‘*The Money Train* is the roadmap to a goldmine; David Pattison spills the secrets that are normally kept to exclusive networks or charged for six-figure fees. Set to be *the* essential guide for entrepreneurs who want to take their business to the next level.’

**Bruce Daisley – author of the No.1 Sunday Times Business Bestseller *30 Ways to Fix Your Work Culture and Fall in Love with Your Job Again***

‘This is a brilliantly practical, well-structured book written by someone who has the experience and wisdom to share his knowledge. It doesn’t preach or lecture but has golden insights into the pitfalls and opportunities young businesses face from someone who has witnessed first-hand huge highs and some lows. Every young business and entrepreneur should make this their handbook.’

**Dame Carolyn McCall – CEO, ITV plc**

‘Spending time with David is always time well spent and this book is no exception. What I appreciate the most about David is his razor-sharp questions and practical insights. Reading this book was the same as every conversation I’ve had with David, he’s supportive but there’s no sugar-coating, and for any business considering investment this is a must-read’.

**Sarah Ellis – author of the No.1 Sunday Times Business Bestseller *The Squiggly Career* and Co-Founder, Amazing If**

‘I have been a business founder and an investor. I have built businesses from scratch and inherited large organizations. I have worked alone and in partnerships. I have used my own capital as well as having investors both private and institutional.

This book takes me back to the early days of being a founder. It made me smile at the memories of some of the situations David describes. His insights and advice are spot on and will help any young business founder to navigate the shark-infested waters of the investment world. He charts the positives and pitfalls of taking outside investment. Either way, *The Money Train* is essential reading for any young entrepreneur.'

**Steve Parish – Chairman, Crystal Palace Football Club, business founder and investor**

'Forget theory, this is entrepreneurship told as real-world life experience – one that every entrepreneur, myself included, can instantly recognize. With this book, David has mapped your uncharted territory for you. Take it on your journey.'

**Mark Eaves – Founder, Gravity Road**

'An excellent read, with an easy layout and flow. This book is refreshingly honest and practical for an up and coming entrepreneur or someone raising money. I wish it had been around when we first started our fund-raising processes! David's experience is clearly demonstrated throughout, highlighting so many of the potential wins and pitfalls, needle moving details and levers that are critical in making a fundraise a success. Highly recommend.'

**Dominic Joseph – Founder, Captify**

'*The Money Train* is not only a great read, but also a fantastic reference book for founders when it comes to fundraising. It provides reassurance on the things you're doing right, as well as guidance on areas that need improvement. I can say this first-hand, as it's exactly how I use it.'

**Paul Grundy – Founder, Baggl**

'Be prepared, you will have David Pattison's voice permanently in your head when you start reading this book. He has managed to read your thoughts, capture your questions, your fears, your hopes, compiled them and answered them comprehensively and compassionately. (He never makes you feel stupid for not knowing what you don't know.) Your Money Train will feel and run more smoothly because this book exists.'

**Muna Nageh – Founder, The Circle of Style**

‘*The Money Train* is an incredibly insightful yet easy read which I’d recommend to anyone going through or thinking about raising investment. The tone is spot on. There are points in the book which I could relate to my short journey so far, but it also highlighted aspects I had not yet considered and could potentially trip me up in the future. The structure of the book makes it simple to read up on quick, actionable advice, whilst the chapter segmentation is perfect for revisiting, which I will undoubtedly do during any future raise. *The Money Train* is effectively your own investment advisor in a book.’

**Tom Jelliffe – Founder, Tzuka**

‘I know I will come back to this book time and again for reference in the future, and I expect other founders to use it in the same way. *The Money Train* is a great analogy because that’s exactly what it feels like.’

**Sam Peters – Founder, Octaive**

‘I’ve been hugely fortunate to have had David as my mentor and chairman, and in that time his knowledge and guidance have been invaluable with regards to fundraising and investor relations. This book is the next best thing if you’re not so fortunate and will provide you with plenty of good actionable advice that you will and should keep going back to.’

**Prash Naidu – Founder, Rezonence**

‘A great idea will never succeed without proper finance. But where to start? *The Money Train* is an expert guide to raising capital. A brilliantly written book by someone who’s lived every high and low of building businesses. David knows exactly what he’s talking about and after reading his book, so will you.’

**David Mansfield – author of *The Monday Revolution***

‘I really enjoyed the read. Lots of good advice in there brought to life with useful anecdotes, quotes and real-world examples.’

