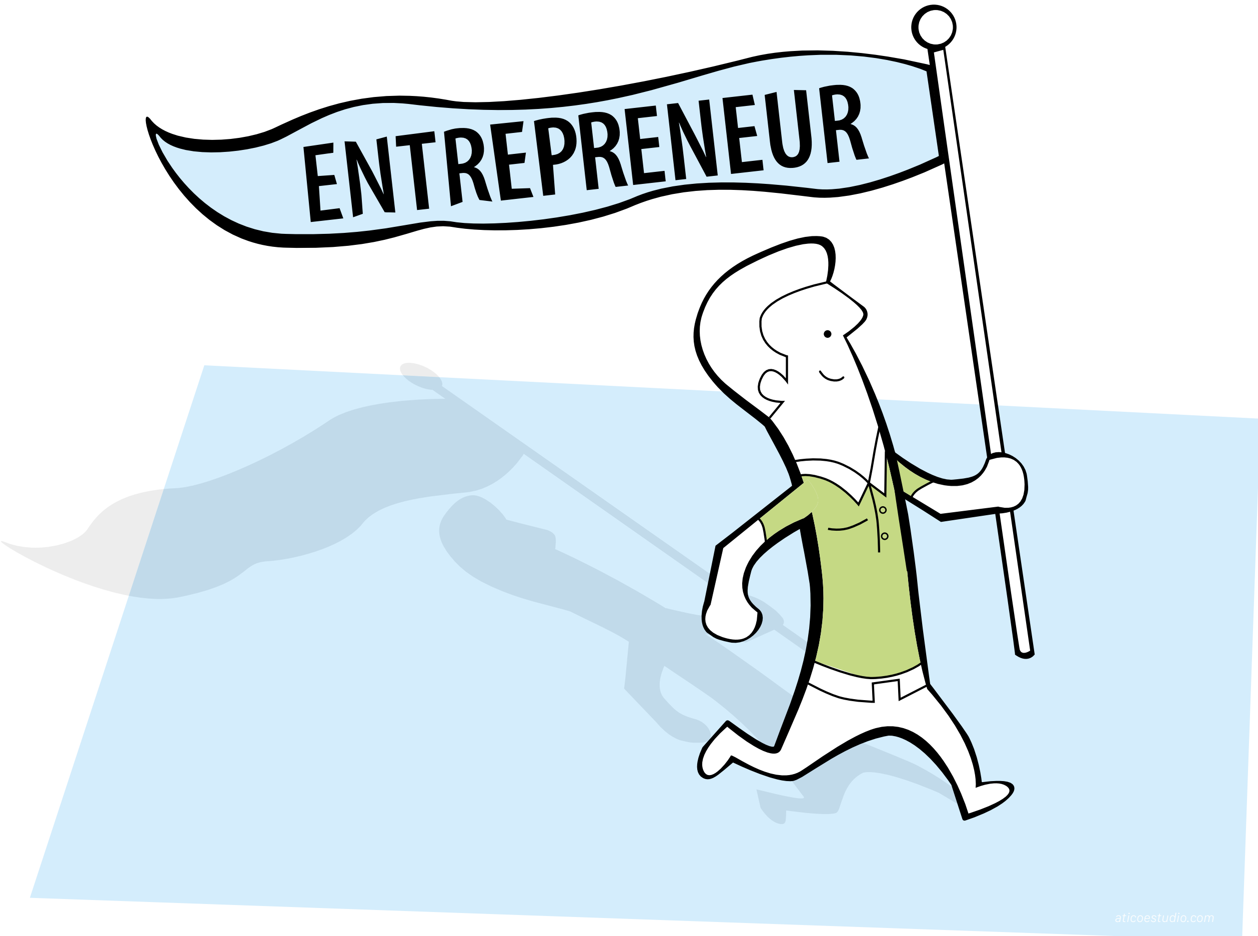
# The Entrepreneur's Guide to Growing and Financing Innovative Energy Technology Companies




May 2018

Trinomics

Dear Innovator,

This "**Guide for entrepreneurs to grow and finance innovative energy ventures**" aims at helping you to raise capital and find the support your business needs to grow and turn it into a lasting and thriving market player. It is organised around "Building Blocks" representing the different development and funding stages of innovative energy start-up businesses. While we present these "Building Blocks" in chronological order, each section is designed to stand on its own. It allows you to dive straight into the situation your business is currently in.

This Guide is also complemented by two further resources that are available via the IC4E Project website (*http://energytechnology-investmentcommunity.eu/*):

- Further information and sources to this guide;
- A compilation of financing institutions and market players that you may contact as your business grows.

This Guide was written by practitioners with input from Charles Reynard (Eversheds), Andrew Morton, David Smyth (Oxford PV), Per Steenstrup (Resen Waves), Gina Domanig (Emerald Technology Ventures), Tarja Teppo (Cleantech Invest), Bernd Arkenau (eCapital), Nicolas Chaudron (Idinvest Partners), Stephane Villecroze (Demeter Partners) and other market players who contributed to these documents via interviews.

Their input was important to make this guide as practical as possible and to explain why building the 'soft parts' of your business (e.g. team, business culture, etc.) is so relevant (see the example below):

**Emerald Technology Ventures, Cleantech Invest, eCapital, Idinvest and Demeter Partners indicate that risks of failure are mostly due to infighting in the management, team split up, burn out - and less so with the underlying technologies.**

We hope you will find these resources useful in taking your business to the next level.

**Koen Rademaekers**, *managing director, Trinomics*
*(in charge of the overall project)*

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*(co-authors to this Guide)*

This publication is one of the deliverables of the European Commission Service Contract N° ENER/C2/2016-500 regarding a study on "Building the investment community for innovative energy technology projects" .

