INVESTING 101:

HOW TO INVEST IN STARTUPS

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INVESTING 101: HOW TO INVEST IN STARTUPS

Investing in a startup can be a profit-making venture for many people, especially retirees looking for a way to generate passive income during their golden years. However, many don't know how to get started or what to expect.

In fact, according to the reports, there was an increase of 5.9 million private businesses in the UK in 2019. Including several small businesses, unicorns and SMEs.

Between 2018-2019, more than 600,000 startups were founded in the UK, an increase of 8.5% compared to the last year, making it the highest number of incorporations since 2009-2010.

The challenge, though, is that investing in startups is so different from others. That's why even those who've delved in other investment opportunities in the past find investing in startups intimidating and overwhelming.

In this beginner guide, you'll learn the benefits of investing in startups and how to invest in them so that you can further diversify your portfolio and generate additional passive income.

What is a Startup?

A startup is a starting company typically founded by one to three entrepreneurs mostly focused on capitalising on a discerned market demand by developing a viable product, service, or platform.

The Startup focuses on fast growth and high-end revenue. Often identified for incorporating technology in their services, they usually rely on raising capital from angel investors, venture capitalists (VC) and crowdfunding platforms at every stage of their development.

Because of this funding model, they attract the best talents to come and work for them and see their product as world-changing.

Startups vs Small Businesses

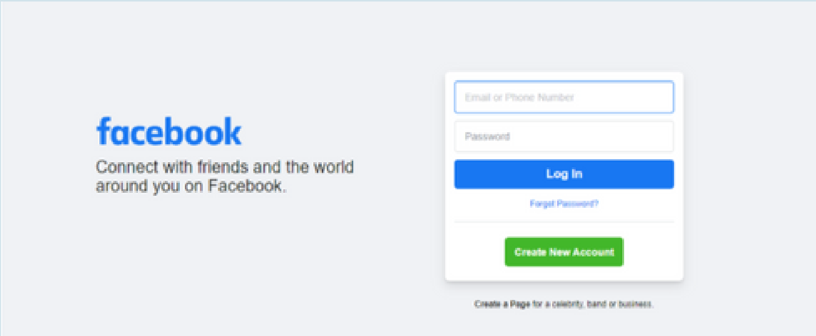
There is a very thin line between startups and small businesses. A startup is often misrepresented as a new small business. However, there is considerable variation between these two.

According to Act 2006 in UK's Companies, a small business is defined not to have an income of more than £6.5million, a balance sheet total not exceeding £3.26 million and does not have more than 50 employees.

Startups, on the other hand, go through many series of funding, including a budget that doesn't attempt to be profitable for the first few years into their plan. That's because their main focus is creating a brand new market or to disrupt an industry and gain market share.

Famous Companies That Began as Startups

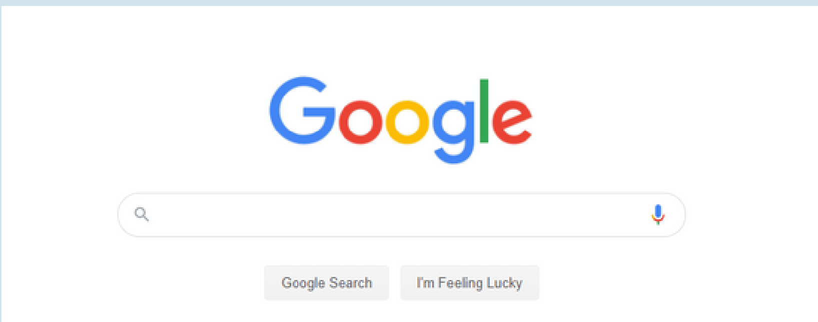
FACEBOOK



In 2003, Mark Zuckerberg created an online programme called "Facemash", which allowed users to compare photos of their faces and select whom they deemed as "hotter".

Years later and renamed, Facebook is one of the most influential social networks in the world, boasting approximately 2.2 billion monthly users.

GOOGLE



In 1995, Google's story began at Stanford University when Sergey Brin was assigned to show Larry Page around the campus.

According to some people, they used to disagree about almost everything during that first year, but by the following year, they formed a partnership.