**Hugh Campbell – Partner, GP Bullhound**

# THE MONEY TRAIN

**10 THINGS YOUNG BUSINESSES NEED TO KNOW ABOUT INVESTORS**

**DAVID PATTISON**

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# Contents

# Foreword

*'We need to accept that we won't always make the right decisions, that we'll screw up royally sometimes – understanding that failure is not the opposite of success, it's part of success.' — Arianna Huffington*

In this quote, Ariana captures the reality facing any entrepreneur on their journey through life. Founding a business is easy. Making a success of it is extremely hard and cannot be done without the help and support of many people. And time. And money.

My long, yet exciting, journey with Blue Prism was successful by pretty much any measure. A British software company that became a 15 year, overnight global success story, with a highly successful IPO in 2016 and fabled unicorn status. Starting with two people and a great idea, we were able to execute with the help of many people: directors, employees, customers, business partners and, of course, investors.

The one area that you don't want to be learning from a mistake is in the fundraising arena. In this practical guide to navigating the scary world of corporate finance for entrepreneurs, David Pattison uses personal experience and many anecdotes from extensive real-world research to illustrate the opportunities and potential pitfalls of engaging with different types of investor. From making sure there is alignment around the board table before raising money, finding the right management team and how you can expect investors to react in various circumstances, through to the importance of building trust with your investors by delivering your promises, this is a wealth of advice that I wish had been available to me in our early days.

An essential read for any business founder or early stage CEO.

**Alastair Bathgate**
**Founder, Blue Prism**

# Introduction

*‘When things go well, they go really well. There is nothing intrinsically good about owner-managed businesses and nothing intrinsically bad about investors.’*

The quote above is from a lawyer. Lawyers see the whole range of investors and investment options and the variety of owner-managed businesses looking for investment.

*‘Raising money: You don’t know what you are getting into. There is only one way to go: Fast growth and losing control. It gives you a five- to ten-year window.’*

This second quote is from the founder of a very successful business who has raised money on four occasions.

*‘People looking for money have no real understanding of the difference between investor types.’*

The third quote is from an adviser who works with young businesses.

*‘Innocence is culpable.’*

The final quote is from the same lawyer as the first quote.

In a nutshell, this book is for young businesses that have decided they need to raise money to move forward. It’s about preparing yourself for the investment journey.

Once you take investment, all the stakeholders know where that journey ideally ends: A sale that generates a significant profit on everybody’s investments – whether those investments are your time, sweat and early funding or from the investors who have put in their money along the way.

That is why this book is called *The Money Train*. Because it is a real journey, and once you decide to take investors' money, the destination is set. You are on a track. It's a real commitment and it can feel like a fast ride.

You will want to be at the front of the train, driving your business to future financial success. If you don't maintain some sort of control, at best it will be a very uncomfortable ride. At worst, you will get derailed.

There have been, and will continue to be, a lot of very successful investment partnerships with owner-managed businesses. The aim of this book is to help your business to be one of those successes.

This book is an enabling book, helping you to prepare for that investment journey. Good preparation is the best time you can spend. If you are looking for cures to an investment mistake, then it is almost certainly too late.

Get the investment process right and you will enjoy all the fruits of a successful relationship and maintain control. Get it wrong in your very first negotiation and the commitments and clauses will be carried over and multiplied every time you go back for more money. There becomes less and less room for manoeuvre and almost no way of fixing it, unless you are very lucky. That is why this is book is an enabler and not a cure.

In putting the book together, I have spoken to business founders, lawyers who spend a lot of time in this space, corporate finance advisers, independent CFOs and investors. I have used a lot of their stories and observations, but no name-attributed quotes.

I have also called on my own personal experiences, gained as a full-time CEO at two companies that had successful multi-million-pound exits. Following on from that, the next stage of my career has been spent helping young businesses start, grow, raise funds, thrive and sell, sometimes as a hired hand, sometimes as an investor/adviser and often as a chair.

The first of my two CEO roles was with a company I founded with two partners, PHD, which is now owned by the American holding company Omnicom and trades in over 80 countries around the world.

The second was with the digital media business iLg. I was hired to sell on behalf of the founders and the various investors. I successfully sold the business for a significant sum of money and a couple of years later, as a non-executive, watched the same company go into liquidation in 40 minutes – ‘character-forming’, I think they call it. But I learned so much about investors, lawyers, bankers and founders.

More recently, I have taken those learnings and passed them on to a range of companies that I have helped over the years, acting as a ‘wingman’ to watch their backs. It’s never plain-sailing, and you learn more from the hard times than you ever do from when everything is running smoothly.

Setting up your own business is the most exciting, energizing, terrifying, motivating, lonely, emotional and rewarding thing you will ever do. Once you decide to bring other people’s money into your business, you have to get it right. That’s why I have written it down. If you have decided that you need money, this is how to prepare to get it on the best terms.

