LANKA ANGELS PRESENTATION

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CRAFTING THE "INVESTABLE" BUSINESS & RAISING INVESTMENT

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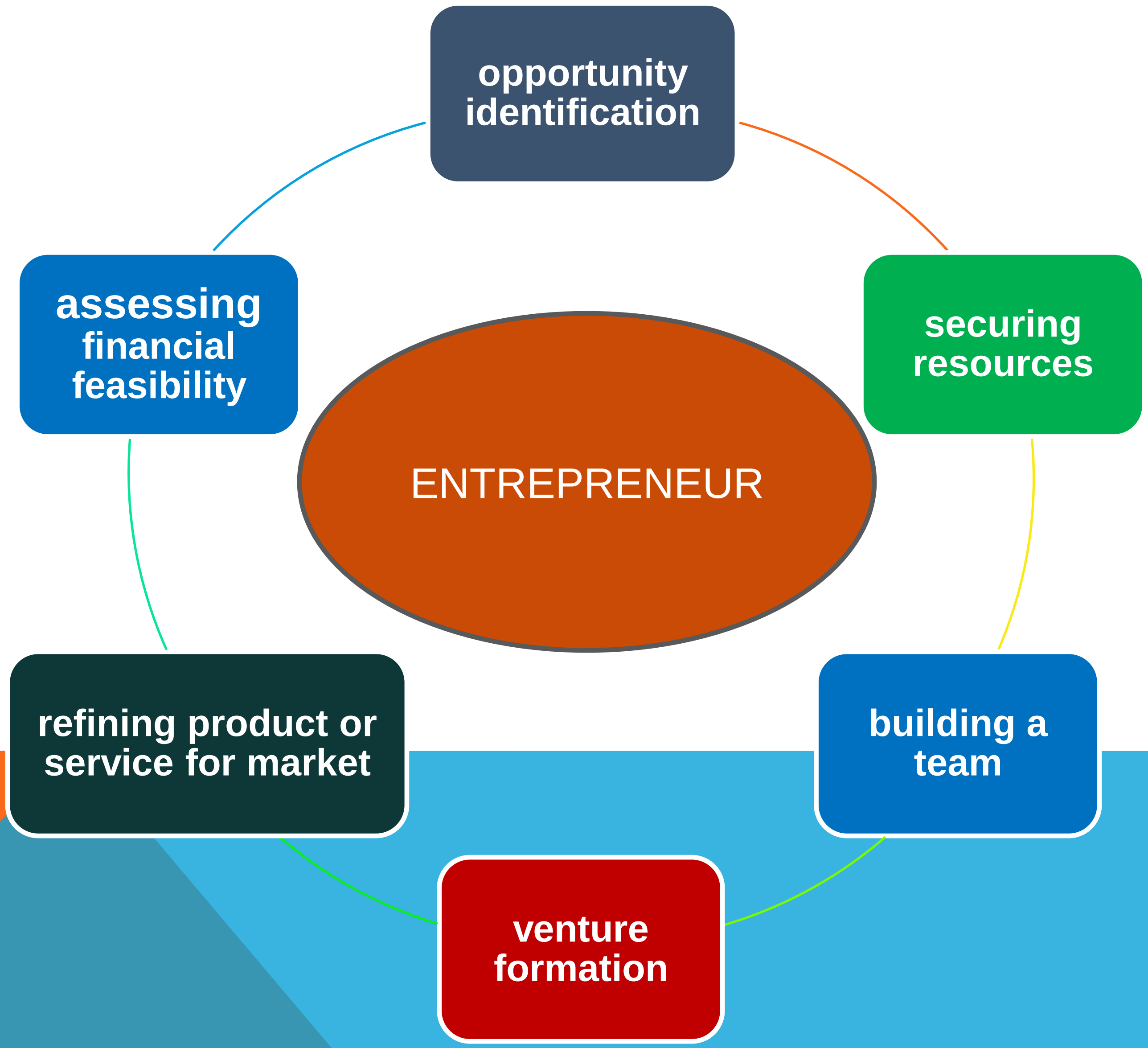
FIGURE 1: KEY NEW VENTURING ACTIVITIES (GREGSON, 2014)



