



# Accessing venture capital

## How VCs evaluate you

<http://www.indiainfo.com>

India Infoline Ltd., India

Venture funds, both domestic and offshore, have been around in India for some years now. However it is only in the past 12 to 18 months that they have come into the limelight. The rejection ratio is very high, about 10 in 100 get beyond pre-evaluation stage, and only one gets funded.

Venture capital funds are broadly of two kinds - generalists and specialists. It is critical for the company to access the right type of fund, i.e. who can add value. This backing is invaluable, as focused or specialized funds open doors, assist in future rounds and help in strategy. Hence, it is important to choose the right venture capitalist.

The standard parameters used by venture capitalists are very similar to any investment decision the only difference being exit. If one buys a listed security, one can exit at a price but, with an unlisted security, exit becomes difficult. There are certain key factors that they look for.

### The management

Most businesses are people-driven, with success or failure depending on the performance of the team. It is important to distinguish the entrepreneur from the professional management team. The value of the idea, the vision, putting the team together, getting the funding in place are, among others, some key aspects of the role of the entrepreneur. Venture capitalists will insist on a professional team coming in, including a CEO to execute the idea. One-man armies are passé. Integrity and commitment are attributes sought for. The venture capitalist can provide the strategic vision, but the team executes it. As a famous Silicon Valley saying goes, "Success is execution, strategy is a dream".

### The idea

The idea and its potential for commercialization are critical. Venture funds look for a scalable model, at a country or a regional level. Otherwise the entire game would be reduced to a manpower or machine multiplication exercise. For example, it is very easy for Hindustan Lever to double sales of Liril (a soap) without incremental capital expenditure; but Gujarat Ambuja would need to spend at least Rs 4 bn before it can increase sales by 1 mn

tonnes. Distinctive competitive advantages must exist in the form of scale, technology, brands, distribution, etc., which will make it difficult for competition to enter.

### Valuation

All investment decisions are sensitive to this. An old stock market saying goes, "Every stock is a buy at a price and *vice versa*". Most deals fail because of a valuation-expectation mismatch. In India, while calculating returns, venture capital funds will take into account issues like Rupee depreciation, and political instability (which adds to the risk premia, thus suppressing valuations). Linked to valuation is the stake that the fund takes. In India, entrepreneurs are still uncomfortable with the venture capitalist "taking control" in a seed stage project.

### Exit

Without exit, gains cannot be booked. Exit may be in the form of a strategic sale and/or an IPO. Taxation issues come up at the time. Any fund would discuss all exit options before closing a deal. Sometimes, the fund insists on a buy-back clause to ensure an exit.

### Portfolio balancing

Most venture funds try and achieve portfolio balancing as they invest in different stages of the company life cycle. For example, a venture capitalist who has invested in a portfolio of companies predominantly at seed stage will focus on expansion stage projects for future investments to balance the investment portfolio. This would enable them to have a phased exit.

In summary, venture capital funds go through a certain "due diligence" before finalizing a deal. This includes evaluation of the management team, strategy, execution and commercialization plans. This is supplemented by legal and accounting "due diligence", typically carried out by an external agency. In India, the entire process takes about six months. Entrepreneurs are advised to keep that in mind before looking to raise funds. The actual cash inflow might get delayed because of regulatory issues. It is interesting to note that in the USA, at times angels write cheques across the table. □

### Asia Pacific venture capital alliance

Asia Pacific Venture Capital Alliance seeks to promote the effective use of private equity and venture capital in Asia and to endorse accreditation of these investments as a significant recognized asset class. It aims to achieve these goals by providing an effective platform for high-level discussions and networking amongst regional private equity and venture capital associations in Asia, global institutional investors, multilateral institutions and regulatory/government authorities. The Alliance will also strive to foster the development of common international standards, rules and regulations across the

region and be an advocate to promote policies that will enhance the environment for entrepreneurial and venture capital activities.

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# The ten steps

## A roadmap to venture capital

<http://www.new-ventures.org>

New Ventures program, World Resources Institute, USA

### 1. Come up with an idea

Behind every successful business is an idea. A great idea supported by competent management or a decent idea supported by great management are crucial to success. The idea must be exploitable in the business world. Successful companies utilize unique ideas that translate into high growth potential, high profitability potential and a competitive advantage.

### 2. Acquire seed capital

Seed capital is used to fund the assets for an emerging company so they can research the feasibility of their business and determine whether it will work effectively. Companies can utilize various sources of seed capital to include personal equity, family, friends, banks, angel investors or, in some cases, venture capital firms. The last three sources are highly improbable since the company at this point is too new and its business plan has not been proven.

### 3. Make business projections

Basic forecasts must be made at this time projecting future revenues, expenses, market share, production efficiency and profitability. Up unto this point, many businesses have been focusing on developing their idea into a viable product or service; but now they must determine if exploiting it is economically feasible. These first projections will determine whether at all the entrepreneur should spend the time required to develop a formal business plan.

