

Venture Capital Funding for Early Stage Companies

Guide for Entrepreneurs to attract Venture/Risk Capital

By: FARZAN GHADIALLY

President

SHAPOORJEE CHANDABHOY FINVEST Pvt. Ltd



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Small Units, big hopes

- ∅ There are around 13 million MSME companies in India.
- ∅ Account for 45% of the manufacturing output & 40% of the exports
- ∅ Provide employment to around 42 million people



Challenges Faced

Some of the key challenges faced by the MSME sector are as follows:

- Non availability of quality raw material
- Power shortages and paucity of resources to invest in design and market research
- The biggest problem is non availability of institutional finance
- Over 97% of the MSME's is starved of institutional credit...Scenario for equity is even worse.

Changing Scenario

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- ü Passing of the Micro, Small & Medium enterprises Act 2006 may be considered as an important mile stone.
- ü Government has redefined FDI cap on MSMEs. According to the new press note the 24% ceiling for ownership in SME units by bigger domestic funds or foreign investors has been removed. Higher FDI will be allowed according to the sector wise cap mentioned.

Changing Scenario...

- ü SEBI is in the process of framing rules to setup a SME exchange. The rationale being that relative bigger small and medium scale units producing high-tech items and having innovative ideas have access to risk and equity capital.
- ü SME rating agency, “SMERA” a joint initiative of SIDBI and Dun & Bradstreet Information Services India Ltd

An overview of various options for Venture Funding options for MSME Start ups

- üGovernment VC organizations

- üAngel investors

- üCorporate Partners

- üVenture Capital Funds



Flip side of government funding

- ü Lack of domain knowledge
 - Often leads to diffused funding
- ü Limited appetite
 - Inability to invest beyond US \$5m in a single project
- ü Often plagued by bureaucracy
 - Delayed decision making



Capital market options

Angel Investors

- ü Risk takers at a significant early stage
- ü Friends albeit at an exorbitant price

Venture Capital

- ü Strong domain knowledge
- ü Long term outlook
- ü Keen on strong due diligence

Strategic Investor

- ü Understand the industry very well
- ü Add a lot of value to the firm
- ü Relatively Long term investors



THE SIX IMPORTANT POINTS FOR START UPS TO GET VENTURE FUNDING



No.1: Real revenue based business model

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üRobust due diligence – People/Systems/Accounting/Legal/MIS

üMarket flavours companies with revenue and a robust revenue model.
And not of 'Hypes' and 'Hopes'.

üNot only should you know who is going to pay for the product development and who will buy the product, but also how much your product will cost and how much the markets will be willing to pay for it.

üEntrepreneurs need to build businesses that can produce predictable and sustainable Margins and Earning Growths.

No.2: PE invests in passionate and quality leadership^{SCFPL}

- ü Top Management team is one of the scarcest resources in start ups and consequently remains the weakest pillar in most early stage ventures.
- ü One of the first questions that a PE firm tries to answer is “Are these people whom we can work with for the next five years?”
- ü Companies are judged by the company they keep. Great LEADERS make great companies. Identify ‘the Face’ of the company from a financial investor perspective.
- ü Within the family, are all member’s roles clearly defined?
- ü Repertoire of managerial skills required to navigate the company successfully from start-up through full integration is wide ranging and different.
- ü Ramp-up ability of the organization for future aggressive growth is a critical attribute that VCs lookout for.

No.3: New technology, new products

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- ü Investors favor 'platforms' of technology that have the potential to generate multiple product lines. One-product wonders are no longer in vogue.
- ü Determining that the technology is patentable is no longer enough. You should be free to operate in the market place without any need for a license from some other patent holder. Premium on Intellectual Property residing in the company.
- ü Maintain a rigorous focus on the chosen product and its underlying technology.
- ü Make sure that the products that will come from your technology addresses a real need of economic significance for investors to view the opportunity favorably

No.4: Ensure adequate cash flow

- ü Many early stage companies are founded on Day One, only to realize that they are undercapitalized on Day Two. Such entities are then forced into accepting less than desirable terms to keep going.
- ü It's like a buffet dining at an Indian wedding – Grab as much as you can – you don't know whether there will be a second helping!
- ü VCs prefer high asset turns coupled with moderate WC intensity leading to healthy ROCE(25%).
- ü Define and distinguish each revenue stream very clearly and its relation with the other if any.

No.5: In the company's success is your own success

- ü Look for success of the long term growth not short term gains
- ü In raising money for your company, worry far less about how much promoter's holding will be diluted as a result of the financing.
- ü Entrepreneurs have a growing fear of losing control of their companies.
- ü Most managers turned entrepreneurs want to have their cake and eat it too. They want to have both, the best in class salaries as well as equity for wealth creation.
- ü Corporate Governance applies to you too! Develop a mindset that family is not always right let professional take a call
- ü VCs prefer, investments with long term value creation rather than a quick 'pop'.

No.6: Making a successful exit

- ü Most VC firms work on the investment timeframe of 3-5 years.
- ü They generally look forward to ROI of 3X and IRR of 25%.
- ü Deal-making skills is an essential element of collaboration. VC firms have great competencies because of the number of early stage companies they finance.
- ü They can leverage their network for establishing contacts and collaborations.
- ü VC firms look for an exit in 3-5 years, via an IPO, Strategic Sale or buy back by the promoter
- ü They can also influence market capitalization and add great value in sale to a strategic investor.

Advantages of PE / VC

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- ü Finance: The VC injects long term equity finance, which provides a solid capital base for future growth. VC also looks to support the company and helps it grow by providing additional rounds of funding for its growth.
- ü Business partner: The VC is a business partner sharing risk and reward.
- ü Alliances: The VC also has a network of contacts in many areas that can add value to the company, such as in recruiting key personnel, providing contacts in the international market , introduction to strategic partners and if needed co-invest with other Venture Capital Funds.
- ü Mentoring: The VC is able to provide strategic operational and financial advice to the company based on past experience with other companies in similar situation.