They built a search engine that used links to determine the importance of individual pages on the World Wide Web. They called this invention of theirs, Backrub. But after a while, Backrub was renamed Google.

The term Google was a name play on the mathematical expression for the number “1 followed by 100 zeros” that later on reflected Page and Brin’s purpose “to organise the world’s information and make it universally accessible and useful.”

After a few years, Google caught the attention of the academic community and Silicon Valley investors.

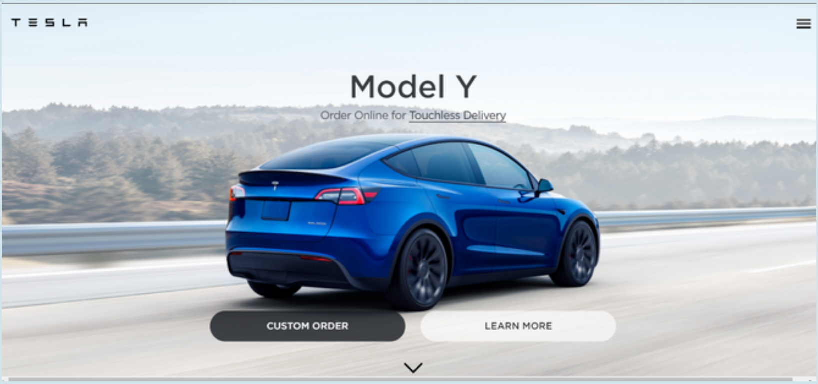
In August 1998, Sun co-founder Andy Bechtolsheim wrote Page and Brin a check of $100,000, and Google Inc. was officially born.

Google became the top search engine used in the world today because they are using advanced algorithms to show the most accurate results to the users.

Over the years, the Google ranking algorithm has enriched with hundreds of other factors remains the most reliable way to find what you are looking for on the Internet.

They diversify from just a search engine and now offer additional services like Gmail, Google Drive, Google Meet, Google Docs, etc.

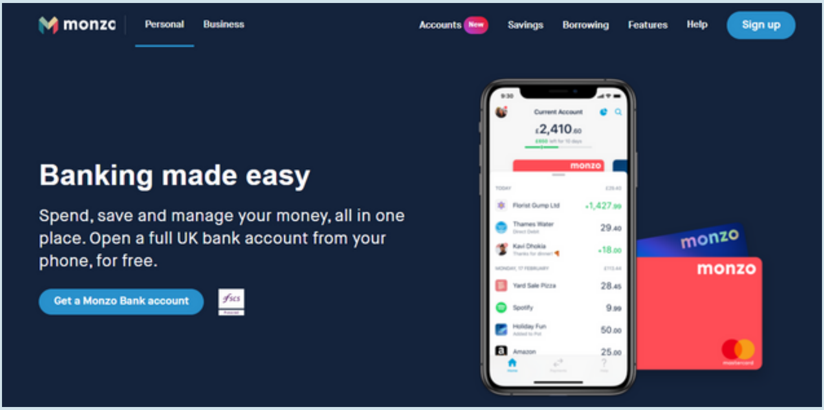
TESLA



Tesla Inc., formerly known as Tesla Motors, an American electric-automobile manufacturer, was founded in 2003 by Martin Eberhard and Marc Tarpenning. The company is named after the Serbian-American inventor Nikola Tesla.

It was formed to create an electric sports car. Eberhard was the company's chief executive officer (CEO) and Tarpenning as its chief financial officer (CFO). The company obtained funds from several other sources. Still, the most notable was Paypal co-founder Elon Musk, who contributed about $30 million to the venture and eventually became the chairman of the company, beginning in 2004.

MONZO



Founded in 2015 by Tom Blomfield, Monzo was launched in October 2015 as Mondo, before its name change.

The initial plan was to release a prepaid card which you have to load funds onto but fully transitioned to a full bank account.

Blomfield used to be a co-founder of Starling together with Boden before Monzo but reported that they had tensions between the two.

Blomfield then left Starling, taking with him some of their team members to form Monzo.