### 4. Prepare a business plan

A formal business plan will consist of the following:

- Executive summary - mission statement, company overview, management team, products and services, market analysis, funds requested, summary of five-year financial projections.
- Industry analysis - trends, growth rate, future outlook, company background, products and services, competitive advantages.
- Market analysis - target market, pricing strategy, advertising strategy, distribution strategy, external influences, government regulations.
- Competitor analysis - Who are the current or potential competitors, their strengths and weaknesses.
- Strategic analysis - strengths, weaknesses, opportunities, threats (SWOT analysis), core competencies, business differentiation, focus.
- Strategic action plan - performance goals and objectives, control procedures for attaining goals.
- Organization and management - type of company, organizational chart, key managers and employees.
- Financial plan - projection for sales, cost of sales, product development, labour costs, other expenses. Quarterly in-

come statements, balance sheets and cash flow statements for two years (recommended) and annual projections for 3-5 years.

- Loan proposal - purpose, amount, repayment schedule or exit strategy.

### 5. Proposal to investors

The entrepreneur takes the business plan to sources of financial capital, mainly the same ones from step 2, and tries to acquire favourable financing. Very rarely does this first attempt succeed. This first attempt usually is an "eye opener" for entrepreneurs, and often the sources they approach will offer valuable advice on how to improve the business plan.

### 6. Revise business plan

The entrepreneur goes back to the drawing board. Armed with advice from investors from step 5, he refines his original plan into a smooth and effective business plan. The key at this point is to take heed of any warnings or concerns raised during the previous steps. Experienced investors have done this before and usually know what they are talking about.

### 7. Prepare a business presentation

Once you have finalized your business plan, the next step is to prepare a business presentation. The entrepreneur at this point will be expected to be intimately involved in the business and should know the business plan in great detail. The entrepreneur's job now is to sell this vision to investors. In many cases the business has been operating for quite some time and the next round of capital needed is quite large. The entrepreneur needs to convince investors to "believe" in him. A smooth, well rehearsed, professional presentation is expected. Practice makes perfect and prepares the entrepreneur for any questions that will arise.

### 8. Take presentation to venture capital firm

The entrepreneur now takes their finely tuned business presentation to a venture capital firm and asks for them to provide substantial capital. The presentation should last approximately 30 minutes and be easy to understand, comprehensive and interesting. Critical points of the business plan should be addressed and other topics like management or board of director requirements as well as exit strategies should be offered. The entrepreneur should allot the last five minutes to answer questions.

### 9. Go through "due diligence" documents

If the entrepreneur has made it to this point, the venture capital firm is interested in pursuing an investment. They will now work closely with the target company to complete a "due diligence" analysis. The company will be asked to provide numerous documents and information to support the viability of the business.

**10. Negotiate deal**

Congratulations. You are one step away from attaining the venture capital firm's investment. The VC has decided it wants to invest in your company but now the details must be negotiated. It is important during this phase to explicitly address all terms of the agreement. Detailed instructions on how the money will be used, the role the VC firm will have in the company as well as an exit strategy should be clearly stated.

**Start up business**

Prepare to put the money to use. Secure additional inventory, employees and other assets to begin growth of the company. Integrate managerial advice and expertise of venture capitalists into your organization.

**Prospect for new investors**

Venture capital financing frequently leads to explosive growth and the business becomes more attractive to other investors. The fact that a venture capital firm has funded a company

shows optimism and confidence in their business plan and usually opens the door for traditional financing.

**Obtain future rounds of financing**

Future rounds of financing will be necessary to support the growth of the business and maintain cash flow. New investors from the previous step may be eager to invest. But control of the company may be in jeopardy if too many outside investors are brought in. Entrepreneurs at this stage must determine how much they are willing to "give up" in order to continue growing the company. More capital from the venture capital firm may be used to increase their equity position. Another popular option for future rounds of financing is the use of an investment bank to take the company "public".

**Venture capital firm exit**

Venture capital firms generally look for a 5-8 year horizon. They target a 5-20 times gain on their investment. The most popular options for exit strategies are going public and being acquired. □

### **Aavishkaar India Micro Venture Capital Fund**

The Aavishkaar India Micro Venture Capital Fund ("Aavishkaar") is a venture fund founded to promote development in rural and semi-urban India. Aavishkaar believes entrepreneurs can be a powerful force for development. To this end, the firm provides micro-equity funding (Rs. 10 lacs to Rs. 50 lacs, approximately USD \$20 thousand to USD \$100 thousand) and operational and strategic support to commercially viable companies increasing income in or providing goods and services to rural or semi-urban India. Aavishkaar commenced venture capital operations on May 22<sup>nd</sup>, 2002.

**Fund structure**

Aavishkaar operates in two tiers. The parent, Aavishkaar International ("Aavishkaar International"), is incorporated in Singapore. Aavishkaar International has been set up to aggregate individual investments and then remit them to Aavishkaar Indian Micro Venture Capital Fund ("Aavishkaar"). Aavishkaar has been registered as a Trust under the Indian Trust Act, and has been authorized to act as a venture capital fund by Securities and Exchange Board of India (SEBI).

**Total capital under management**

Aavishkaar has raised roughly Rs. 5 crore to date. Rs. 3.5 crore remains to be invested.

For more information, contact:

**Aavishkaar India Micro Venture Capital Fund**

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