# What to find in this guide?

This Section explains the Building Blocks to succeed in the innovative energy sector, and where to find their description. Under 'innovative energy (sometimes referred to as 'clean energy technologies')' we include those energy technologies with a Technology Readiness Level (TRL) between 6 and 9 (thus from proto-type demonstration up to a technology that has proven to be successful in operations).

Figure 1 shows the eight Building Blocks of this guide – by clicking on one of the blocks you will be referred to that specific Building Block.

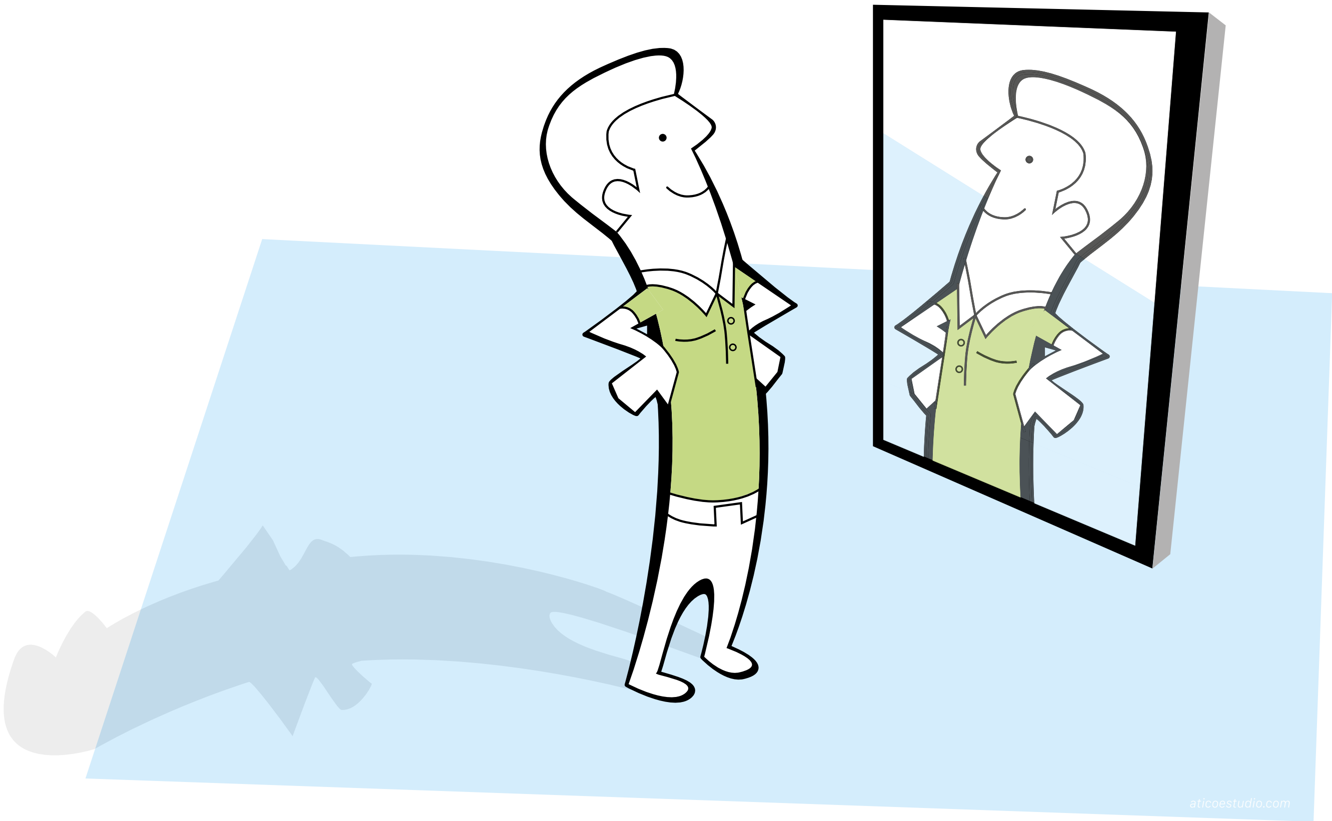
Figure 1 – Eight building blocks to success and glossary



A glossary of terms is included at the end of the document.

We also have written a more Extended Vademecum (Exhibit 1). We do provide in each of the Building Blocks links to this Extended Vademecum (for people with a deeper interest in some topics).

Finally, we also provide a link to Exhibit 2, which is a list of relevant (mostly financial) organisations in innovative energy ventures.



# Building Block 1

## Getting it right from the start

> *A full initial self-assessment including mapping of existing and missing competences is an essential ground work to set the venture on track for success.*

### Going through a self-assessment

Understanding your ability and resources from the outset is key to identifying gaps and needs as you move on. This might seem simple and obvious, but it is worth taking the time to do this properly and include your team in this exercise. It will allow you to generate shared understanding and it will help to make information that is often vague, measurable and comparable.

The key question is 'do your **resources match the needs of the company**' and 'who is bringing what to the table'?

To answer these questions, you should put together the following:

- **Personality and professional assessments and analysis of founders' profiles.** How complementary and redundant are they? What are the functional gaps to fill? Further details of such analysis can be found in Annex 2 of Exhibit 1;
- **A company organisational chart and analyses of missing skills** in the company;
- **A list** of all assets:
  - **Soft Assets**, list of contacts (clients, investors, suppliers, other useful business contacts, network of qualified prospects, etc.);
  - **Hard Assets**, patents, intellectual property, machines, prototypes, contracts or agreements, capital, etc. This may be done via filling a table such as Table 1.