With the card's features always a step behind Starling, Monzo's customer service still won the hearts of people and helped them spread its menu to millions without doing any advertising.

The fast-spreading of Monzo's cards is all thanks to it being radically different to traditional banks.

And the fact that the British banking system is always ahead to the US, in terms of technology and less complex regulations at state and federal levels.

3% of cards in the US are contactless according to a 2018 report from AT Kearney, compared to 64% in the UK.

One apparent reason for this disparity is mainly because the UK is far smaller than the US.

Why should you invest in startups?

Investing in businesses is a way for investors to expand their portfolio and also to generate passive income. Thus, over the decades, corporations have become more popular over sole proprietorship and general partnership.

In fact, between March 2018 and March 2019, there was an increase of 3.3% in corporate businesses (companies and public corporations). Approximately 9,000 businesses that were sole proprietors or partnerships became corporate businesses.

This only shows that there are many advantages to investing in startups. Including:

Higher returns on your investment

Investments come with inherent risks, and to be able to cover those risks, entrepreneurs, capital owners, and businesses require a return on investment.

Return on investment (ROI) refers to the amount of business profit you will receive in exchange for your investment.

The return is typically higher than any other types of investments.

Qualify for tax breaks

Qualifying for the tax break is one of the advantages of investing in startups.

Seed Enterprise Investment Scheme (SEIS) and the **Enterprise Investment Scheme (EIS)** are two of several UK government's initiatives which encourage innovation by granting private investors a tax break when investing in early-stage, 'high-risk' companies. These two schemes are similar, but it is essential to know some of their significant differences.

EIS focuses on medium-sized startups and allows an individual to invest up to £1 million per tax year and receive a 30% tax break in return. Same with SEIS, the investors won't pay any capital gains tax on any profit arising from the sale of the shares after three years.

The Enterprise Investment Scheme launched in 1994. Since its launch, 29770 companies have received investment. And the total funds raised have been more than £20 billion.

In 2017 to 2018, 3,920 companies were able to raise a total of £1,929 million. Compared to the amount raised from 2016 to 2017 wherein 3,655 companies raised £1,901 million.

In 2017 to 2018, 1,710 companies benefited from the EIS scheme for the first time, raising a total of £759 million of investment.

In 2017-18, companies from the Information and Communication sector with 33% or £641 million cornered the lion's share of investment.

Aside from the amount of reduced tax, another thing to note is that EIS allowances are allocated individually. Say a married couple invested a certain amount separately in one tax year, they can each claim tax relief.

SEIS, on the other hand, focuses on early-stage companies and allows an individual to invest up to £100,000 per tax year and to receive a 50% tax break in return. The investors will also benefit from a capital gain tax exemption on any profits that arise from the sale of shares after three years.

Seed Enterprise Investment Scheme (SEIS) launched in 2012 to 2013. Since then, there have been c. 12,900 companies that received investment from it, and over £1 billion of funds have been raised.

In 2017 to 2018, about 2,320 companies have raised a total of £189 million of funds under the SIES scheme. In comparison with the years 2016 to 2017 when 2,425 companies raised £187 million.

One thousand seven hundred new companies were raising funds under the SEIS scheme for the first time in 2017-2018, representing £159 million of investment.

In 2017 to 2018, companies from the Information and Communication sector accounted for £69 million (37% of all SEIS investment).

	EIS	SEIS
UPFRONT INCOME TAX RELIEF	Up to 30%	Up to 50%
ANNUAL LIMITS 2018/19	£1m + carryback allowed	£100k + carryback allowed
TAX-FREE EXIT	Yes	Yes
CAPITAL GAINS RELIEF	Up to 28% deferral	Up to 14% saved
TAX FREE DIVIDENDS	No	No
IHT FREE	Yes (after 2 years)	Yes (after 2 years)

SHARE LOSS RELIEF	Yes	Yes
MINIMUM HOLDING PERIOD	3 years	3 years

Source: Micap

The income tax relief is available to all investors who have a UK income tax liability against which to set the relief; the investors do not need to be a UK resident. These tax incentives enhance the returns and help to reduce risk to investors' capital. However, investors must still consider the investment risks and opportunities before they decide to invest and should seek advice from a financial adviser.