WHAT IS YOUR *BUSINESS MODEL* ?

explains the logic & describes the rationale of how a venture creates, delivers & captures value

BUSINESS MODEL *CANVAS* (OSTERWALDER & PIGEUER, 2010)

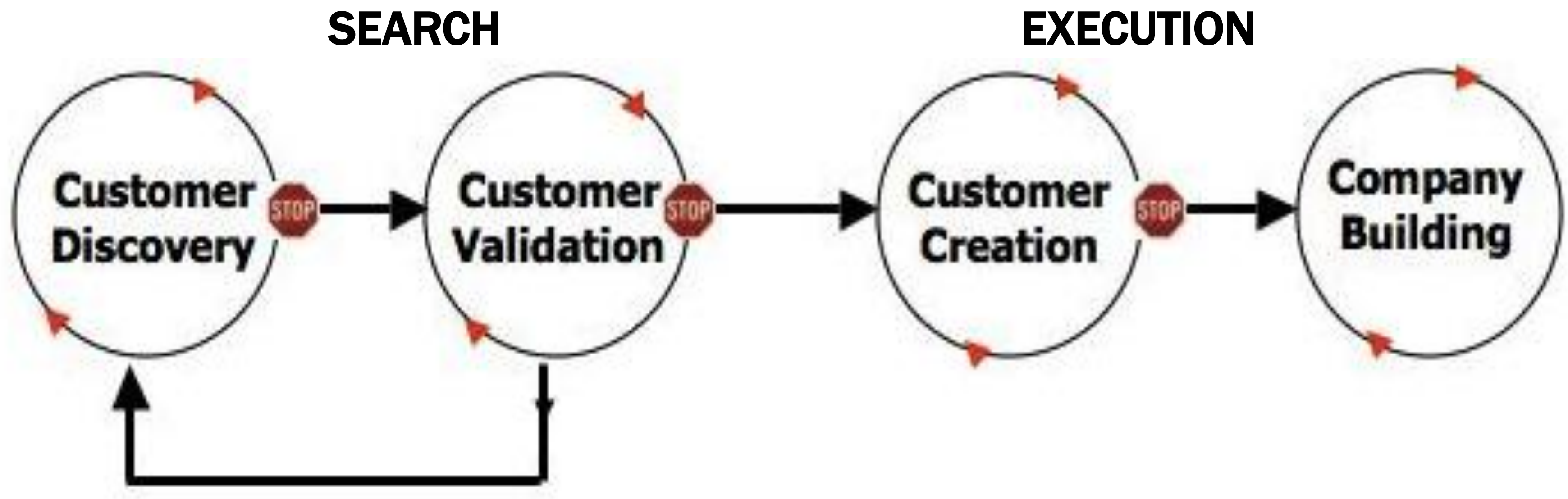
Building blocks	description
Customer segments	Who is the business's customer? What are they like? What is on their mind – their wants and needs?
Value propositions	What compelling things does the business provide to the customer - and why do they care? What needs are satisfied?
Channels	How are value propositions sold & delivered?
Customer relationships	How does the business interact with each customer segment? What is most important?
Revenue streams $£	How does the business receive revenue from the value propositions?
Key resources	What assets must the company have in place to execute the business?
Key activities	What essential key things does the business do to deliver on the value proposition?
Key partnerships	What activities & expertise are outsourced? Which are acquired outside the business?
Cost structure	What are the major cost drivers; costs components of the business?

CUSTOMER SEGMENTS

different customer segments willing to pay for different aspects of your value proposition ?

