diffusetap
Virtual Event Series

Revenue-Based Financing for Minority-Led Companies

Guest Speakers:

Kim Folsom

Founder and CEO
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Director of Investments
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DiffuseTap: Revenue-Based Financing for Minority-Led Companies

Last time on DiffuseTap, Kim Folsom and Bella Gangnes from Founders First Capital Partners, LLC talked to us about driving success rates forward for minority-led companies, the ideal debt strategy for startups, and the key factors to alternative revenue-based financing as opposed to the norm.

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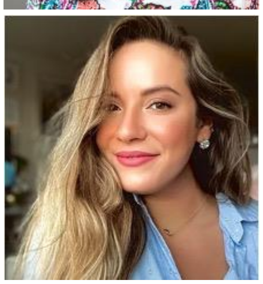
DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speakers

KIM FOLSOM is a high-tech executive and serial entrepreneur who has been founding, leading, and growing innovative companies for more than 25 years. Among others, she is the founder and CEO of Founders First Capital Partners, the largest minority and women-owned direct investor of revenue-based funding and advisory support. LinkedIn: @kimtfolsom



BELLA GANGNES is an experienced finance professional with years of experience in the tech industry and in fundraising. Bella is the Director of Investments at Founders First Capital Partners, as well as Regional Associate of Gen Next, an exclusive membership organization of community-leading CEOs and entrepreneurs. LinkedIn: @bella-gangnes

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KENNY ESTES: Today, we are going to be joined today by Kim and Bella. Kim, do you want to do a brief introduction to start things off?

KIM FOLSOM: Certainly. Good morning, everyone. Well, I'm in San Diego, California, and it's morning here. I'm delighted to be here with my colleague, Bella Gangnes, who is our investment director. First, I want to give you an overview of Founders First, as well as revenue-based financing as an alternative. I am Kim Folsom, founder, chairperson, and CEO of Founders First Capital Partners, as well as the founder of Founders First CDC.

We are an accelerator that focuses on funding and growing businesses led by diverse founders, and we have a very inclusive definition of that. That includes women, people of color, military, veterans, LGBTQ, and those in low and moderate income areas. Founders First is my seventh venture.

As I was sharing with the breakout sessions from earlier, I started my first company in the crazy dotcom era, but I started my career as a software engineer. I eventually got on to the business development side, and later, I found that the best opportunity for me to solve big problems was becoming a founder of my own company.

Prior to Founders First, I founded six tech companies, four of which were venture backed. Most of the money that I raised was from traditional institutional VC. I found that the guys that I went to school with who did the best, who did well enough to retire early, were ones that did not rely just on equity capital. They generally had more debt than equity.

So when my investors had encouraged me to go to the other side of the table, I looked at other models for funding and growing companies, as well as where their gaps were in the market, and I saw two things. One, as I assume everybody has heard the story before, is less than 2% of capital goes to people of color and women-led businesses. And two, there is a lot of a lot more wealth created in asset accumulation when structured finance is used as one of the capital stacks, not just traditional equity.

I gravitated towards revenue-based financing because the interests are aligned with the investor. The success of a company equates to a successful outcome for the investors. And I also found that you don't have to have a liquidation event for there to be a return to the investor. I had the chance to connect with some of the best ones, like Lighter Capital, and that's how I got connected with many of the folks that I've been blessed to be working with. I'll pause there. I'm delighted to have Miss Bella join me for this discussion.

BELLA GANGNES: That's a tough act to follow. But I'm really excited to be here and meet all you guys. This is my second company working in the revenue-based financing space. Previously, I was at Lighter Capital like Kim mentioned, and I came over to help carry out the mission that Kim has put in place. We're really looking to grow and empower underserved small businesses and create more wealth and job opportunities for those demographics.

AYLA: Beautiful. We'd love to dig a bit into the details here. I know that Kim mentioned how Founders First came about, and her background running ventures etc., but an interesting question to ask is, how did you decide to run a hybrid model where you both provide capital and do programming at the same time? I'd love to know a bit more about how you structured that.