Make a difference in today's world

Startups change the world by creating an environment for quick learning with a safe opportunity for failure in a progressive business.

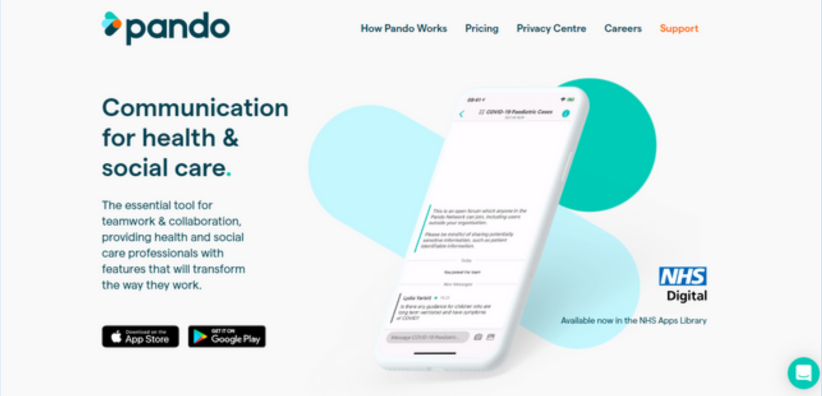
It's about finding the soft spot of the customers, but also including the employees' satisfaction.

Quick thinking means fast advancement, which is how startups change the world by being twenty steps ahead.

Startups change the old ways and come up with new ones that are accepting of failure and uncertainty. They build innovation out of disruption.

Here are some health tech and biotech startups examples:

Pando Health



Pando Health was founded in 2016 by two UK-based doctors and a serial entrepreneur.

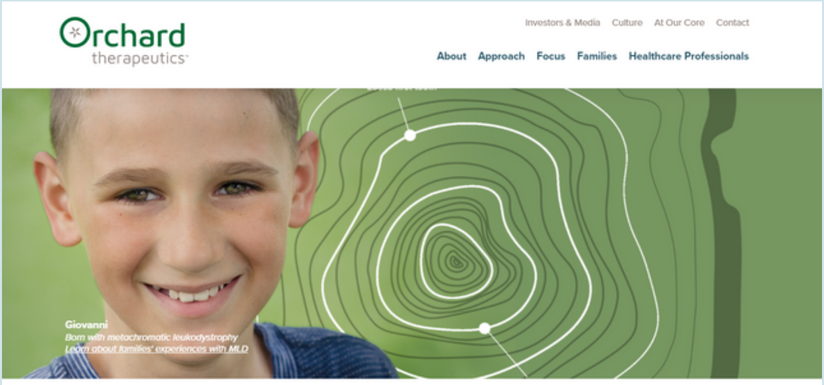
Pando is a clinical communications website that offers different features built for health and social care. Formerly known as forwarding health, their platform is currently used by over 25,000 professionals in 200 NHS hospitals.

They also provide secure messaging, open forums, image sharing, patient lists, file sharing, and active directory enable clinical professionals to provide the best possible care.

The platform is fully encrypted, NHS- and GDPR- compliant and is free for all NHS staff to download and use.

Pando rebranded in January 2020 - when it also announced a $5 million (£3.86 million) cash injection from investment firm Skip Capital, which joined existing investors Stride.VC and Albion Capital.

Orchard Therapeutics



Founded in 2015, Orchard Therapeutics is a biotechnology company dedicated to transforming the lives of patients through innovative gene therapies.

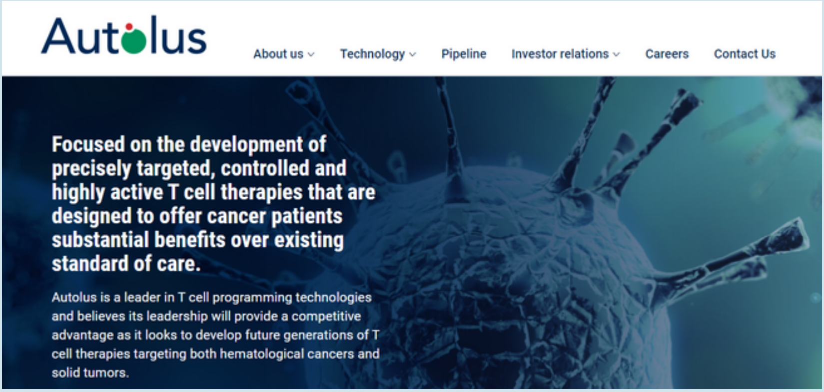
They were developing multiple gene therapy candidates to treat rare genetic conditions.