Types of customer segments	Description	Example
Mass market	Value proposition (VP), distribution channels (DC) & customer relations (CR) focus on one large group	Consumer electronics
Niche market	VP/DC/CR tailored to specific requirements of a niche	Supplier-buyer relations; car part manufacturers
Segmented market	Slightly different needs & problems	Banking: wealthy vs. average customers
Diversified market	Serves two unrelated segments with very different needs	
Multi-sided market	Serves 2+ interdependent segments required to make BM work	Credit cards require large base of CC holders & large base of merchants who accept CC

CUSTOMER DEVELOPMENT MODEL:



C-Discovery: understanding customer problems & needs – in front of customers – by the entrepreneur/founders

C-Validation: develop sales model that can be replicated & scaled

C-Creation: driving end user demand to build & grow your sales

Company Building: transitions the venture - from learning & discovery - to business planning & execution

How Attractive is the Market ?

Market size (£12m+)	**Market growth rate (10%+; ideally 30%+)**	Market capacity (high demand, window of opp.
Market structure (imperfect, fragmented)	**Market cost structure** (cost advantages)	Market share attainable (10%+; segment leader)
Access to customers (reachable, accessible)	Low fixed & variable costs; solid control over prices, costs & distribution	Cash-based; tight credit terms; net 30 days
e.g. retailers, distributors; brick/mortar; internet; combination	Repeatable, recurring revenue	Sales growth 10%+; gross margins 30%+; time to B/E >2.5 yrs;
Competitive advantages; Proprietary protection; lead times; distribution channels; regulatory, contractual advantages	transaction fee; unit or volume based; license or syndication; membership or subscription; advertising	**Management team;** industry, tech expertise; accomplishment; integrity; goals and fit; integrity & honesty
ARE THERE ANY FATAL FLAWS (weak criteria)?	**DOES EVIDENCE SUGGEST THIS MARKET IS ATTRACTIVE?**	**DOES THIS MARKET COMPELL YOU TO COMMIT TO IT**?

VALUE PROPOSITION

- ✓ **What features/benefits of your VP are most critical to the market you will serve?**

Value element	description
Newness	New set of needs; e.g. mobile & apps; ethical investment
Performance	PC hardware (limits to growing customer demand)
Customisation	Customer co-creation + mass customisation – scale advantages
Design	Fashion & consumer electronics; difficult to measure
Brand/status	Using & displaying specific brand; status conscious segments
Cost reduction	Helping customer reduce costs; e.g. salesforce.com (CRM costs)
Risk reduction	Service guarantees, quality products
Accessibility	Space travel; time-shares; e.g. leasing luxury cars, boats, jets
Price	Low cost provider requires a low cost business model
Convenience	Ease of use; iPod/iTunes

CHANNELS (i.e. selling to customer)

- ✓ **Direct *owned* channels**: sales force; web sales
- ✓ **Indirect Partner channels**: wholesale distribution, retail, partner-owned websites

Awareness
About company's offerings?

Evaluation
How to assist customers to evaluate Value Prop?

Purchase
How do customers purchase?

Delivery
How to deliver to customers?

After sales
How to provide?

CUSTOMER RELATIONS

- ✓ What relationship is required with customers?
- ✓ How are CRs integrated into your business model?

Types of customer relations	Description
Personal assistance	Human interaction: POS, call centre, e-mail
Personal assistance	Account managers, private banking
Self-service	All means to allow customers to help themselves
Automated services	Access to customised services; customer recognition
Communities	User communities to exchange knowledge, solve problems, help firm to understand customers
Co-creation	Amazon book reviews, YouTube

REVENUE STREAMS $ £

- ✓ **What are customers <u>willing to pay ?</u>**
  - ✓ For what do they currently pay?
  - ✓ <u>How</u> are they currently paying?

