Raising Money

Elena Andonova, Isis Enterprise

Technology Transfer Project Management

IDENTIFY	PROTECT	TRANSLATE	MARKET	LICENSE	SPINOUT	POST DEAL
Internal Marketing	Patenting	Proof of Concept	PEST	Valuation	Planning	Billing
Ownership	Patent Strategy	Development	ID Customer	Negotiation	Fundraising	Distribution
Evaluation	Other Protection	Design	Promotion	Legalise	The Team	Re-Negotiation

Sources

- Customers
- Government grants
- Friends and family
- Banks
- Investors
  - business angels
  - early stage venture capital
  - later stage venture capital
  - institutional investors
- Public stock exchanges

Sources - Equity

- In selling equity you are granting investors a share of future profits and/or capital gains
- If you sell 25 shares and keep 75 shares – you have sold 25% of the business
- If an investor pays US$ 1m for 25% the whole business is notionally worth US$ 4m
- The investor presumes that the money made from the investment will be many times more than the alternative – putting the money in the bank to earn interest
- Owning part of something valuable is better then owning all of something of no value
- Investors bet that a few investments (say 1 in 10) will produce spectacular results

Sources – Equity Splits

- There are no rules for who gets what but this is a typical example based on the Oxford experience

	Pre-Company	Seed	First Round	Second Round
Research	50	32.5	20	7.5
University	50	32.5	20	7.5
Investor		25	50	75
Management		10	10	10
	100	100	100	100

- Some researchers are unable to hold equity in spinouts; others can only hold a small shareholding which is non-diluting

Investors

- Business angels (US$ 25k-1m)
  - Made money elsewhere
  - Looking to be helpful
  - Wants to put in time and money
  - Hands-on approach – usually wants to be near to business
  - Due diligence focuses on the people
- Early stage venture capital (US$ 500k-2m)
  - Rare to find first hand experience of running businesses
  - Appropriate for businesses with modest capital requirements
  - Due diligence focuses on technology and markets
- Late stage venture capital and institutional investors (US$ 10m+)
  - Deep pockets
  - Due diligence focuses on numbers, performance and team

Investors

- Deficiencies in investment opportunities as reported to NBAN

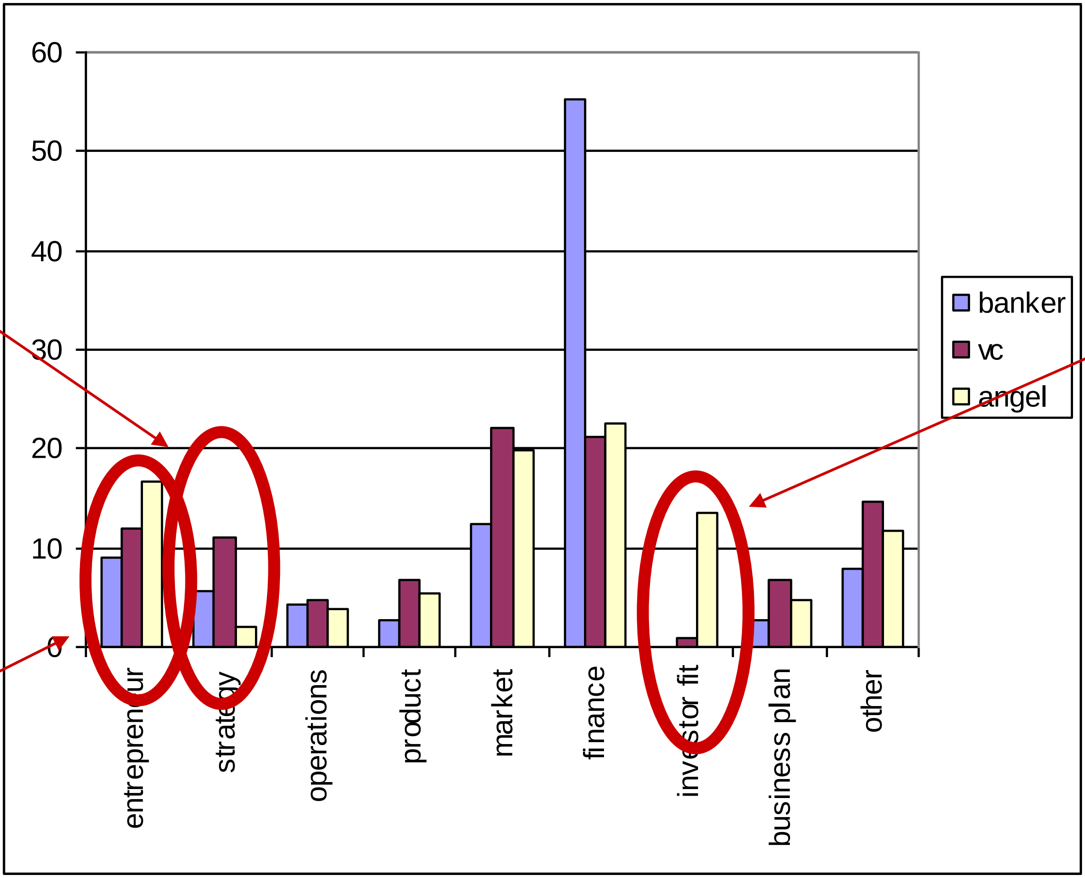
	Frequency
Assumptions unrealistic; information lacks credibility	43
Entrepreneur/management team lacks credibility	42
Insufficient information provided	31
Business concept needs further development	24
Growth prospects appear limited	23
No obvious exit route	20
Lack of originality in product/service	20
Lack of long term vision for business	20
Business undercapitalised; lacks liquidity	19
Insufficient commitment from entrepreneur	12
Lack of integrity of the entrepreneur	10
Other deficiencies	1