KIM: Sure. Well, if you look at any successful outcome, it's not all just about the money. It's what you do when you do it, and the network of people that you put together. As one of my investors shared with me, success has many fathers, but failures are generally orphans. Being able to help the companies get an understanding of what a big, economically feasible strategy looks like, giving them the resources to help them do that, advocacy, community — all of this gives them better chances to achieve success.

Funding a critical portion of our model, we have an accelerator on one side providing pre-funding education. It's not for everybody, but the majority of companies that we work with do take advantage of this. And we provide a flexible, low dilutive capital base. Additionally for the companies we fund on the other side, we provide them with expansion advisory support to help them with execution.

KENNY: Bella, can you talk a little bit about how you source companies? I think Kim alluded to the accelerator there, but what are the main sources of opportunities for you?

BELLA GANGNES: A lot of our model is boots on the ground, making connections and taking advantage of networking opportunities, and just getting the brand out there. I think the education piece is huge. With a lot of companies, especially in the market that we're trying to serve, there is just a lack of education around other options and resources. Of course, people know banks and VCs, but having that, again, boots on the ground mentality of just being a sounding board, and being a strategic partner and resource for these companies, is our biggest focus. It's definitely a mix of inbound and outbound efforts to find the right fit with companies that really believe in the mission and could benefit from our type of support to grow.

KIM: To add to that, as I mentioned to the folks earlier in the breakout room, we are a national platform. Today, we're in four regions. We're based in San Diego, we have a presence in Midwest (Chicago), Texas, and just recently we launched into the New Jersey and Pennsylvania area.

We expand to new regions with the launch of our job creators grant to identify and recognize those diverse founder led businesses that are committed to grow and create jobs. Many of the companies that we work with are service-based businesses, or tech-enabled service-based businesses.

They may not be the next Facebook company, but our model platform provides a great way for them to get access to flexible growth capital, without having to give up a substantial amount of their equity. And so, if you go to foundersfirstcdc.org, you can see our various grant programs, and we welcome you guys to share that with other people.

AYLA: That takes us to one of the points about the way you source companies and how you evaluate them. With regular revenue-based financing, it's highly data-driven, and it's based on whatever financials that they might have in place (past revenue, etc.). What have you learned about these minority-led companies or diverse founders in the way that they manage their own data and the data that you can get from them to conduct your own underwriting process? What's different about these companies and these founders than with a standard RBI candidate?

KIM: I'd like to defer to Bella as our investment director, who has done a fantastic job of helping us refine our model to help these companies get access to growth and capital, but I'll make a comment about the opportunity of diverse founders to create value.

Access is important, and with the right capital, there is an opportunity for diverse founders to create value. Recently, one of the last companies we funded came to us mostly a service-based business, but they were able to add a SAAS software platform as a key component to their business, that they would not otherwise be able to if they had not gotten that funding. I guess everybody knows this, but most VCs do not fund service-based businesses.

But with this type of capital, they were able to create substantial value. Their valuations went from being an EBITDA base to top line revenue. With Founders First, we can fund up to $1 million dollars, which is a substantial amount of capital to help businesses making that transition. As our method of underwriting them I will defer to Bella on that one.

BELLA: Strictly speaking to the difference between companies that I evaluated in a previous role versus here, a lot of the founders that we see are very much first-time founders. Most of them are first generation entrepreneurs. They often aren’t fully aware of all the options available to them, and they don't know everything that’s out there. And so, there's a little bit more hand holding and education that goes into it.

There's a bit more of trying to make sense of financial statements that they've put together in an Excel file, as an example, and sometimes more skeletons in the closet. But that doesn't make them any less of a valid candidate for funding or growth. It just may take a little longer, require a little more creativity, and a little more reading between the lines. But at the end of the day, the biggest theme is that they are so excited and inspired to be talking to an institution that is truly out for their best interest and focused on empowering them in a market that has been traditionally marginalizing.

