

ENTREPRENEURIAL FINANCE

Who Funds a Start-up?

Capital providers across the entrepreneur's journey — from bootstrapping to angels, venture capital, private equity, mezzanine finance, IPOs and bonds

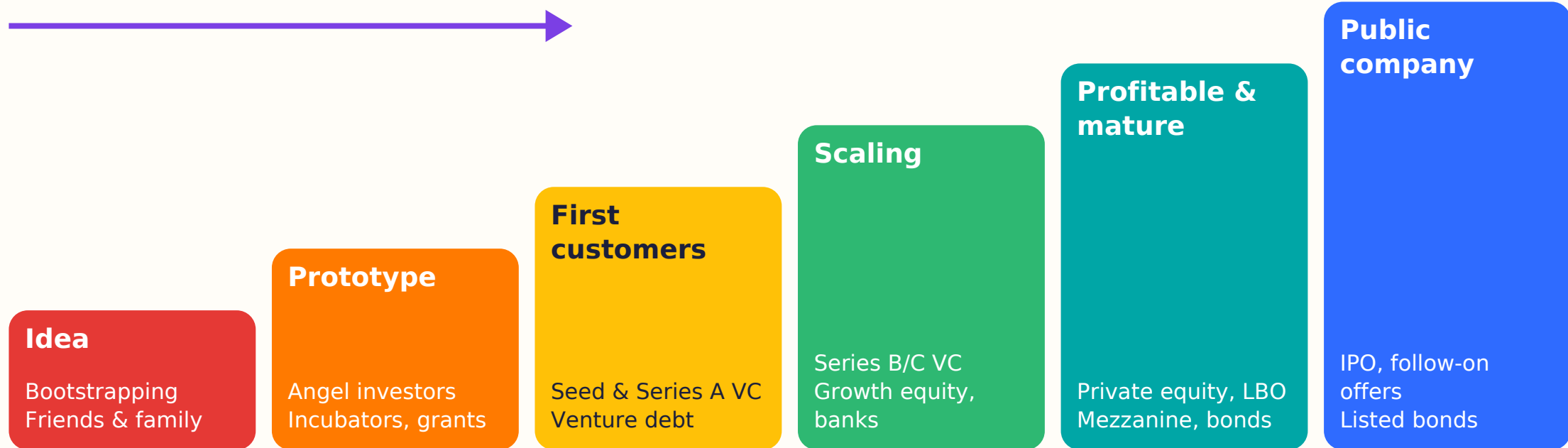


THE BIG IDEA

Money follows evidence

A start-up does not raise “funding” once. At every stage it raises the kind of capital that fits its risk, its evidence and its cash needs. As risk falls, cheaper and larger pools of money open up.

Risk falls · amounts grow · cost of capital falls



Match the money to the stage: risky ideas need patient equity; proven cash flows can carry debt.

Three types of capital

Every capital provider offers some mix of three instruments. They differ in who gets paid first, what it costs, and how much control the provider gets.

Equity — Owners' money

- Shares in the company
- No fixed repayment
- Paid last, earns the upside
- Most expensive; dilutes control
- e.g., founder, angel, VC, PE, IPO

Hybrid — In between

- Convertible notes, preference shares
- Mezzanine debt with warrants
- Interest plus an equity kicker
- Ranks below banks, above equity
- e.g., mezzanine funds, venture debt

Debt — Lenders' money

- Loans, bonds, debentures
- Fixed interest and repayment
- Paid first, often secured
- Cheapest; interest is tax-deductible
- e.g., banks, NBFCs, bond investors

Cost of capital rises from debt → hybrid → equity, because risk to the provider rises in the same order.

Bootstrapping, friends & family

Before anyone else will invest, the founder funds the venture — with savings, credit cards, early customer cash and a lot of frugality.

Founder savings

The first and most committed money. Shows investors “skin in the game”.

Friends & family

Trust-based money, often on loose terms. Put it in writing to protect relationships.

Customer cash

Advances, pre-orders and fast collections fund growth without dilution.

Frugal operations

Used equipment, shared space, rented assets, founders on low salaries.

Plus: keeps full ownership and control. **Minus:** slow growth, personal financial risk, and an opportunity cost — the salary and returns the founder gives up.

Bootstrapping is not free capital — it is the founder paying in time, savings and forgone income.

Angel investors

Angels are wealthy individuals who invest their own money in very early companies — often alone, sometimes through angel networks or syndicates.

What they bring

- Early cheque when banks and VCs say “too early”
- Industry experience and mentoring
- Introductions to customers and later investors
- Flexible, often simpler terms

What they look for

- A strong founder and a real problem
- Early proof: prototype, pilot, first sales
- High return — many angel bets fail
- A path to a VC round or an exit