# PART I

# Three questions

# Why is there a need for this book?

*'You really don't know what you are getting into.'*
*'I wouldn't change it. The company might not exist.'*
*'Most stressful experience of all time.'*
*'Our early investors were amazing.'*
*'I felt like an incompetent criminal.'*
*'They promised a lot and delivered little.'*
*'Their value-add was immeasurable.'*
*'They didn't really understand our company or our market.'*

These are just some of the things that founders of young companies have said to me about the process of getting investors into their businesses and, I think you will agree, they cover a bit of a range. How on earth do you decide who to go with and on what terms? It's really hard and not at all straightforward. You will need luck and timing as well as good advice and a lot of commitment and energy.

For young businesses looking to raise the first round of serious funding, the founders and executives are at their least experienced and most naïve. The first negotiation will be the one that will set the future shape of the business and put in place a whole range of parameters that the next set of investors will use to inform their investment offers.

Getting the first major raise right, at the point at which you have the least experience, is a very difficult thing to achieve, let alone getting it somewhere near perfectly right. And you will almost certainly be negotiating with people who are very experienced at doing deals. You will need to prepare well and take a lot of advice and help. You will also need to take it very seriously.

## What do I mean by a first major raise?

A first major raise is likely to be after you have raised the first investment from friends and family to get the business started. I will go into more detail a little later in the book.

## Why a book about raising money and dealing with investors?

Over the years I have seen the effect that looking for investment has had on companies and their owners, which one should never underestimate. It's usually massive. I have led teams, been heavily involved or have been a light-touch adviser to companies looking for funds to develop their businesses. I have learned a lot about what to do, and what not to do.

## Why now?

There is an ever-increasing amount of investment money available from an ever-increasing number of sources. There are various business models, but one model expects young companies to take on investment and, in many cases, 'enjoy' debt in their business. Through personal experience (some really good and some less so!), I have learned a lot about what to look for and what to avoid.

I want to help companies prepare and ask the right questions of themselves and their potential investors, to prevent them making some of the mistakes I have made and witnessed along the way and to learn from things that helped me succeed.

Fundamentally, I want to help to ensure that the first investment negotiation doesn't become a suffocating straitjacket for the future.

There isn't a specific chapter on how to negotiate. This is by design because there is no single solution. Every negotiation is unique and different. However, I will attempt through the book to identify the things to look out for: What investors really mean when they say certain things/behave in a certain way; how to get the best you can for yourself/other founders, your shareholders and your company; what legal clauses really mean. I will use personal examples as well as experiences from people I have met along the way.

> I want to help to ensure that the first investment negotiation doesn't become a suffocating straitjacket for the future.

Here is the first piece of advice: listen, a lot, to other people who have been there and done it.

I will also use personal examples from another part of my life. At the age of five I wanted to be a racing driver. That ambition stayed with me through my life, to a point where I thought it was too late. However, in recent years I had the opportunity to fulfil that ambition and become a racing driver. I approached it as a project and whilst doing it I learned that there were many applications from the business world that helped me achieve success. I did it for six years and it was amazing – and I did pretty well, as the range of unattractive trophies in my house would attest to. I found that I took some similar approaches to my racing as I have in business and, as a result, I have used racing analogies as examples throughout this book.

Here is the first racing analogy: rather like being on the Money Train, when you are on a racetrack going fast, you don't want to leave the track and you know in advance where the destination is. Being well prepared and in control will get you there intact and enjoying success.

# What does the investment market look like?

The investment market is complex and very hard to generalize. There is a lot of money out there waiting for you. It comes in different shapes and sizes and with different degrees of difficulty to get hold of.

## Why is there so much money around?

Since the economic crisis in 2008, it has been very hard for people to make money in what were the traditional investment markets. Interest rates have stayed low and equity markets are complex for all but the very well informed. Other global events, such as pandemics, terrorism and wars, continue to make it harder to profit.

So smart people with smart money are trying to make money in other ways. Art, wine, property and classic cars are just some of the areas that money has poured into. Values have skyrocketed and this has of course attracted gullible followers who don't really understand the markets they are getting into – the very people who will almost certainly take the fall when the markets reset themselves. And markets always reset themselves at some point.

One of the other areas money has poured into is the business investment world. Knowledge of the investment world is much more readily available, and governments have introduced attractive tax-saving schemes to encourage investment in young businesses. In the UK this includes the SEIS and EIS. These schemes give individuals and companies instant tax relief, provided that a number of criteria are met.