A lot of people relate to the mission that Kim has set out to achieve, and it's really rewarding to watch it come to fruition. We really get to be these long-term growth partners with our clients, - we get to have multiple calls a day with people trying to make sense of how they're looking at certain numbers in their business or want insight on how to grow a new line item or revenue model in their business to make them more attractive to not only us, but future investment partners. We see a lot more openness and a lot of willingness to get down to work and to get their hands dirty.

On the contrary, many of the other companies that I've worked with have that “been there, done that” mentality, where they think they know everything already and there’s much added value besides capital. They think that we're just kind of another cog in the machine for them to get to the end goal. Whereas I think this market that we're trying to serve really wants to be partners with us, and we want to see them grow just as much as they want to have this proof of our mission fulfilled.

KENNY: That's great. It's always nice to be able to have a direct impact on people, where you can actually see their efforts pay off. Kim, this question is from the audience. Going back to your intro, specifically about equity and RBI debt strategy, if you're a startup going out there, what do you recommend to people if they're doing a blended strategy? Should they go with equity to start, and then go to RBI, and then debt? What does that look like in an ideal world?

KIM: I'm going to use one of my friends as an example. This guy that I went to undergrad with who started a company, most of his funding was debt. He took a small amount of equity, and he was in a position where he had friends and family money. Most diverse founders don't have friends and family money. Most diverse founders start their companies by using their 401k or savings. So, when they start with a small amount of money, they start with the mindset of getting to a certain level of profitability.

The mindset is a bit different, focus on positive cash flows and path to profitability, than just building something and burning a lot of cash, and just constantly doing an ongoing series of raises. Using this mindset, you can start with a small amount of capital to get to a specific operating cash flow model. And then from there, you can go into debt, if you happen to have the profile to meet lenders' requirements.

However, most entrepreneurs don't have a lot of personal assets that you need to pledge a traditional debt. So alternatively, if you can demonstrate that you have sufficient cash flows and margin, revenue-based financing is an attractive option, because you're not having to give up a lot of equity and so forth.

My view is that if you can wait to do a significant equity financing beyond a small amount of money from friends and family, or angels, before you do a series A, and if you can wait to the point where you are in the high seven figures, you're going to be in a much better position to raise equity capital. That is because you are going to give up a lot less equity before you do your first series A.

You might have read about this, but Founders First just closed our series A financing. This was my fourth series A, and I purposely waited almost five years to get to this point because I wanted us to have a certain level of traction before taking on any equity financing. I practice what I preach. I've learned from my other six companies that taking equity too early might not be ideal because stuff always happens, and you're going to need capital to fuel what you're going to do. Until you really get to a significant level of scale, you have to be able to manage that capital stack. It's important.

AYLA: When looking at managing capital stack, and the model that came about, what is your experience raising that capital? Who was interested in this model? Because it's so unique and different. It's not something that they might have seen before. And also, who is your ideal LP, and how do you get them across the line? How did you communicate this process?

KIM: It varies. Raising funds is hard work, especially because we are a structured finance company that is focused on revenue-based financing. Our proof-of-concept fund aimed to demonstrate that you can provide returns that are equity-like by funding this diverse market and these specific demographics. People were saying they haven't seen anyone do that before.

The investors that participated in that were largely some of my prior investors from my prior companies. As I shared, this is not my first-time raising capital, so many of my early angel investors were my early investors, and we were able to demonstrate enough traction.

That's because the way our model works is, we raise an amount of funds to invest in our companies, and the majority of those companies come through our accelerator. And we provide distributions back to our investors on a quarterly basis. And so, I had a couple of years' worth of proof of not only providing a certain level of return but providing a certain level of distributions back.

And that was sufficient enough evidence that it allowed us to attract a $100 million facility through CIM. But ultimately, our goal is for our portfolio to attract more catalytic capital. We're actually in the midst of working on our third pool of capital. The process continues.

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Corporate Director, CME Group

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