Table 1 – Example of list of external resources and their qualification

| Name or identification of the resource | Type of resource | | Ranking (1 to 5 stars) | | |
|---|---|---|---|---|---|
| | Soft | Hard | Available | Reliable | Level of quality |
| Business angel A | Advice on strategy | Capital | **** | **** | **** |
| Mentor B | Advice on product development | - | ** | ***** | ***** |
| Incubator C1 (member) | Events | Office space and shared physical resources | ***** | ***** | *** |
| Accelerator program C2 (member) | Events, network and advice | - | **** | ***** | *** |
| Membership of network D | Suppliers network | Access to production facilities | *** | ***** | **** |
| Contact with Prospect E | Prospective beta tester | | | | |
| Contract with University F | Recruitment pool, mentorship, expertise | Shared patent and know-how, access to prototyping machines | ** | ** | ***** |
| Contact with Venture capitalist G | Advice, contacts | Capital | * | ** | *** |
| Patent H | Recognition | Capital | ***** | ***** | *** |

*Source: authors. For illustration purpose only. These items could then be subdivided for further qualification, and sorted and grouped according to specific criteria.*

For a productive self-assessment, founders and managers are advised to **take time away** to conduct such analysis in good conditions. We recommend that innovators spend one to three days **offsite to brainstorm**, reflect on and map out listed elements. Depending on the size of the company, this can be done in multiple instances and jointly when building part of the business plan. This can be self-guided or done with the help of facilitators or advisors.

## Mapping resource gaps

Once the preliminary self-assessment is done, the founders and managers should scout for peers or comparable companies to **benchmark** their assessment. This comparison will further support the self-assessment and significantly improve your perspective and knowledge. As your initial resources will not likely cover all your business needs, you will identify resource gaps (to be filled in probably by one of the founders or by external sources).

This resource gap analysis could be done by using a template such as Table 2.

Table 2 – Resource gap assessment tool

Table 2 indicates a situation where there is no HR officer and as such the founders should deal with the recruitment process.

| Resource gap | Operational needs | We have | Resources to assess |
|---|---|---|---|
| No HR officer | Recruitment process management:<br>• Sourcing<br>• Operations | • Founder A – Operations – 0.5 day/month<br>• Board Member C – network – 0.5 day/month<br>• Assistant to founders – 1 day/month | • Recruitment management software<br>• Part-time / freelance professional<br>• Recruitment agency |
| | Candidates assessment | • Founder A - management experience – 1 day/month<br>• Founder B - operational recruitment experience – 2 days/month<br>• Board Member D - extensive recruitment experience – 0.5 day/month | • HR software (assessment)<br>• Part-time professional<br>• Headhunter |
| | Practical handling:<br>• Interviews handling<br>• Interviewee assessment<br>• Synthesis, report, selection | ... | ... |

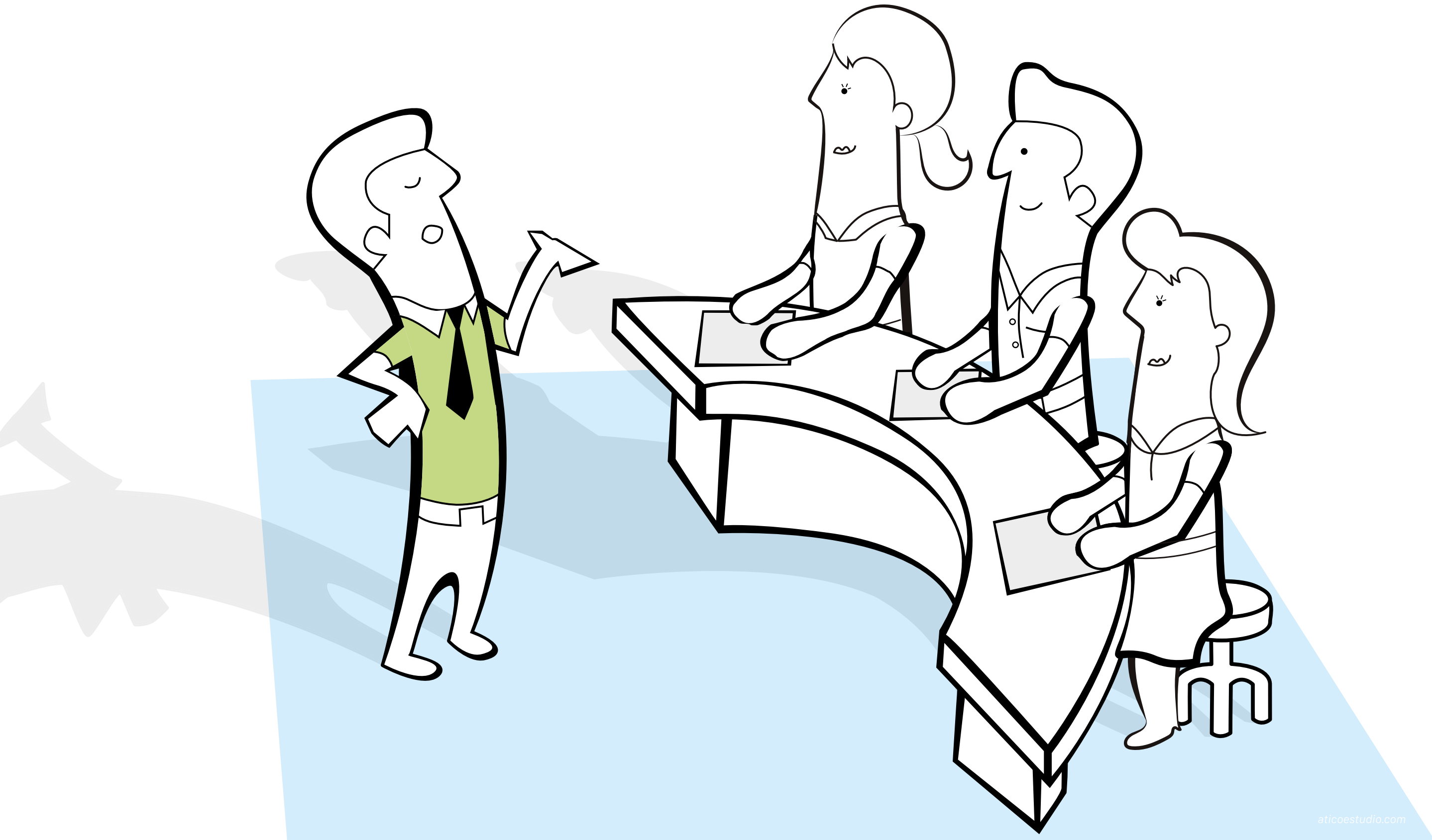
*Source: authors. For illustration purpose only. These items could then be subdivided for further qualification.*

The output of this table and this analysis should help you to understand why these competences are missing and how important they are. The analysis of weaknesses and list of resource gaps are referred to in the Business plan (see Building Block 3).