Revenue streams	Description	Example
Asset sale	Selling ownership to physical product	Amazon, BMW, etc.
Usage fee	More service used - more customer pays	Telecoms, hotels, couriers
Subscription	Continuous access to service	Clubs, telecoms
Lending, leasing	Temporary rights to use asset for fixed period	Car, accommodation rentals
Brokerage fee	Intermediation services performed on behalf of 2+ parties – real estate agents	Credit card: %of value of ea. Sales transaction
Advertising	Fees for advertising product, service or brand	Media industry, event organisers, social media

BUSINESS PLANNING

a continuous questioning & refinement of the business model & related competitive advantages

- a regimented, analytical approach to business planning doesn't suit most start-up ventures

- i.e. under the 'fluid' conditions experienced by the entrepreneur, an ability to roll with the punches is often more important than careful planning

FURTHER THOUGHTS ON BUSINESS MODELS:

WHY NEW BUSINESS MODELS <u>FAIL</u>

1 Flawed logic:

Assume conditions & situations <u>that do not exist</u>

e.g. Napster:

- Expected it would not be held accountable for copyright violations on MP3 files that its users swapped, down-loaded
- Shut down by court order in 2001

2 Limited strategic choices

Should reflect both value creation & value capture

e.g. dot coms:

- Pets.com: easier to buy dog food online?
- Funerals.com: face-to-face contact when grieved

Must maintain value of product/service

Avoiding commoditisation; i.e. compete on price

Offer new ways to satisfy changing needs of customer

3 imperfect value creation & capture assumptions

Will beneficiary of VP be the paying customer?

e.g. Optos, Touch Bionics

- Medical device must be sold to health providers, whose mission may be to contain costs

e.g. Interface3

Children as users but teachers, school boards as customers (ones who will "pay")

INVESTABLE BUSINESS CASE ?

Meets criteria for raising external investment

- **requires more than positioning the entrepreneurial opportunity into an attractive market**
- **requires an appropriate business model**
- **requires a strong evidence base to forecast an uncertain future**

EXECUTIVE SUMMARY i.e. elevator pitch *(Gregson, 2014)*

1. What does the business do or plan to do?
2. What is the product/service (in non-technical terms); why is there a need for it; and how big is that need?
3. Who are the customers for the product/service?
4. What are the advantages of the business (e.g. advantages over larger, more reputable or better financed competitors)?
5. What is the business model? How will it make money, when will it become cash-flow positive & what are the growth aspirations?
6. *Who* will make this happen?
7. What investment is being requested & what will it be used for?

FINANCIALS (2)

Are <u>customer conversion</u> figures realistic? Does this suggest an insightful, well researched understanding of the target market?

Have product/service prices & costs of goods sold been validated?

Is there a need to frequently "renew" the products? How will the venture sustain itself if further product development is required?

Does the financial forecast accommodate a range of different business conditions <u>that verifies the robustness of the business model</u> (e.g. worst case, most likely, best case conditions)?

How profitable is this business model? How long will it take to see profitability?

COMMON PITFALLS IN BUSINESS PLANS

MARKET	VALUE PROPOSITON	CHANNEL TO MKT	FNCL. FORECASTS
"There are no competitors for this product/service" If there is no competition, there may be <u>no customers</u>	Unsolved but small problem being addressed; i.e. not a significant investment opportunity, but suitable lifestyle business?	Access to customer difficult. CM not available unless business builds it; channel occupied by competitor(s)	<u>Assumptions</u> upon which financials are based are not clear or realistic (given market conditions)
Good identification of opportunity, but customer segment assessment is weak	More than one business model; business trying to solve too many pain points	Market entry strategy unrealistic; not novel to stimulate interest in product/service	Sales growth shows growth in margins (unlikely if market highly competitive)
Using a "percentage of market capture" forecast, e.g. *"we only need 1% of this $200million market"*	Product too immersed in "deep-science;" unclear pathway to market & business validation	No clear "scale-up" strategy required for business growth	Working capital will grow proportionally to growth in sales (must consider credit terms for customers/suppliers