As a result, the market is much more attractive and accessible for individuals with investment money. In addition, there is a significant variety of new, more formal, investment funds in the market. Again, a lot of them come from followers who don't fully understand the markets or companies they are investing in. But there is a lot of money available, and as time has gone on this money has potentially become more and more available to fledgling business start-ups.

## Why do they want to invest in you?

They want to make some money. A lot of money can be made if yours becomes the next well-known success like Apple, Facebook or Amazon, or even a less well-known but successful unicorn business.

## What market are they looking at?

Employment market expectations go through cycles, and increasingly the cycle seems to be that anyone leaving education needs to come up with an idea for a business – tech-based, and probably an app. OK, that's a sweeping generalization, but I do think that the pressure now is on coming up with an idea and setting up your own business.

The reason is that technology innovation has opened up a lot of markets within markets. Niches within niches are now accessible and acceptable. Wide-ranging generalist businesses are no longer the norm.

The plan for the aspiring college-leaver entering the employment market in the 1980s, 1990s and early 2000s would have been to enter the worlds of investment banking or strategic consulting with one of the large, established companies. There was a bit of a crossover from the late 1990s and through the 2000s, when it became about working for the big tech giants like Google, Facebook and Amazon.

With the coming of the digital age, the huge reduction in research and development (R&D) costs, the fragmentation of markets and the relative simplicity of building something, there has been a huge rise in optimism amongst new workers. No one needs to build a mainframe today, and the march of cloud-based services has made development more and more accessible and affordable. There is also a lot of investment money around to bring these ideas to life. They just need to look successful and scalable.

As the markets continue to fragment, no idea is too small, and there have been and will continue to be some spectacular successes from this new tech world. That's why investors want to invest in you. There is potentially big money to be made for them and for you.

There is a model for these businesses to succeed and grow. But beware: this model is largely constructed by the investment industry. A clear case of the tail wagging the dog.

So – surprise, surprise – the models that are deemed by the investment community to be the sexiest and most investable are the ones with a lot of investment funding built in. However, this 'one size fits all' model doesn't work for every business, and for some it's a model that is seriously flawed.

Let me explain.

## Flawed businesses survive for too long

One of the consequences of an investment market with a lot of money and investors with low levels of market knowledge is that limited ideas and flawed businesses survive for longer than they should.

### *What does a flawed business look like?*

> It's very easy to spot a gap in the market. It is much harder to see if there is a real market in the gap.

At a business's early stage, it's very easy to spot a gap in the market. It is much harder to see if there is a real market in the gap. It's also relatively easy to find someone to fall in love with an idea and put funding into it. Anything in the tech area is particularly easy to entice people into.

As an example, I see loads of ideas that rely on advertising revenue as the main income generator. Quite apart from the fact that it's really hard to bring advertisers' attention to your offering, there isn't enough advertising in the world to make all of these businesses profitable. But early money gives false hope. A second round makes you feel invincible, even if the business isn't really performing. As one founder said to me: 'You believe everyone will see the proposition and the money will keep coming.'

In my experience, founders often kid themselves for a long time about this. They are always the last to see their business is flawed. If sales aren't going well, then for them it is the market that doesn't understand. There is nothing wrong with their offering.

The reality check is usually harsh and comes when a round of fundraising doesn't work because the potential investors can see that the market really *does* understand. And the current investors have run out of money or commitment. It's brutal when that happens, and I have witnessed founders being emotionally crushed by this.

Eventually it's the false hope that kills you. But the reality is that it's the investors that have allowed the business to survive for longer than it should have. The shape of the investment market has driven the business, not the market that the business operates in. It probably showed some weaknesses, but the signs have been ignored by the over-excited early investors and the equally over-excited founders.

And then, in a heartbeat, the investors stop investing and it all comes crashing down. It's very painful, and the investors run for the hills with as much of their investment as they can and claim their tax reliefs and capital losses. The business founders have no confidence left, are financially spent and, at best, have a very unclear future.

## *The exceptions*

As always, there are some exceptions which make it hard to know whether you are a flawed business or are just needing some luck or are having timing issues. Some businesses can take time to catch. They can be slightly ahead of their time, get the first marketing iteration wrong or have the wrong people leading them.

I worked with one company that took four years to start really flying. In those four years it nearly ran out of money on three occasions. There was always a gap in the market and, over time, a market appeared in the gap. The proposition was changed, and the company grew on a double-digit monthly basis. It had always been the right idea and, in reality, it was the real trading market, not the investment market, that reshaped the offering.

## *Ask yourself the hard questions*

Why is all this important? Because when you are working out whether you need to raise money, and how much, be honest with yourself. Ask the following questions.

