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Innovator of the Month

Loan rangers: Lighter Capital has built a new way to grow (Video)

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Before Jesse Proudman sold his startup to IBM in 2015, he was forced to put everything on the line to keep his company alive.

BUSINESS JOURNAL PHOTO | ANTHONY BOLANTE
Lighter Capital CEO BJ Lackland says his firm has an interest in growing companies quickly, but entrepreneurs don't have to give up equity.

Proudman, who had two kids in diapers at the time, financed his company's servers through personal credit cards, student loans, home equity loans and by putting up his own assets to personally guarantee millions of dollars in small-business loans.

"It's a terrifying endeavor," Proudman said. "You feel so locked in. The only way out, at that point, is to make the business successful or go personally bankrupt."

A Seattle company is aiming to change the way entrepreneurs like Proudman fund their ventures.

Lighter Capital, founded in 2010 and incubated in Seattle's Voyager Capital, gives cash-strapped entrepreneurs an alternative to giving away pieces of their companies to investors or putting up their houses to guarantee bank loans.

Startups traditionally raise money by issuing equity to venture capitalist and angel investors. That works well for companies with low overhead — software startups, for example — and grow quickly. Investors hope their 15 percent stake will be worth 10 times what they put in after a few years. When the company gets acquired, makes a public offering or makes a deal with another investment firm, earlier investors cash out.

That works great for some companies, but equity funding can be difficult for others to come by — particularly for companies that might take longer to build or are trying to create a new market. Harvard Business Review in May 2013 found fewer than 1 percent of U.S. companies raise venture capital.

Additionally, some entrepreneurs don't want to give up a piece of their company — and the control that goes with that.

Banks, meanwhile, usually require entrepreneurs to personally guarantee loans and pay a fixed rate regardless of whether the business is bringing in revenue. But if the business doesn't work out, an entrepreneur can lose everything. For some, that's too much risk and can prevent a good idea from becoming a company.

Lighter Capital came up with a simple solution: a revenue-based loan. Startups pay back the loans based on their monthly revenue. The payment is usually between 2 percent and 8 percent of their monthly revenue until they reach a fixed dollar amount arranged ahead of time. The interest rate is between 15 and 25 percent.

It's the best of both equity and debt financing, Lighter Capital CEO BJ Lackland said, because Lighter Capital has an interest in growing the company quickly, but entrepreneurs don't have to give up equity. Lighter Capital has raised $120 million to issue loans to startups.

"We're trying to break the classic mold of how startups have grown," Lackland said. "Our tagline is 'revolutionizing the business of startup finance.'"

Lighter Capital funds startups with less than $10 million in annual revenue. The companies on average bring in around $2 million in annual revenue, but it can be as low as $200,000. Loans range between $50,000 and $2 million.

The revenue-based loan is an easy sell for many Lighter Capital clients because it poses less risk for young companies.

"A bank could put a company out of business," Benson said. "If your revenue does not take off as fast as you planned, that fixed repayment of a bank loan will put you into bankruptcy."

If a Lighter Capital startup's revenue is $0, its loan payment is $0.

"The payment will never put a company out of business," Benson said.

Tacoma corporate philanthropy software company Good Done Great is one of Lighter Capital's borrowers. Founded in 2008 and bootstrapped until 2014, Good Done Great took out a loan between $250,000 and $300,000 to finance an acquisition and then borrowed from Lighter Capital three more times. The loans helped convince angel investors to back Good Done Great.

"It would have stunted our growth had we not been able to make that acquisition," Good Done Great CEO David Barach said. "Financing from Lighter Capital did help a lot in defining our trajectory."

Seattle venture firm Voyager Capital came up with the idea for Lighter Capital, identified founding CEO Andy Sack, put together a team and provided an initial $1.5 million in funding.

The idea was inspired by the work of Harvard Business School professor Clayton Christensen, the father of disruption theory.

Erik Benson, the Voyager partner who came up with the idea for Lighter Capital, wanted to find a way to apply Christensen's theory — where an innovation takes root at the bottom of the market and goes on to displace the major players — to venture capital and finance.

"We said, 'There's got to be a better way to do banking and venture capital in America for startups,'" Benson said. "There was $35 billion in venture capital raised last year. Banking is a trillion-dollar-plus industry. We wanted to apply disruption theory to the industry and find a way to use big data and analytics to make better decisions on startups."

Lighter Capital made 101 loans in 2016 and is on track to make 200 loans this year. Benson expects the company will one day complete thousands of loans each month and is a candidate for a future initial public offering. For every venture capital-backed company in the U.S., Benson said, there are at least 50 companies Lighter Capital could fund.

In addition to providing revenue-based loans, Lighter Capital has come up with another innovation — a credit score for small businesses.

Banks often require startup founders to sign a personal guarantee, which determines the credit quality of a business based on the owner's personal balance sheet and FICO score. Banks, Benson said, have yet to understand the creditworthiness of a business that's only been around for a few years.

Lighter Capital evaluates loans based on the creditworthiness of the business, not the owner. The company uses cloud technology, business analytics, machine learning and artificial intelligence to project the growth of a company based on data from thousands of similar businesses and 6,500 data points from sources including accounting records, banking records, tax records and LinkedIn.

Lighter Capital so far has funded 170 companies. Two have folded. If a company folds, Lighter Capital takes the loss. The high interest rate helps mitigate the risk for Lighter Capital.

The company justifies the high rate by comparing it to other forms of financing. While $50,000 in interest might seem like a lot to pay for a $100,000 loan, it prevents an entrepreneur from losing a slice of the company in an early equity deal that could eventually be worth much more.

Lighter Capital's interest rate is higher than the typical small business loan rate of between 4 and 5 percent, Washington Bankers Association President Jim Pishue said, but may be a good fit for borrowers.

"It's more about what the borrower thinks is the best, most suitable borrowing position," Pishue said. "It's one alternative funding source."

Lighter Capital tries to reduce its own risk by targeting particular types of companies for its loans — typically technology companies with high recurring revenue streams, such as subscription models.

Tightening the scope of potential customers could limit the company's ability to grow, but Lackland said Lighter Capital ultimately plans to offer new financial products to a wider range of customers. Meanwhile, there are many companies that fit Lighter Capital's current customer profile.

By the time the Lighter Capital revenue loan concept emerged, Proudman was already on the hook for bank loans.

"It was too little, too late for us," he said. "The price of a revenue loan seems very expensive, but now having sold the company, the equity we traded in exchange to grow the company was significantly more expensive."

Lighter Capital

CEO: BJ Lackland
Founders: Erik Benson and Andy Sack
Innovations: Revenue-based startup loans and a credit score for small businesses
Founded: 2010
Employees: 40
Headquarters: Seattle
Investors: Voyager Capital and others
Funding raised: $120 million

HOW IT WORKS

Lighter Capital offers a new kind of funding for startups that combines the benefits of debt and equity financing in the form of a revenue-based loan. Loans are repaid as a percentage of the borrower's revenue, usually between 2 and 8 percent each month. Founders don't have to give up equity in their startup, but Lighter Capital is still invested in growing the company quickly because loan payments grow along with a client's revenue. Lighter Capital funds startups with less than $10 million in annual revenue. The companies bring in an average of around $2 million in annual revenue, but it can be as low as $200,000. Loans range from $50,000 to $2 million.

Ashley Stewart
Staff Writer
Puget Sound Business Journal