### Regular analysis of business needs

Innovators can significantly increase their chances of success by conducting such exercise **on a regular basis**, to understand how the venture and its resources evolve. Successful businesses tend to do this **yearly** or even **each semester** during the initial years.

As part of this exercise, you may want to brainstorm to **list the skills and resources necessary for the success of the venture**. What are the most important skills? This builds on previous iterations. For example, as the business grows, sales and marketing will increasingly be required skills. The self-assessment should then include this and lead you to  evaluate if necessary skills are available in-house or must be hired externally.



# Building Block 2

## The key for growth is to delegate

> *Delegating efficiently and diligently is a clear indication and factor of a healthy growth.*

Every entrepreneur knows the temptation to do and control everything. This appears more efficient and faster but soon becomes a hindrance to growth and regularly preludes to failure.

### Addressing resources gaps

**Efficient delegation** is the key to address resources gaps and to support a healthy company growth. This could be done **internally** or via **outsourcing**. Figure 2 below illustrates the pros and cons of these options.

Figure 2 – Mapping of the pros and cons of different delegation options

**Team up with start-up co-founders**
Brings strategic and operational skills for the long term,
(+) Experience of successful entrepreneur is invaluable, but
(-) Risk of disharmony in the team.

**Actively partner with stakeholders (such as key suppliers, industrial partners and distribution partners)**
Provide advisory and feedback,
(+) Part of a **formal or informal Board of advisers**,
(+) Incentivize **stakeholders** on the success of the venture.

**Efficient Delegation**

**Recruit key human resources**
To attract and retain talents is key,
(+) High motivation of talents also important,
(+) Investors may take active role in HR, but
(-) Remote resources can be difficult to manage.

**Outsourcing to service providers**
Makes sense for accounting, basic legal, etc.,
(+) Start up may pool their needs to get better terms and services from providers, but
(-) Can be costly and time consuming,
(-) Risk on quality of the end result. Loss of freedom when choosing stakeholder.

*Source: authors*

## Sources of external assistance

Within the EU, the **European Investment Advisory Hub**[1], provides a list of programs supporting projects and investments (and notably ELENA, the European Local ENergy Assistance program[2]), helps to structure projects and provides advice[3].

A common way to get access to external resources is via **joining** a start-up **incubator** or **accelerator** (see box below). These provide a series of mutualized services (e.g. shared office space, meeting rooms, IT infrastructure, coaching and training programmes) but also opportunities to exchange best practices and share ideas with business in a similar development state and break the isolation that affects entrepreneurs all too often. See also Exhibit 2 which lists relevant incubators and accelerators.

[1] http://www.eib.org/eiah/index.htm
[2] http://www.eib.org/products/advising/elena/index.htm
[3] Other European programs of interest to energy innovators include the NER300 (http://www.eib.org/products/advising/ner-300/index.htm), which is dedicated to support green technologies and in particular innovative renewal energy technologies. However, no new calls are planned at the moment.

### Identifying and approaching business incubators and accelerators

**Incubators** provide services to emerging businesses. They offer fully equipped office space and experts (staff, directors, specialized service providers). Remuneration is usually a monthly fee.

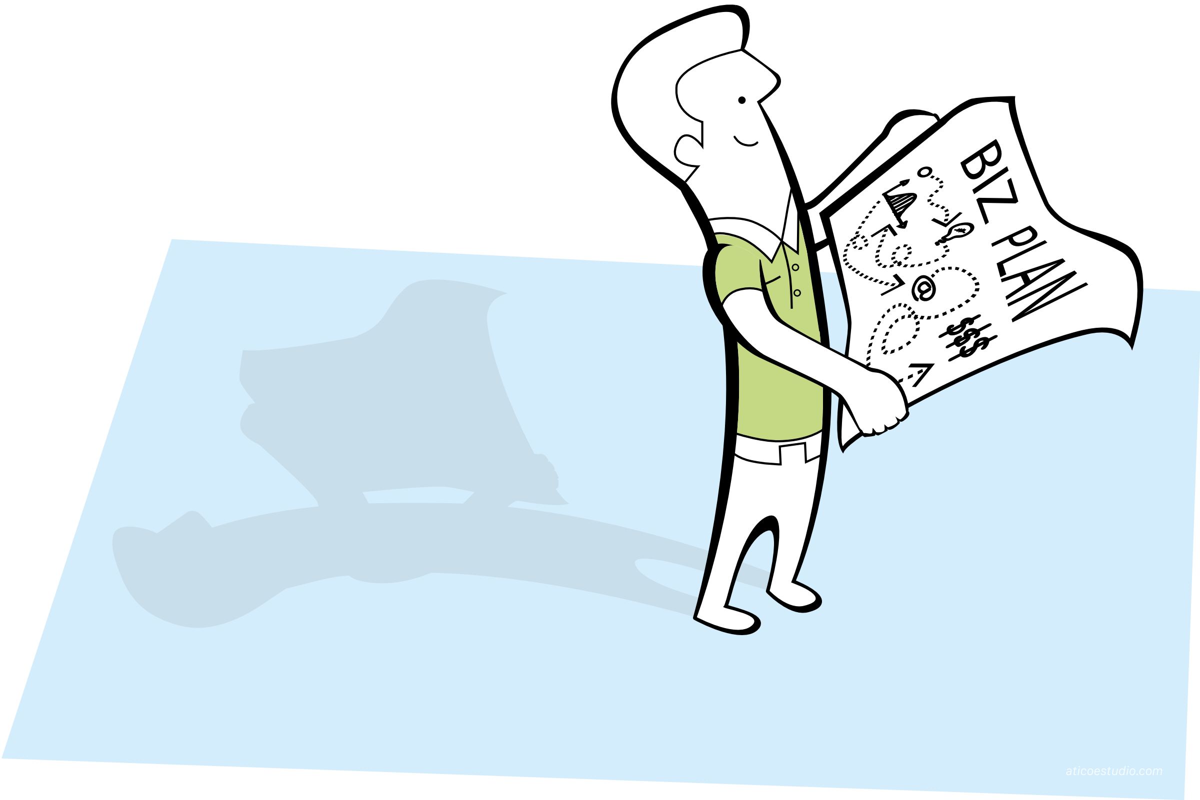
In certain cases, innovations emerge from the incubator itself (sometimes linked to a corporation). There, the incubator takes a percentage of ownership of the resulting company, often between 15% and 30%.