Advantage of Venture Capital Funding

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- ü Exit : The VC is experienced in the process of preparing a company for an IPO and facilitating its strategic sales.
- ü Attracting talent : PE firms are able to attract good talent for their investee companies which is the most crucial factor in the biotech industry.
- ü Corporate governance : There is a huge gap between the corporate governance followed in the existing state and a listed status. PE/VC helps bridge the gap by creating systems and procedures wherein board level controls could be exercised.

Advantage of Venture Capital Funding

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- ü **Systems and Risk management** : Most entrepreneurs and high growth companies lack the requisite management expertise in choosing the right kind of systems and vendors for their MIS, ERP, risk management and supply chain management. The funds through their experience in other companies are able to identify appropriate vendors and negotiate better.
- ü **Speed to move** : The investment process highlights a lot of factors related to the fund; specially internal decision making capability and timelines.
- ü **Brand** : A marquee name as an investor helps on various fronts including at the stage of IPO.

Disadvantages of Venture Capital Funding

- ü Excessive interference in strategic decisions.
- ü VCs may want to fund innovative projects by entrepreneurs who might have some prior experience and credibility (which is a catch-22 situation).
- ü Pressure on the promoter to go public to provide an exit option which may lead to excessive pressure on the management to look for quarter on quarter results.



Tips to attract VC funding for Early Stage Companies/SME's

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- ü Understand the market needs : You need to understand the market before approaching a VC. Solutions have to be developed for existing problems. One cannot develop a solution and then look for a problem. There has to be a balance between technology push and market pull.
- ü Business plan : VC investment is long-term in nature. And ranges from 3-5 years. To attract investment a comprehensive business plan has to be made that provides information on the planned product, the market potential, necessary talent pull, and required seed capital is crucial.
- ü Appointment of intermediately : It is of prime importance to appoint an investment banker before approaching a VC or raising private capital. Because investment bankers offer support in terms of estimating the market potential and valuation of the company.

Tips to attract VC funding for Startups

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- ü Zeroing in on a few VCs : It is very important to do your homework on the VC firms you plan to approach. It is not a good idea to randomly circulate your business plan. You need to study the investment preference and philosophy of the VC fund before approaching them.
- ü Networking : It is the most important aspect for the success of the company and for attracting the right kind of funding.
- ü Look at fund raising from a VC perspective : Normally VCs look at management team, ownership structure, promoters credentials, quality of business plan, the idea itself, the exit option and whether they can add value to the project by not just providing money.

Management view points from a PE / VC funding perspective

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- ü What is the vision for the next 5 years : The road map.
- ü What is the technical competence of the promoter : Who is going to drive the business in the next 5-7 years.
- ü Identify key strengths of the management : Manufacturing or Marketing.
- ü Organization benchmarking in peer comparison.
- ü What is the critical success factor / core competence.
- ü Identification of key markets : Domestic or overseas market.
- ü Strategy for growth : Organic or inorganic.
- ü Is the management open a further dilution of stake.

Key Message

- ü Look for Smart Capital
- ü Appointment an investment banker who understands the space.
- ü Be patient
- ü Develop a mindset to put systems and processes in place.
- ü Be realistic in valuation of the company
- ü Do not fear dilution of equity stake.



What Investors Want

- IRR of 25-30%
- Board Seat
- Clear EXIT
- Transparency with the promoter
- Comparable Investment Avenues:
 - Listed Market
 - Short Term Debt Market
 - Alternative Assets like Art, Wine & Emotional Assets



About Us

- Shapoorjee Chandabhoy Finvest Private Limited is a NBFC originally established in 1868 registered with the RBI involved in fund based as well and non fund based activities.
- Super specialty Investment banking division (IBD) that caters to MSME, start up and early stage companies.
- Create Value by guiding the promoter on fund raising transactions by handholding and arraigning smart equity capital.
- Arrange venture capital for companies from Angel investors in Indian and abroad.
- Look at good ideas and good companies and arrange venture capital across borders. Export of good ideas and import of capital and vice versa.

About Us (Cont..)

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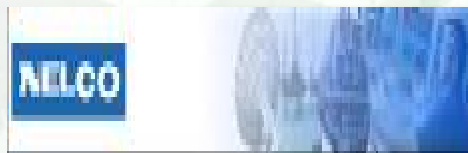
- Fund based activities mainly includes Inter Corporate Deposits (ICD's) and Loan Against Shares (LAS)
- Investment in good early and growth stage companies via the proprietary fund.



Our Clients



AMAR Remedies Ltd.



Nelco



Elder Pharma



Helios Matheson



Ind-Swift Ltd.



Ind-Swift Laboratory Ltd.



Net 4 India



Anil Products Ltd.

Our Clients



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Borosil India



Cox and Kings India



Auto hanger

Our Clients



Excel Industries Ltd.
The courage to dream. Together.



JYOTI STRUCTURES LTD.

Kajaria
Create Grow Innovate...

Excel Industries Ltd Godrej Hershey Jyoti Structures Kajaria Ceramics



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Kingfisher Airlines

Kores India

PBA Infrastructure



Thank You



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Contact Details: FARZAN GHADIALLY

**SHAPOORJEE CHANDABHOY FINVEST PRIVATE
LIMITED**

9/13 Kamanwala Chambers, 2nd Floor,

Sir P.M. Road, Fort TEL : 9768008004.

www.scfpl.co.in

Mail: farzan@scfpl.co.in