Orchard now has one of the most advanced genes therapy products in the industry spanning multiple therapeutic areas where the disease burden on families current treatment options are limited or not yet exist.

Since April 2018, Orchard has been in charge of selling Strimvelis, gene therapy for the rare immune disorder ADA-SCID initially invented by the pharma GSK while they had only managed to sell the treatment once.

In 2018 Orchard reported €1.9M (£1,732,036.67) in sales from Strimvelis in Europe. The company did an IPO last year on the Nasdaq that set the company value at over €1B (£912,178,199.10).

Autolus



It was established in 2014 by Dr Martin Pule. Autolus is a biopharmaceutical company that focuses on the development of next-generation CAR-T therapy.

They're dedicated to bringing life-changing treatments to cancer patients by changing their T-cells to fight the treatment of solid tumours and haematological malignancies—healthy T cells required to protect the body from infections and other external threats.

Autolus now manages multiple clinical trials, and first results are expected next year. After the company did an IPO in 2018, the company now valued at over €1B.

The downside of investing in startups

One of the most significant risks involved in a business is a failure. What if the company collapses? There are many reasons as to why a startup may fail, whether it is running out of funds, a lack of product-market fit, or poor business management.

It is even more challenging since a startup does not have history and has less profit to show.

This makes investing in them risky and the fact that about 20% of new business ventures fail in the first year, 30% fail in the second year, and by year five, about 50% of them have dissolved can be more nerve-wracking.

Higher risk involved

Even with such growth potential, startups are high-risk investments because the majority of small businesses fail.

In 2018 to 2019, there were more than 500,000 companies dissolved, making it risky for the investors since the number of incorporations or new businesses founded from the same year was more than 600,000.

Making the percentage of 'business deaths' about 83.33%. More than half of the registered businesses failed.

This statistic only shows how vulnerable and unstable startups are. Therefore, an investor should take into consideration the ideas and plan of the founders and also the growth potential of the startup.

Longer timelines

Since the business is still starting, and it's an idea that is yet to be implemented, it would take longer for the startup to produce profits and revenues.

The investors might not be able to get the return of their investment (ROI) yet, and it would take months or even years (all depending on the skill and knowledge of the business founders) before they can finally see the fruit of their investment.

Equity is not liquid

When you buy a share in company stocks, you take part in the ownership interest of the company, and every share of stock represents a portion of company equity you own. Equities are usually liquid, which means it's easy for you to buy and sell them quickly.

However, startup investments are not tradable like publicly traded stocks. It means that when investing in startups, you should expect that you cannot market your stake until the business either goes public or is acquired.

Now that you know the downside of investing in startup businesses, here are some examples of the most notable UK startup failures of 2019:

Metalysis

Metalysis developed a technology that claimed to produce metal and alloy powders with reduced financial and environmental costs. The technology had several applications across the aerospace and automotive industries but was primarily being used to make titanium powder for 3D printing.

Faraday Grid

Faraday Grid produced devices that designed to aid electrical energy conversion by increasing the energy-carrying capacity of existing infrastructure and networks.

Loot

Loot developed an online bank where clients will use a prepaid MasterCard and an app with money management features. The bank, which was operating through FCA authorised Wirecard, was aimed at students, and reportedly racked up an impressive 212,000 customers.

TIPS ON HOW TO INVEST IN STARTUPS

If you are still new to the stock market, there is a high possibility of making a mistake that could cost you dearly. A wise investment is a combination of three P's — Patience, Practice and Practical hands-on application.