**Accelerator** programmes usually provide teams of innovators with seed capital, mentorship, coaching, workshops, events, networking opportunities (among entrepreneurs; and between entrepreneurs and selected communities) and access to investors. In certain cases, access to office space and facilities is also provided.

Other programs do not provide capital but focus on training and mentoring. Accelerators recruit founding teams by batches (called 'cohorts' or 'classes'), which are guided by mentors/coaches over three to six months to reach a stage where they can pitch ideas to potential investors in 'demo days' (called the 'graduation').

Private accelerators get compensated by a percentage of ownership in the resulting firms (between 5% and 15%), while public accelerators often ask for no or little remuneration.

Certain programs can combine features of incubators and accelerators. For example, 'entrepreneur in residence' programs are offered by venture capital funds to innovators, who will be hosted by the fund to grow an idea. This approach combines features of an accelerator and an incubator. The fund will get a percentage of the resulting firm.




# Building Block 3

## Business planning
## the backbone of your venture

> *A Business Plan is a central communication tool built collaboratively within the venture, to communicate a vision, translate it concretely and guid the operations.*

The Business Plan should be the **most complete and up to date document** about the company and consequently the **reference document** (Figure 3). It should be as factual and precise as possible. A good Business Plan demonstrates (and does not simply state). The client is and should remain the main reference point.

Figure 3 – Uses and operational process of a Business Plan

**Use of the Business Plan**

Iterative process of regular updates of the Business Plan

**Internal purpose**

- Provides **strategic instrument** to pilot the company in the future,
- Guides the **transformation of** a **vision into** concrete **actions**,
- Brings an **operational instrument**, defining budgets and targets for each department of the venture,
- **Ensures cohesion** of participants to actively fit together in the overall plan of the company,
- **Provides a clear indication of future capital needs.**

**External purpose**

- Is the main document **looked at by prospective investors.**
- Provides a precise **perspective on the assumptions** (documented), **costs and business choices.**
- Becomes the **ground for negotiation** on capital needs and venture valuation.
- Gives sets of **scenario analyses** within the business plan to support **capital needs and venture valuation.**

*Source: authors*

A Business Plan combines

- a **descriptive part** (the 360-degree perspective on the business) and
- a **quantitative part** (past, current and projected financial statements).

## Descriptive part

The content of the Business Plan will be more or less detailed depending on the stage of development of the company. It includes the pre-seed stage, the commercialisation stage and exhibits[4].

Examples of Business Plans from renowned public and private institutions can be accessed freely on line[5]. The most commonly included items are listed in Table 3 below.

Table 3 – Main sections of a typical business plan

| Chapters | Description of content |
|---|---|
| **Executive summary** | Key points of the document that logically lead to capital needs, explains use of cash and milestones. |
| **Introduction of the innovators and the venture** | I introduce objective and purpose of the company, its history to date, some key factual elements such as legal form and date of incorporation (if any), current ownership and amount of capital raised, location, structure of management with short biographies, aim and purpose (including which market need is addressed and how, introducing the underlying technology) and the vision of the innovators. |
| **Market and market need(s)** | As the client is at the centre of the business plan, the first section should address what is the need addressed by the venture, what is the associated market, client segmentation, detailed competitive analysis (including potential entrants), market gap, niches, barriers to entry and exit, dynamics over time, reference to market studies (listed and detailed in exhibit), pricing assessment and sensitivity and reference to findings from customer interviews/panels (detailed in exhibit). |
| **The product/service and the technology** | How does the product/service address the market need(s)? Why was it not possible before? How does the technology enable the venture to do this? Why would this specific product and service win over the existing or potential competition? |
| **Strategy** | How does the venture make money (or sustain itself) and what is its long-term business model? Where does the venture stand in the industry value chain? What does it do? How does it plan to evolve? How will it compete? What does it want to achieve? What are the targets? What are the alliances to reach? |
| **Technology: core differentiator and barriers to entry** | What is the underlying technology, and how relevant it is to the market, the clients and the competitive environment? How advanced is the technology now, and how is it expected to progress (including future milestones)? How does it deliver value to the clients? What is it lifecycle, how is it going to improve or develop over time? How are pre-sales, sales and post-sales organized? Is there any maintenance to factor in? |
| **Marketing and sales strategy** | How to approach prospects? How long will it take? How expensive will it be? What is the sales cycle? How is the product/service priced and how does it compare with the competition? How was the price set? How does the company plan to sell? What is the plan? |
| **Governance and management** | How is the venture organized? What are the roles of innovators and which function do they assume? Who are the shareholders and stakeholders? How is the governance organized? How is the management of the venture organised? |
| **Operations and development plan** | Who are the partners of the venture and how does it interact with them? What are its human resources? How does it plan to operate (production capacity)? How are these parameters expected to evolve in the future (staffing needs, suppliers, office space, inventory, equipment…)? |
| **Capital needs** | How much capital does the company need and for what use? How long will it take to reach the expected milestones? Will the company need further capital injections? |

*Source: authors.*

[4] Exhibits should include: **past achievements, CV** of team members, current and projected **organisation chart**, detailed **description of technology**, detailed **description of product and services**, eventually a Gantt diagram with a **planning, past financial statements** if any, description of current **IP protection** (if any) or pending one (if any), **market study, customer panels/interviews/description**, a **value chain analysis**, a **sales cycle analysis**, any **visual of prototype**/mock-up of product/service, a **business case, references to academic literature** (if applicable), **competition assessment** (including barriers to entry, potential entrants), **pricing assessment**; a **list of business partners, a list of current/prospective suppliers** (if not name, at least description); a **commercial pipe-line** (and list of clients, if any).