- Is there a real market here?
- Where is sustainable revenue coming from?
- Where is the competition for that revenue?
- Have I got a real business?
- Do I just need more time?

Just because the market model is investment-driven doesn't mean that everyone will succeed. Investment driving accelerated growth isn't the only answer. The 'go big or go home' mentality isn't always the best route. Sometimes doing that old-fashioned thing of reassuring yourself that the business can make a profit without investment is a good starting point.

One of the businesses I was involved in from the start only took money from the three founders, including me. Despite lots of offers on the way through – and, to be honest, a few close scrapes with cash flow – when the time came to sell it was a simple process and the terms were what the founders wanted, not what the outside investors wanted. Could we have grown more quickly with outside investment? Almost certainly. But at what cost? The founders also achieved their goals of securing both a good financial deal and a future career with the purchasers.

It's the simplest business model to retain control in, and all of the success is yours.

## Where do you start in the investment cycle?

By understanding your business financially. The first thing to do is to work out if you need any money at all. If you can see a way of building a business without needing to raise any money, or by raising a smaller amount, then look very hard at those options. For a number of businesses, if a model can't be put together that works without investment, then there probably isn't much of a business. If such a model puts the business's growth back by a number of years, then it probably needs investment. If it's a number of months, then it might be worth reconsidering.

One founder I spoke to said that one of their big regrets was not having a grip on their financial model early enough. If they were doing it again, they would have looked at a model that did not require any investment, just to see what that looked like, to help them decide whether investment made a big difference. It undoubtedly would have been lower-level and slower to build, as well as personally more painful, but it would have given them more control for much longer.
I pushed them on whether they would have done it differently and not gone down the investment route, and they said they wouldn't have changed a thing. They simply wished they had known what the alternative was, and in addition they felt it would have been much better business practice.

Part of the reason they didn't know was because they had inadequate financial management experience in the business. I will make this point again and again through the book. It never fails to amaze me how slow new businesses are to get good financial planning advice into the company. It is always seen as an unnecessary cost. It isn't unnecessary. It's an investment that will pay for itself in ten minutes. I see it every single time. Even if you have to hire an outside resource in the early days, then do it.

It never fails to amaze me how slow new businesses are to get good financial planning advice into the company.

There are lots of businesses for which 'no investment' isn't an option, so you need to work out if yours is one of these businesses. Good examples of exceptions include businesses that require heavy R&D investment or manufacturing plant, or businesses that need to grow quickly and run very fast to take advantage of a market trend: 'bubble businesses'.

## Who are the potential investors?

On the face of it, the investor market looks easy to understand and well ordered. The truth is that there are a lot of nuances within the structure. A seemingly unlikely investor can always make an exception because they really like your business: 'we don't normally invest at this level/in these markets, but we want to go with you'. Likewise, a potentially perfect investor really might not like your business: 'it's too early/too late/the wrong market/the wrong price'.

As an aside, the unlikely investor is usually just that, and if they aren't used to working with a business like yours then I would question whether they are the right partner.

On a simplistic level, investors in the market fall into two sectors: the *emotionals* and the *rationals*. Understanding the crossover point is really important in both the way you deal with those investors and what they expect from you.

### *The emotionals*

The emotionals are easy to understand but the hardest to classify. In a nutshell, an emotional investor is almost always an individual investor. They come in a variety of forms, with seed investors, angel investors and high-net-worth individuals being the most regular. Some angel investor networks are brought together into one fund by investment companies whose investment is usually made up of individuals putting in identified amounts in their names. It's their own personal money and that's what makes it an emotional decision. Being seen to pick a winning business is part of their motivation.

There is one thing that unites almost all emotionals: tax relief. There are a number of very well thought-through government-funded tax schemes that allow investors to reclaim some of their investment and, if it all goes wrong, they can then claim some or all of the losses against other gains and income (see 'Abbreviations, information, resources and jargon' at the end of the book). In their eyes, the major thing that you have to do is to ensure that the company maintains its tax relief status.

At the very early stage, investment usually comes from people you know. They are generally described as seed investors. Either you and your partners know them or, as one corporate financier described them, they are 'friends, family and fools'.

The demands of seed investors are not usually very onerous and as well as tax relief, all they really want to do is back someone they know, for you to remain in business long enough to return their money plus a bit at some stage in the future. They will normally agree to the slightly over-optimistic valuation you have set. The shareholders' agreement (if there is one) is usually pretty simple and because you know everyone it is relatively easy to manage this group. They usually leave you to get on with it and are not really very demanding. If it's the 'bank of family and friends', then its potentially even less demanding but probably even more emotional.