First-time investors often make a mistake by overthinking about the amount of money they will invest. Most of them wait for a very long time to make a large initial investment. When in fact, waiting to have a large capital sum is just delaying them to get on the investment bandwagon.

If you are like this, what you can do is to start with a small amount of money but be consistent about it. By doing this, it can help you get started without putting a strain on your resources.

Another thing to note is to avoid putting all your eggs in a single basket. Ideally, an investor should make a portfolio consisting of seven to ten investments that have a low correlation with each other.

This will help you have a diverse portfolio while also trying to avoid losing all your money all at once.

Moreover, the reason why you should look for investments with low - or even without correlation with one another is that different businesses react differently to some economic or world changes.

First-timers often turn to quick buying and selling, hoping to make a profit on their deals, but these short-term gains are taxed at regular rates, whereas long-term investments are often taxed at a lower rate.

Thus, having a long term and more precise plan is the way to succeed in the Startup world.

01 Decide on what kind of startup investor you'll be

The two main types of investors are angel investors and venture capitalists.

An angel investor, also known as business angels, are influential individuals that typically have a high net worth who invest and provide funds for small startups in return for equity in the company.

The UK hosts a large number of angel investors who have invested in at least 15,000 small businesses from 2015, and the median initial investment by an angel investor is 25,000 GBP.

In contrast, venture capitalists (VC) are firms that consist of a bunch of professional investors that provide financial support to startups with high growth potential in exchange for an equity stake.

If you prefer to work alone, being an angel investor might be better for you, while those who function well with others should turn towards being a venture capitalist, as they work with a company.

Another difference has to do with how much they invest; angel investors typically invest between £20,000 and £75,000 of their personal money. When angels aggregate in a group, their combined investment may exceed £576,390.

On the contrary, venture capitalists (VC) can invest up to £5.3 billion on average in a company.

02 Know what type of startups you'd want to invest in

One reason why a startup fails is that they are too broad within a market. The same goes for investors. As an investor, it is crucial to narrow down your hunt for a market niche. A niche targets a distinct industry in which investors are most likely to find startups and businesses that solve specific, little-serviced problems.

Here are some startup investment opportunities worth considering:

Stork Card

Target amount: £500,000
Raised: £100,000
Minimum: £20,000

StorkCard empowers parents taking back control by offering an AI-driven cost prediction, tailored financial solutions and an uncomplicated way for family and friends to provide support.

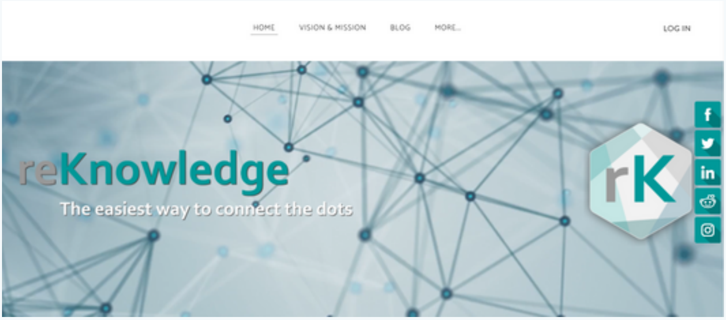
Teysha Technologies

Target: £2,500,000
Raised: £1,900,000
Minimum: £20,000

Together with leading research scientists, this EIS Advanced Assured company has developed a unique IP to fulfil the growing need for sustainable plastics. Teysha Technologies have created a patented, renewable, fully biodegradable plastic replacement, using waste from landfill to produce sustainable and biodegradable plastic alternatives for hundreds of different applications.

They have been recognised throughout the mainstream media for promoting tackle the Plastic Pollution crisis and have numerous letters of intent and pre-orders with scalable international partners.

Machine Empowering Human Led Research



Target: £250,000
Raised: £350,000
Minimum: £10,000

reKnowledge offers a new paradigm in how humans and machines interact to build actionable knowledge. They are changing knowledge research from narrative-driven tradecraft to a data-driven one, by bringing the power of new technologies to the domain experts in an intuitive and easy-to-use interface.

