How to Fund Your Start Up

So you have come up with the perfect idea for a business. You are convinced that your idea is the best thing since sliced bread and there is a huge market for it. Only problem is that just having an idea isn't enough to get the cash registers ringing - you need to take that idea and turn it in to a viable business. Unfortunately to start and grown a business you need capital.

So where would you turn for this capital? You could turn to your own personal savings but let's be honest most people do not have enough money lying around to allocate to a start up a business. Luckily, entrepreneurs have a number of external options for funding, and finding the best fit for you is the key.

An obvious option is a financial institution after all they are in the business of providing money. However, in return they ask for small percentage, or interest, on their capital. This interest allows the institutions themselves to remain profitable enterprises but will be reflected as an expense for your newfound business. To ensure that you can and will repay the capital they will also ask for some type of collateral. This collateral will come in form of some asset you currently own (for example your house), which can be sold if their capital and interest is not repaid. Long story short, if you do not or cannot honor your agreement you risk losing ownership of the asset you put down as collateral. On the plus side they do not require equity in your business.

Venture Capitalists (VC's) are another option. They may offer you the required capital to start and grow your business but instead of requiring collateral they require a stake in the business. For example let's say Ranil and Samith decided to start a business called Sliced Bread LTD. As equal partners they divided the shares in the company on a 50/50 basis. A Venture Capital company, seeing the potential in Sliced Bread Ltd offer Ranil and Samith the amount of money they need to grow Sliced Bread Ltd in exchange for 1/3 of the company. If Ranil and Samith agree they will not have to put down collateral or pay interest but there will now be three shareholders in the company (Ranil, Samith and the VC).

If the business fails then the VC loses the money it invested but has no recourse against Ranil and Samith. The risk is essentially shared by all parties. If and only if, Sliced Bread Ltd becomes a profitable business does the VC make money alongside Ranil and Samith. Since the risk is shared VC's tend to be 'active investors'. They help businesses get started by offering advice, making introductions and helping with strategic decisions.

There is a common misconception that VC's hold on to their share of the business forever. In reality venture capitalists typically look to realize their investment between 3 -7 years after they buy into a business. During this period the VC aims to help the business grow and become profitable so that the business (and their share in it) becomes more valuable. If the company succeeds the VC will look to exit either by selling their share of the business either to the original partners or to an external third party for a higher price than what was initially invested. Since the Venture Capital companies interests and those Ranil and Samith are aligned it serves as a win-win situation for everyone involved.

In essence when deciding whether or not to help you raise capital for your new business VC's tend to look to the future (or potential) of a business and also take into account how invested the entrepreneurs themselves are in making it work. On the other hand debt based lenders tend to look to the past. If you don't have a business track record and collateral a loan can be almost impossible to get.

While the above has been simplified to make a point the general theme runs true. If you have a great idea and are looking for partners to provide some financial stability and/or industrial knowledge Venture Capital could be the option for you.

At present the potential for Sri Lankan entrepreneurs is immense, and the right kind of advice and funding can make all the difference.