[5] See: UNCTAD: http://unctad.org/en/Docs/iteiia5_en.pdf
IFC and IBM joint approach: http://smetoolkit.org/en/business-planning/business-plans

## Quantitative part

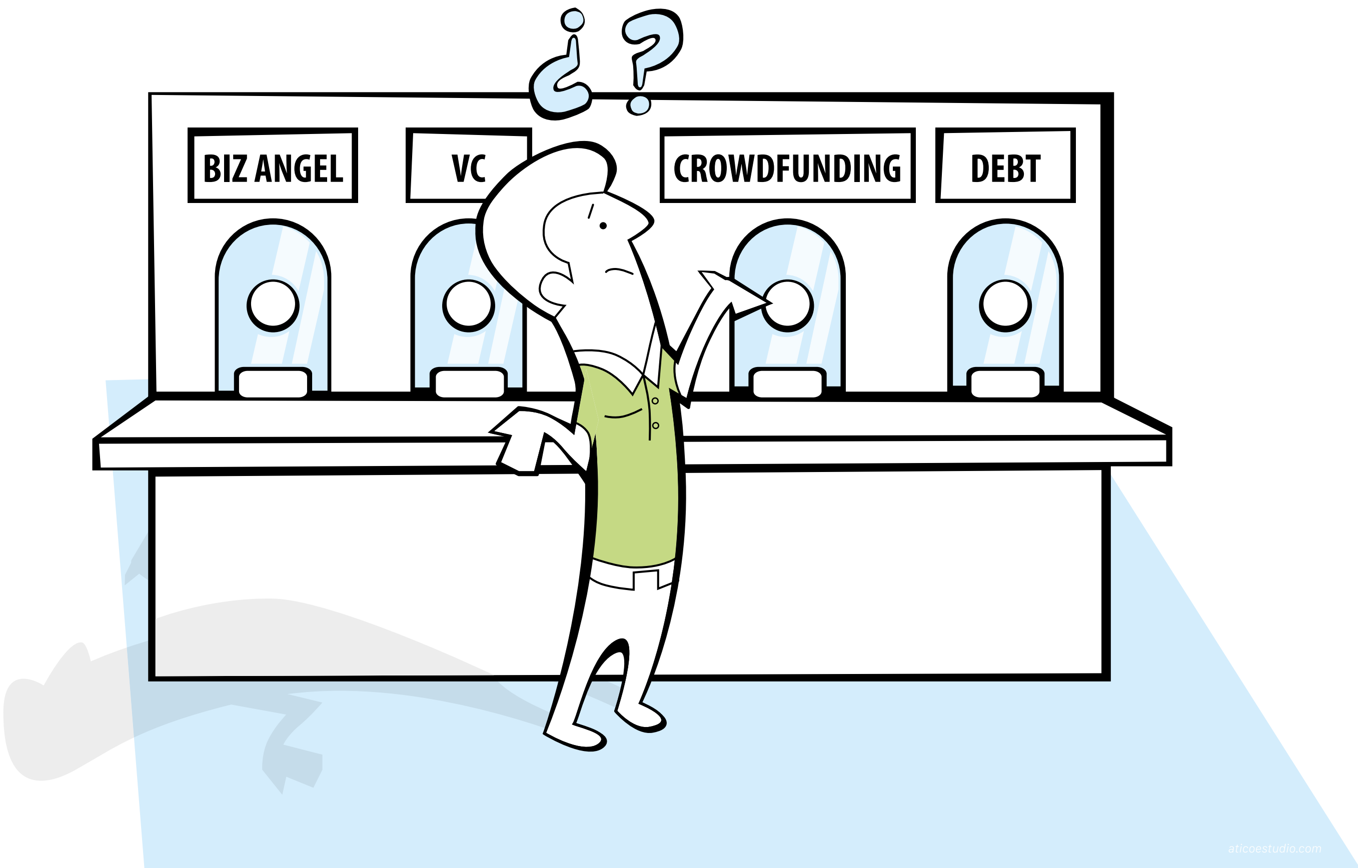
The **quantitative part** of the Business Plan is **focused on financial statements** (past, current and projected), which should mirror the descriptive part. These statements include profit & losses, balance sheets, detailed cash-flow statements, investment plans and scenario outputs.

This part should **include metrics** that the management can further use **for piloting and benchmarking**.

The **metrics (which do include the prospection plan, sales indicators, cash flow burn rate, operational costs, delays of payment, progression of R&D, recruitment plan and costs, negotiation with business partners)** allows to keep track of the activity of the venture on a regular basis (monthly, quarterly, semi-annually and annually). These metrics are used to monitor the evolution of the business and to check if they are in line with **the business plan**.

More details about funding needs and uses are included. This section might include a valuation analysis, if innovators want to disclose it at this stage, and possibly a section on the exit strategy (type of exit envisioned and time horizon).