Angel investors and high-net-worths are pretty much the same thing. Tax relief is again a big driver for these investors. They are normally people you don't know, but could be friends of friends or acquaintances. These investors are sometimes bought together by an angel network or non-institutional fund. They will want properly lawyered paperwork and will be more demanding than seed investors.

They may well demonstrate a bit of bravado to prove what good negotiators they are. If you find yourself in a room full of them, as often happens with the networks or funds, it can be excruciating to watch them try and out-ego each other. As a lawyer said to me, 'the worst investors are the high-net-worth funds that have no discipline'.

However, if you find the right ones, they will be your most loyal supporters and your best 'foul weather' friends and will invest again, sometimes when others shy away.

## *The rationals*

The rational investors are broadly the institutions. These are the venture capital investors, the private equity investors and a relatively new group called *growth capital* investors.

They are rational because they are driven by the demands of the investor clients in their funds. These are almost always institutions, although there can sometimes be very wealthy individuals involved. The rational investors have targets by which they are measured and systems and processes that they adhere to.

It's very difficult to generalize who does what in the rational world, and this isn't helped by the general media, which takes little interest in differentiating or paying attention to the detail. So, there are always blurred lines and exceptions.

Broadly, venture capital is interested if a business is successful in generating revenue at a sub-£10-million level but is not yet profitable. Such an investor would look to make five to ten times its money in five to seven years. It would take more risk than private equity, hence the word *venture*.

Private equity is interested when a business is making over £1 million of EBITDA (profit) and would look to get three times its money in three to five years. There is a slight variation that sits largely in the private equity space, known as family funds. These are exactly that – funded usually by one family, as a result they tend to work to slightly longer timelines. As an aside, I have always found them well organized and professional to deal with.

Growth capital sits somewhere in the middle, for businesses that are not making a profit, but are growing at about 30% a year and probably need about £10 million+ of investment.

As I said, these are generalizations and there are other options that can offer investment. A venture capital trust works broadly on the lines of venture capital but the investors in the fund are taking advantage of enhanced tax breaks. They also tend to have longer timelines as the funds don't usually have fixed exit dates. However, you do have to be sure that all of the criteria to keep the venture capital trust tax-efficient are kept in place at all times. It can be the case that if your business loses its tax status then the whole fund, not just the investment in your business, loses its tax status. And that is a very expensive mistake, not just financially for the fund, but reputationally as well. So, expect added scrutiny.

## Where else does money come from?

### *Corporates*

A lot of the big traditional corporates have venture arms that invest in early start-ups. By this, I mean the huge, globally well-known corporate giants. They are definitely on the rational spectrum. Their investment can look very tempting. The initial reaction is often that they will provide 'a customer base we can sell to', or 'market knowledge for free', or 'a leg up'.

However, if you come to sell and they have a significant share, or they make up a large part of your client base, then you can paint yourself into a corner, with the only viable purchaser being the initial corporate investor. Not many competitors will want their main rival sitting around their boardroom table. It doesn't really lead to a competitive process and the price paid will reflect that.

The media have made investment from the corporates look very attractive, with headlines such as 'XXXX Tech Company Pays $1 Billion for a Start-Up that Doesn't Make a Profit'. It happens, but it's very rare. Some corporates have such investment funds so that they can look cutting-edge and cool. However, not surprisingly, they can be very corporate and rarely have staff that understand the pressures of starting and running a young business – mainly because they haven't done so.

As one finance consultant said to me, 'If a corporate is interested, go and look at the venture capital market. I would take a 20% discount on valuation every day from a venture capital fund versus a corporate.'

If it's a fund from a known entrepreneurial business, like the new tech giants, it is likely to have a different attitude, but probably with the same level of scrutiny and desire for control.

## *Trade investors*

Trade investors don't really invest in this market as they are rarely able to compete on valuation and tend not to want to take massive risks or large shareholdings. They are more likely to get involved early or be the purchaser at the end of the cycle. When they are investors, they tend to tolerate under-performance better.

Funding from trade investors is very unpredictable money, here in the good times and gone in the bad, which is not good if you are looking for a second investment in the future. As one corporate finance adviser put it, 'They have very short memories, so in long bull market runs they become active and then shut down when their share price collapses in bear markets.'

## *Accelerators*

There is a slight hybrid which is early-stage and quite institutional, and that is the category of the accelerators. They tend to put relatively small amounts into very young businesses and offer facilities and resources to these new companies. These facilities are normally paid for by the investment they make, as well as charging you a monthly fee. So, if you are not careful, you can end up paying back all the money for the services provided and being part-owned by an accelerator – a painful truth that many don't realize until it's too late. There is also no guarantee that the next round of funding will arrive. However, accelerators are usually linked to a lot of angels and high-net-worths and will do their best to introduce the next round of investors.