Common instruments

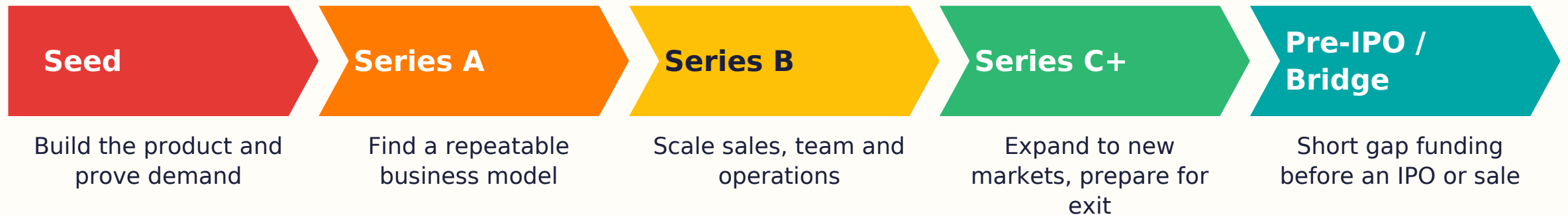
- Equity shares
- Convertible notes or similar instruments that convert into equity at the next round
- Usually a minority stake and sometimes a board or advisory seat

Angels are “smart money” at the riskiest stage: they price risk high and expect a big share of the upside.

Venture capital — stage by stage

Venture capital firms raise funds from institutions and wealthy investors and invest them in high-growth start-ups — in rounds tied to milestones.

How VC works: money arrives in stages, each round at a higher valuation if milestones are met · investors take minority stakes with board seats and protective rights (liquidation preference, anti-dilution) · each new round dilutes earlier owners · the fund makes money only on exit — a sale or an IPO.



Also at this stage: **venture debt** — loans to VC-backed companies, usually with warrants, used to extend runway with less dilution.

Staging the money limits the investor's risk: each round buys the evidence needed to justify the next.

Private equity and the leveraged buyout

Private equity funds invest in established businesses. In a leveraged buyout (LBO) the fund buys control of a company and pays for it largely with borrowed money.

How an LBO is paid for
illustrative mix



Three ways the PE fund earns its return

- 1 Grow EBITDA** — better operations, pricing, add-on acquisitions
- 2 Pay down debt** — the company's own cash flows repay the loans, so equity grows
- 3 Sell at a better multiple** — exit to a strategic buyer, another fund or an IPO

Also: **growth equity** — minority investments in profitable, fast-growing firms, usually with little debt.

Leverage magnifies returns — and risk. It only works when the business has steady cash flows to service the debt.

Mezzanine finance — the middle floor

Mezzanine finance sits between senior debt and equity in the “capital stack”. It is used for buyouts, expansions and recapitalisations when banks will not lend more and owners do not want more dilution.

Common equity

Paid last · highest risk · highest expected return

Preferred equity

Fixed dividend, ranks ahead of common shares

Mezzanine debt

Subordinated loan + interest (cash and/or PIK) + warrants

Senior secured debt

Paid first · secured on assets · lowest cost

risk & return rise
↑

Why use mezzanine?

- Fills the gap between what banks lend and what equity covers
- Less dilution than raising new equity
- Flexible: interest can be paid-in-kind (added to the loan)
- Provider earns interest **plus** an equity “kicker” through warrants
- Costs more than bank debt, less than equity

Mezzanine = debt that behaves partly like equity: higher return for lending behind the banks.

Going public: IPOs and bonds

A mature company can raise money from the public. The equity capital market sells shares; the debt capital market sells bonds. Both need disclosures, ratings or regulatory approvals and a track record.

Equity capital: the IPO

- Initial public offering lists the shares on a stock exchange
- **Fresh issue** brings new money to the company; an **offer for sale** pays existing shareholders — the exit route for VC and PE
- In India, smaller firms can list on SME platforms such as BSE SME and NSE Emerge
- Later: follow-on offers, rights issues and QIPs
- Gives liquidity and a market price; brings scrutiny and disclosure

Debt capital: bonds and debentures

- Bonds / non-convertible debentures (NCDs): fixed coupon, repaid at maturity
- Commercial paper for short-term needs
- Credit rating sets the interest rate investors demand
- High-yield bonds can fund buyouts
- No dilution, but fixed obligations and covenants

An IPO is both a funding event (fresh issue) and an exit event (offer for sale) — know which money goes where.

PUTTING IT TOGETHER

Who funds what — the summary

Provider	Typical stage	Instrument	Control	Cost to the company
Founder, friends & family	Idea	Equity / soft loans	Founder keeps control	Opportunity cost
Angel investors	Prototype, early sales	Equity, convertibles	Minority, advisory	Very high
Venture capital	Seed to late stage	Preferred equity	Board seats, rights	High
Venture debt / banks	Revenue, assets	Loans, working capital	Covenants	Low-moderate
Private equity (LBO)	Mature, cash-generating	Control equity + leverage	Majority control	High (equity)
Mezzanine funds	Expansion, buyouts	Subordinated debt + warrants	Covenants, some rights	Moderate-high
Public markets	Proven, scaled	Listed shares, bonds	Dispersed owners, regulation	Lowest at scale

“Cost” is the return the provider expects, in broad relative terms — not a quoted rate.

KEY TAKEAWAYS

Five things to remember

- 1 Capital follows evidence: each stage of proof unlocks larger, cheaper money.
- 2 Equity is expensive and dilutes; debt is cheaper but must be repaid from cash flow.
- 3 Angels and VCs fund risk in stages; each round buys the evidence for the next.
- 4 PE buyouts and mezzanine use leverage — they suit steady, cash-generating businesses.
- 5 IPOs and bonds open the deepest pools of capital — and an exit for earlier investors.

Illustrative teaching material. Terms and practices vary by market and change over time.