IMPORTANT: A Business Plan is **not a static document**, but it is part of an **iterative process** which is regularly updated and enhanced as the venture growth. Such **iterations** are **part of the management of the company.**




# Building Block 4

## Where and how to get financed?

> *Understanding the optimum combination of sources of funding for the venture is an art and a key to an efficient growth.*

### Choosing sources of financing and support

The choice of such sources depends on:

- The stage of development of the venture;
- The amount needed;
- The type of support required (direct and indirect);
- The use of capital (new hire, purchase of machines, etc).

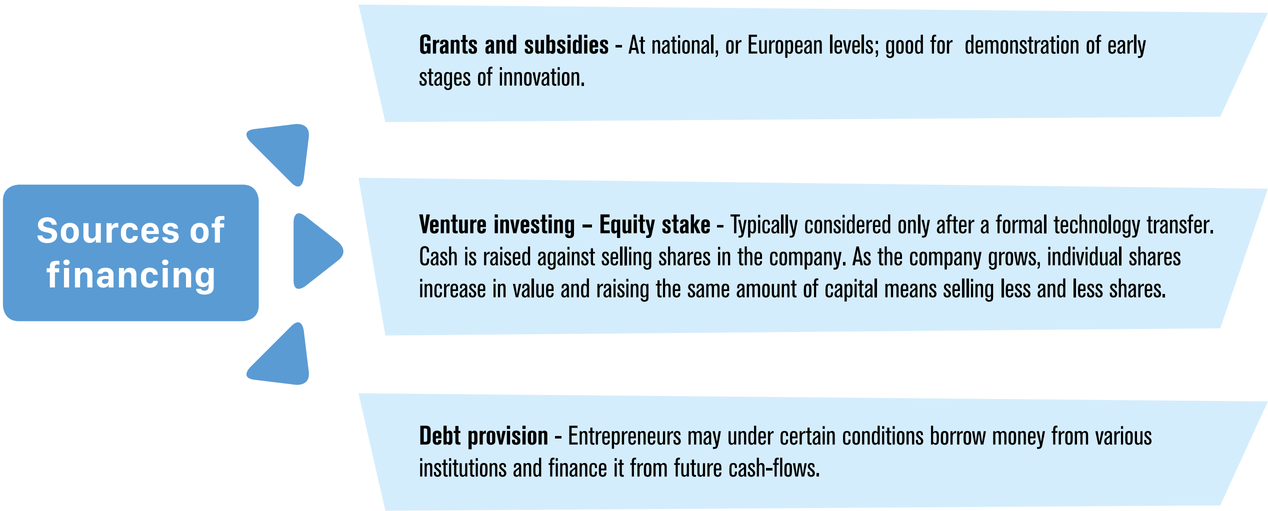
Each source of financing has its advantages and disadvantages, which should be carefully assessed by entrepreneurs to make the best choice and find appropriate support.

We therefore suggest you to build an intimate knowledge of the sources of financing. The following section should help you in your first approach. Exhibits will guide you for a more in-depth understanding.

## Sources of financing

Three main sources of financing are available to ventures (Figure 4).

Figure 4 – Sources of financing




*Source: authors*

## Grants and subsidies

### Main characteristics:

- Usually require little to no compensation;
- Provide often limited amounts;
- Relatively easy to access (although applications can be lengthy and cumbersome);
- Some institutions require that public grants are matched by amounts collected from private investors. These may offer larger amounts and can be used at a later stage of the development of the company;
- Lists of grants and subsidies are maintained by countries' chambers of commerce, by innovation agencies and by public agencies dedicated to small businesses.

## Venture investing – equity stake

### Main characteristics:

- Raising capital is done in **successive rounds**. This is to limit the dilution of the current shareholders and to set up the discipline of reaching milestones of development, which trigger the next capital injection.;
- In most cases, more than one investor will invest. Therefore, investors syndicate their investments and negotiate by drafting term sheets;
- It is common that investors who have **invested once** may **want to invest more** if the company developments are satisfactory;
- Venture investors also bring "**soft capital**" such as **expertise, advice and contacts of financial, corporate, strategic, operational or commercial nature**. They may sit on the Board. They may actively support the management and informally contribute to the success of the company. The selection of venture investors by entrepreneurs should thus

include the assessment of their soft capital contribution;

- Different sources of capital tend to focus on different stages of development of a company (see figure 5 below);

- **Sources of finance can be combined**. Interactions between sources need to be assessed, for example corporate venture investments may discourage competitors to do business with the venture. (Exhibit 1) of this guide.

### "In the words of" multiple venture capital firms

Emerald Technology Ventures, Cleantech Invest, eCapital, Idinvest Partners and Demeter Partners confirmed that:

- A typical venture capital (VC) firm invest in less than 1% of the opportunities they look at every year;

- At the due diligence stage, important factors that investors look at include the team and human factors;

- For lead generation, though large VCs usually have their own channel (relationships, universities, walk-in applications) they also largely attend specialised events. Highly rated events include the event of KfW fund HTGF "High-Tech Gründerfonds";

- Grants are instrumental at an initial stage, especially the H2020 programme. Some grant applications can have a cumbersome process of application.

To gather a good syndicate is seen an important factor of success. VCs interviewed try to have a seat on the Board and a lead position within the syndicate.

## Debt provision

### Bank loans

This is often **limited in its scope and volumes** for innovative energy ventures as qualifying for a bank loan in Europe usually requires:

- Five years of existence;

- At least three profitable exercises with significant positive cash flows;

- Additionally, certain loans require providing assets pledged as a collateral (to be seized in case of default), which entrepreneurs do not have or not under the right features.

### Venture lending

Outside of traditional banks, specialised **venture lending firms** provide loans to ventures. Such loans are usually **convertible loan**, the lender has the possibility to **convert the debt into equity**. Repayments are usually flexible and interest rates can be high (700 to 900 bp above the market interest rate).