Investors

- Different types of funder analyse proposals differently; have different funding criteria and place emphasis on different kinds of information

Overall concept and strategy

View of the individual



Match with investors background and/or sector preferences

Pursuing Venture Capital?

- Is it a technology company?
  - With proprietary technology, a company can dominate a market and protect its profit margins
- Can you be a market leader?
  - It's too difficult and too unlikely to succeed simply by stealing market share from the leader
- Will it be cheap to make this company?
  - In most venture capitalists' terms, cheap is a company that can be put together and establish significant profitability on $10 million to $15 million
- Is there a clear distribution channel?
  - They ask whether the distribution channel can be accessed fairly inexpensively
- Can this product be distributed without significant support?
  - Complex products or services usually require customer-support organizations that are expensive and sometimes difficult to establish and maintain

Pursuing Venture Capital?

- Can the product or service generate gross margins of more than 50 percent?
  - It's much more likely that a company will deliver the required high-operating or net margins if its gross margin is above 50 percent to begin with
- Can the company go public or be acquired?
  - First, are the company's founders willing to go this route? Second, does the company have the ability to go public?
- Can the company achieve $25 million in sales, and are there prospects for $50 million to $100 million in sales?
  - With $25 million in sales, a company can generate the level of profits that makes the business worth enough so that a venture capitalist can become involved

The most important factor considered for potential investment

MANAGEMENT

POSITION IN MARKET

GROWTH POTENTIAL

QUALITY OF PRODUCT

FUNDING REQUIRED

Almost 90% of respondents state that management/team is one of the most important factors in a potential company