SUMMARY OF INVESTABLE BUSINESS CRITERIA

Scalable business model with a value proposition based on *sustainable* competitive advantages;

Clearly identifiable <u>& reachable </u>customer segment with a compelling need;

Sound pricing model & strong recurring revenue-generating capabilities;

Channels for scaling sales & related business operations that can support a growth strategy;

A management team with skills and experience to execute a growth strategy & is willing to work with & take advice from advisory board (& investors);

FOR EXTERNAL INVESTMENT: a route to exit & options for a financial or strategic sale within 5-7 years (discussed next week)

KEY QUESTIONS FOR LEAD ENTREPRENEUR

What kind of founding team is desirable or necessary?

Do I want to grow a high growth company?

What talents, know-how, skills, track record, contacts, and resources are currently available?

What are the key resources needed to succeed?

Who is needed to complement me?

COMMON START-UP PITFALLS

Failure to use the "honeymoon" period of start–up advantageously

Lack of clarity over *who* is in charge, who makes the final decisions, and how real differences of opinion are resolved

Fail to address or recognize the deficiencies of the lead entrepreneur or the management team

Lack of trust & integrity amongst team members

GROUP EXERCISE: 10 MINUTES

1. **Describe the <u>latent customer need</u> that is not being well-served? (i.e. CUSTOMER DISCOVERY)**

2. **Describe your CUSTOMER VALIDATION process; i.e. <u>how you will validate that</u>:**

- The customer is not being well served?
- Your proposed offering will serve that unmet need?
- You have a business model that offers sales growth (i.e. **CUSTOMER CREATION** & **COMPANY BUILDING**?

3. **<u>Briefly summarise your business model</u> (using the BP canvas?)**

ENTREPRENEURIAL FINANCE

Three core principles of entrepreneurial finance:

- More cash is preferred to less cash
- Cash sooner is preferred to cash later
- Less risky cash is preferred to more risky cash

FACTORS AFFECTING FINANCING

Accomplishments and performance to date

Investor's perceived risk

Industry and technology

Venture upside potential and anticipated exit timing

FACTORS AFFECTING FINANCING (2)

Venture anticipated growth rate

Venture age and stage of development

Investor's required rate of return or internal rate of return

Amount of capital required & prior valuations of venture

FACTORS AFFECTING FINANCING (3)

Founders' goals regarding growth, control, liquidity, and harvesting

<u>Relative bargaining positions</u>

Investor's required terms and covenants

Why equity finance ?

- Little/no collateral from business assets
- intangible business assets (i.e. *the balance sheet walks out the door at 6pm*)
- limited personal cash or assets to secure loan
- limited track record
- perception of “knee-knocking” risk by lenders

INVESTOR READY BUSINESSES: CULTURE, CAPABILITY AND COMPETENCE

A business <u>which is ready to receive</u> equity investment

- is willing to sell equity
- understands the role of equity investment
- is **ready and able to grow significantly**
- has appropriate governance structures
- has product/technology and market advantages
- **can make the case for the need for finance**
- can demonstrate a return for the investor

THE ROLE OF BUSINESS ANGELS

The largest pool of equity finance for unquoted businesses

- 20,000+ active business angels (UK)
- 3,500+ investments per annum
- £600+ million invested annually

- 10 times number of early stage VC investments and 4 times amount invested by VCs

angel investors cannot find sufficient investment opportunities: WHAT PREVENTS THEM FROM INVESTING? i.e. **poor quality “deal flow”**

ANGELS MORE APPROPRIATE…

for early financing of high-tech inventors who have not fully developed a commercial prototype

for ventures that project high levels of free cash flow within 3-5 years

for ventures seeking to maintain control of their business

THE INVESTMENT DECISION MAKING PROCESS - RISK

Business angels generally invest in industries and markets they know

The entrepreneur/management team is the greatest source of risk, especially where

