There are some very well-known startups that become successfully like Google, Facebook, WhatsApp or Uber, but most are failing to survive. Without a real growing potential and a good business plan, the entrepreneurs are struggling for financing their ideas or projects. Even if they find small investors or business angels through crowdfunding platforms, will be only for a short time. They have to convince bankers to support them on the long run. On the other hand, companies that are poised for sustainable growth have all chances to become unicorns, because unicorns exist in the business world.

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