Accelerators work on the premise that a few will succeed, thus paying for the ones that don't, at the same time as charging everyone for everything on the way through. It's a good business model for them but can quickly be overwhelming for you.

## *Crowdfunding*

The final investment route I want to cover is crowdfunding. This splits into two types: reward or equity crowdfunding. Sometimes it can be both of these.

What most people think of as crowdfunding is specifically *reward* crowdfunding. This can be a very useful way of raising funds if your product or service is a thing that people can identify with and want to be part of. An investor puts in money and gets the product or service at a favourable rate. Sometimes that is the offer, and sometimes there is some equity attached.

Equity crowdfunding is just that; the investor buys equity in a similar way to the standard investment routes, albeit usually at a lower funding level.

I haven't had much experience of crowdfunding and there are some well-established fundraisers that can organize the whole process for you. It can be quite time-consuming and not every business achieves its funding goal. It normally helps if your product is recognizable to a wide audience.

There are two things to watch out for here. First, one founder told me that that by the time he had raised money through a crowdfunding site, he had been charged close to 10% of the money in fees. Second, an institutional investor warned me that having crowdfunders as existing shareholders can lead to complications later down the line, just because of the sheer number of shareholders.

But there are some successful examples from this route. It means you are unlikely to have a dominant investor, which should leave you to get on with it. Communication is vital and you have to beware the disaffected investor who has put in a relatively small amount of money but can make a lot of negative noise on social platforms.

## *Other funders*

There are regional, government-backed funds that are driven by different criteria. I know of one fund that only looks to break even on its investments, but its success is measured by the number of jobs it creates in a region. There are many other regionally focused funds that are about stimulating growth in their areas.

Ethical funds and social impact funds are also on the increase, whether they be focused on gender, ethnic, environmental or ethical lines. The millennial generation is much more likely to care about where the fund is investing. They may even seek out funds that specialize in just these areas. The more general funds are definitely starting to be affected by these relatively new market entrants.

An investor I know lost a deal to an ethical fund even though the deal was less good for the founders. As the investor said, 'The young aren't kidding when they say it's not just about the money'.

Part of the decision for the founders looking for investment will be the company the funds keep in the shape of their other investments. This is a trend that I believe will only become more significant.

Occasionally, the really big players – typically hedge funds – become enamoured with the early-stage, young business sector. They invest, often make mistakes and then pull their support overnight. They call it being decisive. My advice would be to give these investors a very wide berth.

> The investment sector is a very male-dominated and aggressive sector.

One thing to know. One of the reasons for the growth in specialist funds (e.g., ethical/gender/ethnic) is that traditionally the investment sector is a very male-dominated and aggressive sector. Investors are, in the main, competitive and macho. Like the rest of the world, this is being forced to change, but very slowly. When dealing with them, be yourself; you don't have to change, but be prepared for this when you come into the market. It can be intimidating, uncomfortable and overwhelming if you aren't ready for it.

And finally, there is a lot of jargon in the investment world. I have tried not to use abbreviations and shortcuts in this book, but have attempted to explain some of the language in the section 'Abbreviations, information, resources and jargon' at the end of the book.

That's a quick dance through the main areas of the investment market. You will have noticed that there are a lot of options if you have decided you need to find some money. And there are 1,000 more nuances that I haven't covered.