Next-gen Nano

Target: £1,500,000
Raised: £1,500,000
Minimum: £20,000

Disruptive Nano company is being led by a world-renowned scientist that has made a breakthrough which could lead to many other advancements. Their patented technology will help allow world governments to reach its goals of reducing CO2 emissions, meeting climate policy and even giving clean choices to the transportation sector.

The company's innovative technology will keep drawing from the limitless solar energy to help pave the way to a more refined and less polluted world.

You can find more startups on our home page.

03 Match the startups with your passions

In reality, finding your niche means choosing to invest in something you love discussing and are interested in – and becoming the most knowledgeable you possibly can in that respective area. It is more than diving into a subject.

It's researching the domain expertise, spending time learning it, and deciding if you should bet on the products that support it.

04 Set realistic expectations

Setting realistic expectations is a must in everything that we do, to avoid being disappointed when not able to achieve our expectation. We all want to get the most out of our money as possible, but the expectations must be realistic. The research proposes that many investors are assuming returns far higher than what the average investor can expect to produce. It's a miscalculation that could put plans at risk.

The findings of the research suggest that investors are way too optimistic about the returns they can expect. If your plans rely on you achieving returns that are higher than the realistic amount, it could leave you in a financially vulnerable position, which you should not be.

Focussing on UK investors, expectations were not as high, but there was still a marked difference when compared to reality. UK investors expected returns about 9.3%. In which, actual stock market returns between 2014 and 2019 were 5%.

05 Take advantage of startup investment platforms

Look for websites or platforms that could provide you with information about investing. Seek experienced help since they know everything you need to learn about investments.

If you are looking for examples, then our website is the best example for you.

Trendscout, for example, is a reliable UK-based platform that connects aspiring entrepreneurs with angel investors.

With more than 30 collective years of experience in investment, risk strategy, and market research Trendscout specialises in identifying successful business opportunities by connecting the right investor with the right founder.

06 Practice due diligence when choosing startup investment opportunities

The first step in regulating due diligence for a startup is to critically assess the business plan and the model for generating profits and growth in the future. The economics of the idea must translate into real-world results.

Many new ideas are so advanced that they risk not gaining market adoption. Strong competitors or significant restrictions to entry are also important concerns. Legal, regulatory, and compliance issues are also crucial to consider for brand-new ideas.

Many angel investors and Venture Capitalists (VC) investors mean that the personality and drive of the company founders are just as, or even more important than the business idea itself.

Founders must have the skill, knowledge, and passion for carrying them through periods of growing pains and discouragement. They also have to be open to advice and constructive feedback from inside and outside the firm.

They must be flexible and quick-witted enough to turn the company's direction, given unexpected economic events or technological changes.

07 Do not be afraid to ask questions

As the ancient Chinese proverb says, "He who asks a question remains a fool for 5 minutes. He who does not ask remains a fool forever."

Most people do not feel comfortable asking questions and prefer figuring things out by themselves. Though that could work as well, the best investors are still those who continuously ask questions and try to seek the right answers.

Because, as with everything in life, if you haven't done it before, you will most probably not do it perfectly. The same goes with startup investing, but it is a skill that can be acquired. Always be willing to learn more, and try educating yourself.

Also, for whatever topic, you can likely find an expert who knows more about the particular matter that you are interested in. There are sites which offer angel investment training online. Or perhaps you have a colleague that has tried startup investing before, whom you can learn from. Ask for their advice.

Do not be afraid to ask questions. Because the more you ask questions, the more you learn about the thing you want to try and venture in.

SUMMARY

In this guide, you would have learned the following:

- A start-up is a starting company whose founders focused on capitalising their still developing product.

- There is a fine line between start-up and small business that people often confuse them like each other.

- A person is never too old or too young to start investing. The sooner you realise you need to keep your money working for you, the better. Investing in a startup is a smart move, and it could help you get big. But it could also be precarious when you are not knowledgeable enough to make wise and accurate decisions.

THE NEXT STEP

Even though we've gone in-depth in this guide, you most likely still have questions on how to invest in startups.

Often, the best way to get the answers to your questions is to talk to someone who has greater knowledge and expertise about the industry you are interested in.

You can schedule an appointment with us today, and someone will get in touch with you to answer all your other questions.