- the entrepreneur has a low financial commitment to the business

the entrepreneur seeks status (being a ‘business owner’)

THE INVESTMENT DECISION MAKING PROCESS - RISK REDUCTION

Risk is reduced where the entrepreneur:

- is thoroughly familiar with the target market
- is able to evaluate and react to risk
- has demonstrated leadership/management ability
- has a functionally balanced team
- is capable of sustained effort
- has a major financial commitment to the business
- can demonstrate strong market acceptance

INVESTMENT STAGES

1. Deal **Origination**
2. Deal **Screening**
3. Deal **Evaluation**
4. Deal **Structuring**
5. Deal Negotiation & **Agreement**

VALUING THE NEW VENTURE

What is your new venture worth?

- Never known with certainty
- Alternative valuation methods consistently fail to produce same outcome

Valuation only as good as data and estimates brought to them

VALUATION (2)

Company worth different amounts to different parties, e.g.

- Strategic acquisition of small tech firm by larger firm

Asset-based valuations not appropriate:

- e.g. equity book value - total assets minus total liabilities, liquidation value, replacement value

Earnings-based valuations not appropriate

- Depends on availability of comparable businesses whose price-earnings multiples are known

  Current share price X number of outstanding shares = market value of company´s equity (+ debt = total value of company)

VALUATION (3)

Discounted cash flow (DCF) appropriate:

- Future-looking orientation
- Estimation of future cash flows from deployment of technology, products, operations
- Recognises investor cost of capital
  - Discounts cash flows to present value of a FAIR RATE OF RETURN (i.e. investor IRR)

BUT **DIFFICULT TO PRODUCE RELIABLE ESTIMATES OF FUTURE CASH FLOWS**

VALUATION (4)

Venture capital valuation method

Begins with <u>investors estimating how much they plan to invest</u>

- Amount invested comes from 1) analysis of venture financial situation and 2)assessment of funds necessary to take it to next stage

Link between cash in and cash out; **pre-money** (value before financing) and **post-money** (pre-money plus financing)

VALUATION (5)

Option pools:

- Entrepreneur and investors will likely reserve pool of shares for future use as employee incentive

- Entrepreneur should attempt to exclude reserve pool from valuation
  - Affects price per share, value of investment, control rights

Investors want corporate governance provisions to monitor capabilities and discourage misbehaviour of entrepreneur

THE IMPORTANCE OF PRESENTATION

Poor presentation can kill a deal from the outset:

- sketchy/incomplete information
- unrealistic assumptions
- over-emphasis on technology
- unrealistically claims on “uniqueness”
- claim the standard as novel
- **LACK OF TRUST**

In absence of information, investors will assume the worst

SELLING YOURSELF

"Entrepreneurs should remember that they are the products when raising money. They are selling themselves to investors and image is important"

- *UK business angel investor*

MAKING THE PITCH: THE NEXT STAGE

Get the funding structure of the business right at the very outset

Work the ‘funding pipeline’ (the 3Fs, public sector funding, business angel funding)

Build the business

Adopt the culture, build capability, demonstrate competence

KEY THEMES FOR A PRESENTATION (GREGSON, 2014)

INTRODUCTION
who we are
what does this business do?
1

WHAT PROBLEM & NEED IS BEING ADRESSED?
2

WHO IS *THE* CUSTOMER?
WHAT IS THE CUSTOMER SEGMENT (CS)?
3

WHAT IS THE VALUE PROPOSITION (VP)?
competitive advantages
4

WHY IS THIS MARKET ATTRACTIVE?
growth & positioning
5

WHAT IS THE CHANNEL TO MARKET?
how to get VP to CS
6

WHO WILL DO THIS?
management team & partners
7

FINANCIAL PROJECTIONS
sales, revenues, costs of goods sold, timelines
8

WHAT $£ IS REQUIRED?
WHAT WILL INVESTORS RECEIVE?
9