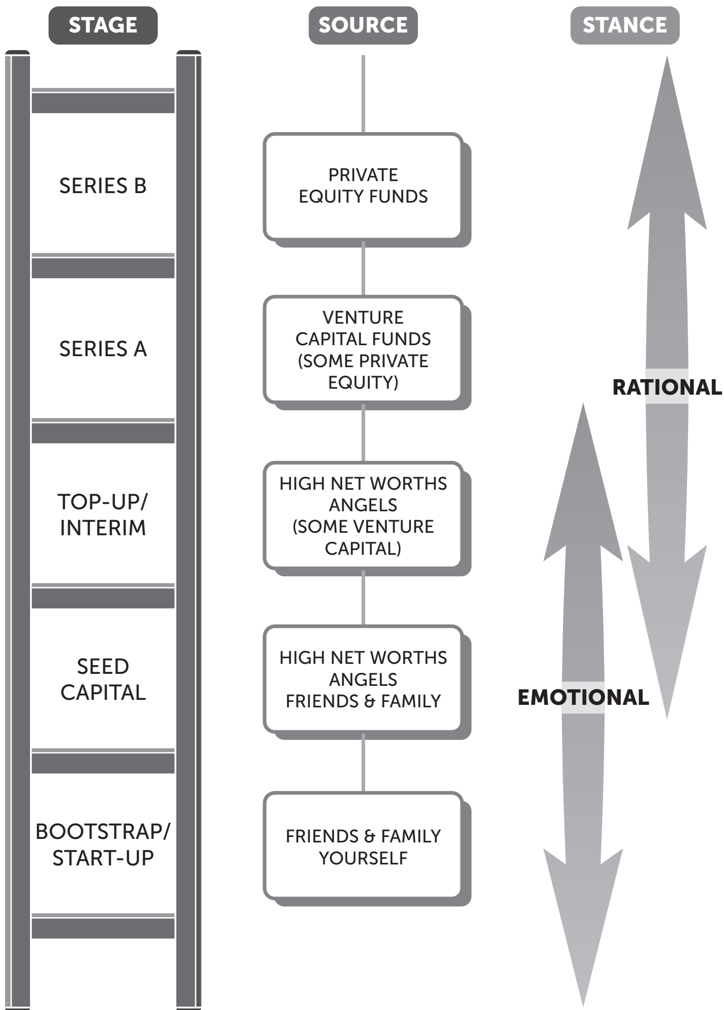
## The investment ladder

As you will read often in this book, there are many 'norms' in the investment processes but no real 'norms' in the fundraising hierarchy. What does that mean? It means that *how* investors invest and behave will always be true to type, whether it be emotionally or rationally. However, *where* they invest can be a moveable feast. Within the hierarchy, investors can always make an exception and invest (or not) outside of what would be their investment criteria 'norms'. So, money can present itself from the least expected sources or won't come from where you expect it to.

The progression for fundraising would typically be: raise some very early money to establish the idea (often called bootstrap funds); raise some seed capital to get it going; get some top-up money to get to proof of concept and some revenue and then raise big funds to accelerate the business by volume/geography/product lines and more; then a really big raise to max out the company potential. These stages would typically be called *bootstrap funds*, *seed capital*, *interim top-up*, *series 'A'* and *series 'B'*.

To prove the point that nothing is linear, the step across from emotional to logical can happen in the top-up or series 'A', but not exclusively in either.

# THE INVESTMENT LADDER



# Are you ready to start the investment journey?

The key question is: ‘Do I need to raise investment money?’ As discussed in the last chapter, the market will almost certainly expect you to raise some money and will encourage you to do it. What will the investment ladder journey really look and feel like?

There are many routes your investment journey could take but I suspect it might end up looking a bit like the following.

- You have had your idea. It’s a risk to go on your own. You decide to take some early investment to slightly lessen the risk.
- You have some success, not profit, but you generate some revenue and you have ‘proof of concept’. You are feeling optimistic but underfunded.
- The idea works. People get to hear about it. Potential investors get to hear about it. You feel popular and have investment options.
- You are ‘hot’. Just think how you could accelerate this success with more resources, more people… and, of course, more money.
- You take the money; you spend the money. Profitability is two years away and the cash runs out in 15 months. Then you take some more money and have to promise more accelerated growth.

And so, it goes on – the Money Train at full speed and in all its glory. It will all feel very fast. It will seem like every investment conversation you have moves the goalposts in terms of what you need to achieve to get that investment. If you aren't careful, your business will be shaped by an investment market influence, not necessarily by the strengths of your people and your offering.

## How to decide if you need to take investment

Before you get onto the investment ladder or climb aboard the Money Train, there are a lot of questions that need answers. Some are as follows.

- What would funding add to the business?
- How much do I need?
- How much time would it save?
- What would be the costs of raising money and diluting shareholding and controls?
- What multiple of success would it add?
- What would happen if I didn't raise money?
- When would I need the money?

And the following, which is not to be underestimated: what do I have to offer investors?

- Are there tax breaks I can offer to investors?
- Does my time frame look attractive?
- How much might an investor make?

The biggest change resulting from taking investment is that the business is no longer 100% your baby. And if, having taken investment, you are seen to be behaving as though it still is, then you will hit problems pretty quickly.

The assumption for this book is that you are now at the point where you are starting the fundraising journey. You need money. You broadly understand the structure of the investment market.

The rest of the book is a guide to what to ask, what to expect and how to approach the processes. It's for the young businesses looking to raise some money, mainly covering the range from start-up and seed investing through to series 'A' with venture capital funds or venture capital trusts. It will also cover that switch from the emotional investor to the rational investor – the step where, time after time, I see the relationship between founders and investors under the most strain.

Want more? *The Money Train: 10 things young businesses need to know about investors* by David Pattison is out on 26 January 2021 - available from all good bookshops!