Base: All members answering (84), Open-ended question, July – August 2009

Ipsos MORI

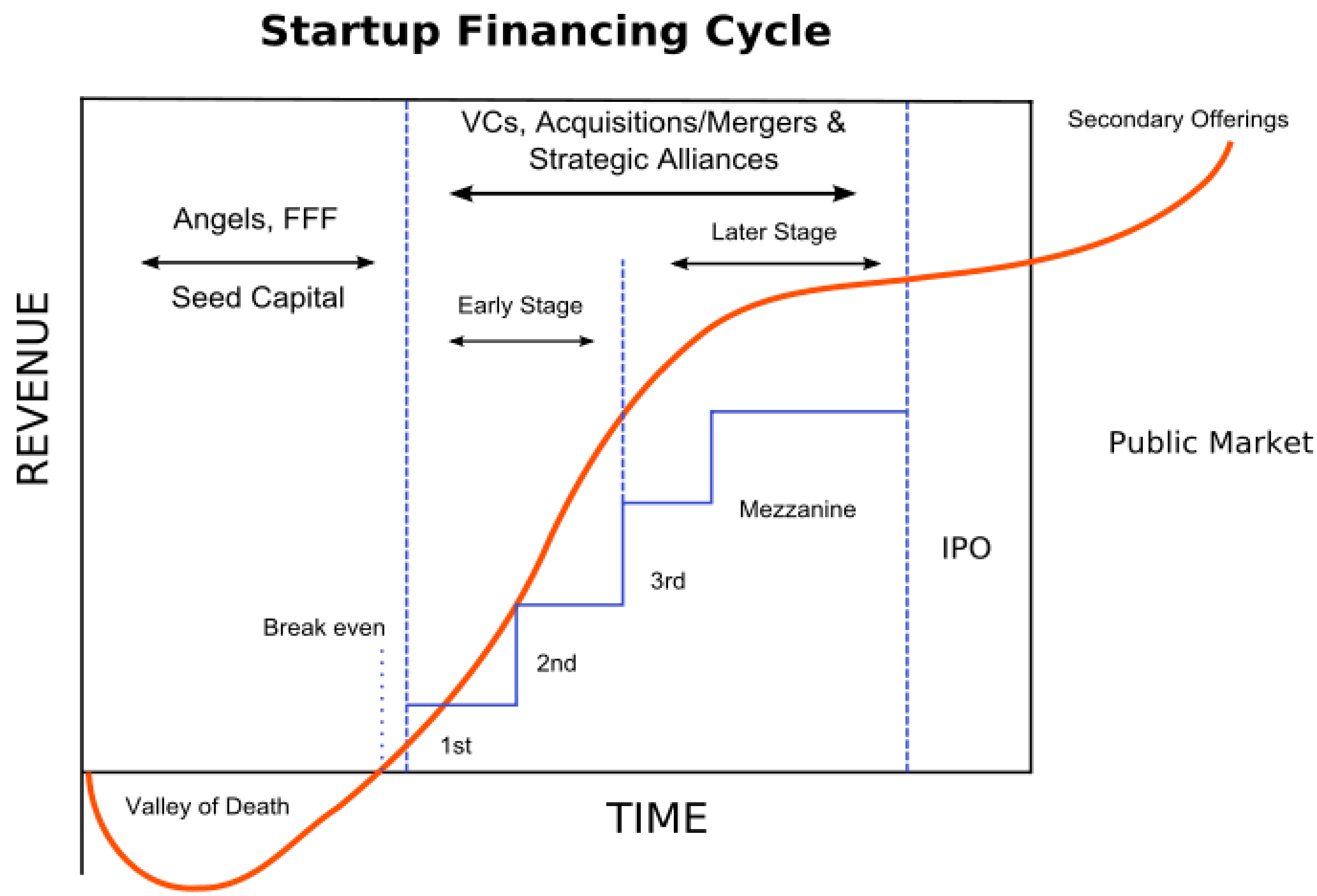
What VC DO NOT like to fund

- Half baked business plans
- Focusing too much on the idea and too little on the management
- Not asking for enough money
- Having too many lenders or investors
- Failing to get the proper legal agreements
- Poor cash flow management

Stages of company development and financing

- VC investors tend to define their investment stages by concept, and not monetarily:
  - **Seed Stage:** The idea/concept stage. Company proves a concept and qualifies for start-up capital.
  - **Start-Up Stage:** Company completes product development and initial marketing.
  - **Early Stage:** Expansion of company that is producing and delivering products or services.
  - **Expansion Stage:** Product or service is in production and commercially available. The company demonstrates significant revenue growth, but may or may not be showing a profit.
  - **Later Stage (Pre Public):** Product or service is widely available. Company is generating ongoing revenue; probably positive cash flow. It is more likely to be, but not necessarily profitable. It may include spin-outs of operating divisions of existing private companies and established private companies.

The Start Up Financing Cycle



Performance – Business Angels

- On the performance of business angel investments
  - 34% fail totally; 13% show loss or breakeven; 23% show IRR > 50%
  - Trade sales are the most common exit route
  - Average time to successful exit is 4 years
- There is no difference in the performance of high tech versus non-high tech business angel investments
- In 2000 it was estimated that there were 20,000-40,000 active business angels in the UK investing £0.5bn to £1bn in 3,000-6,000 companies
- There is more heterogeneity in the preferences and behaviours of business angels than in other classes of investor

Performance - Pitfalls in Picking Winners

- Business Failure Statistics from UK, US etc
  - US: four-year survival rate in the information sector is only 38 percent
  - UK: 400,000 new businesses start up each year - as many as one fifth of these cease trading within their first 12 months

- Reasons for Business Failure
  - US-based writer, Michael D. Ames in his book called "Small Business Management" gave 10 reasons for small business failure:
    1. Lack of experience
    2. Insufficient capital (money)
    3. Poor location
    4. Poor inventory management
    5. Over-investment in fixed assets
    6. Poor credit arrangements
    7. Personal use of business funds
    8. Unexpected growth
  - Gustav Berle adds two more reasons in The Do It Yourself Business Book:
    9. Competition
    10. Low sales

- Conclusions:
  - It's Hard
  - Avoiding Losers may be easier

Corporate Venturing

- Examples
  - IBM
  - NTT
  - BASF
  - Ericsson
  - Nokia
  - Mitsui
  - Boeing
  - Siemens
- Used to invest in almost anything – now tend to focus on areas related to their own businesses
- Can be very good routes to customers
- Questions marks over when is the appropriate time for a small company to enter into a corporate venturing deal – don’t want to put off other partners too early

Who funds UK start ups?

Funds raised – by geography