### Additional support: loan guarantees and export guarantees

At a later stage of their development, innovative energy technology companies may face significant difficulties to access funds (due to more capital-intensive investment needs). This is eased partly by **"loan guarantees and export guarantees" provided by various public institutions.**

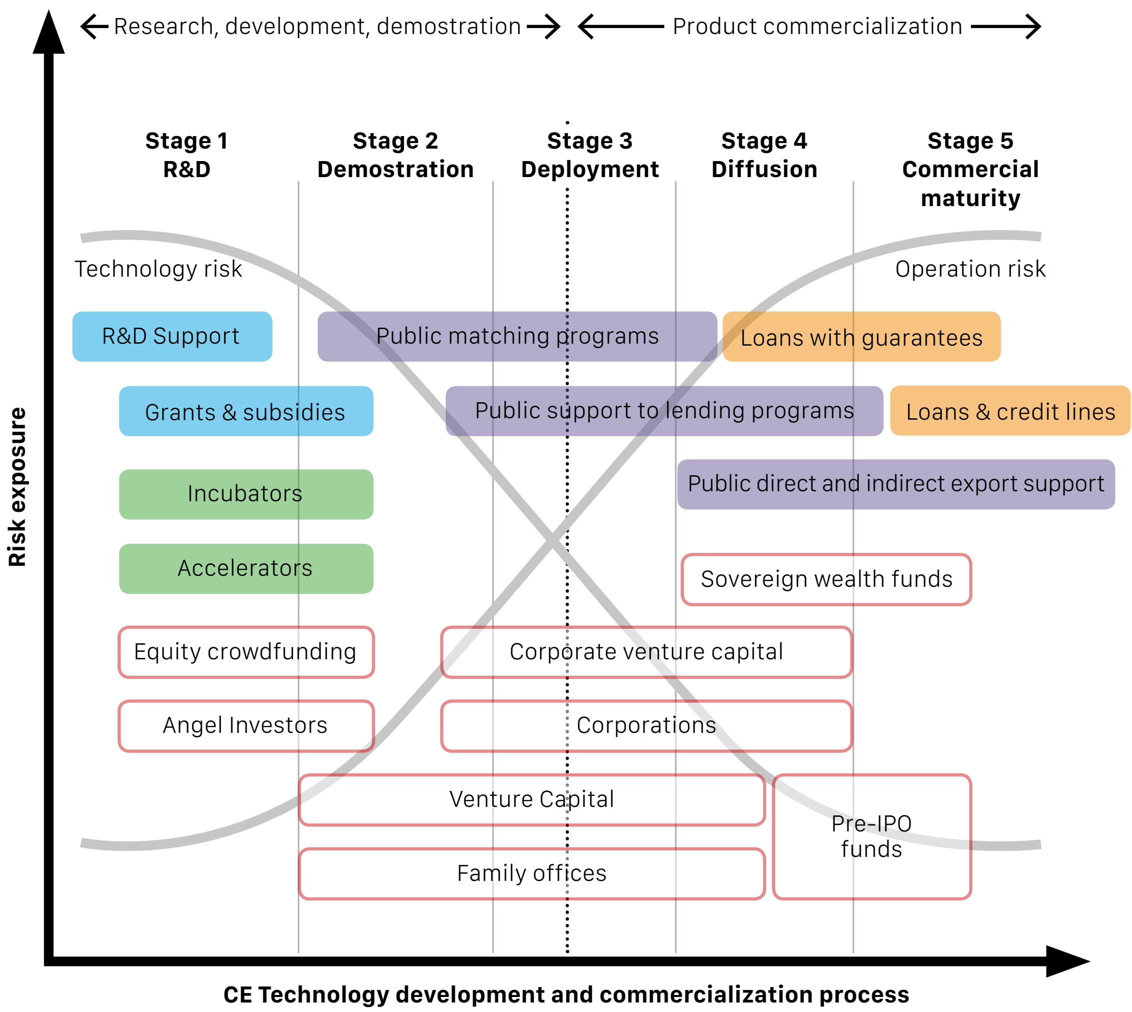
In particular, the **European program InnovFin Energy Demo Projects (InnovFin EDP)**, of the European Investment Bank (EIB) aims at financing first-of-a-kind demonstration project in renewable energy, energy storage, smart energy systems, carbon capture and storage and use fuel cells and hydrogen. These loans and guarantees finance innovative power plants, fuel production plants or manufacturing plants. The loans are EUR 7.5 to 75 million for a maximum of 15 years. This program is a joint initiative of the European Commission and the EIB under the Horizon 2020 framework for research and innovation (2014-2020). This program in effect bridges a major gap in the financing chain, which usual capital and debt providers struggle to fill due to the size and the risks involved.

Also, **National programs** offered by governmental agencies such as BPIFrance in France and Cassa Depositi e Prestiti in Italy; or economic development banks such as the British Business Bank in the UK, the Instituto de Credito Oficial in Spain and KfW in Germany, provide loans and guarantees for local ventures. Though these programs are not specifically designed to support innovative energy technology companies, they nevertheless are potentially of help to innovators in the energy space. Credit guarantees aim to alleviate constraints in borrowing by ventures associated with a lack of collateral. These guarantees are accessible by the lenders and not directly by the individual innovators (borrowers) and therefore can prove to be difficult to use, as innovators can only suggest to their lenders to use them.

## Venture investing: identifying the stages of investing

Figure 5 provides an overview of the whole finance scene of new ventures.

Figure 5 – Risk profile of clean energy commercialisation, stages of development of a venture and sources of financing




*For illustration purpose only. Source: authors, adapted from Malek et al.[6] (2014). 'CE' refers to clean energy.*
*In blue: sources of capital non-refundable.*
*In green: sources of soft capital.*
*In red: sources of equity capital.*
*In violet: public programs.*
*The color filled box refer to debt and grants. Color outline box refer to sources of capital.*

[6] Malek, K., Maine, E. and McCarthy, I., 'A typology of clean technology commercialization accelerators', Journal of Engineering and Technology Management, 32, pp. 26-39, 2014.

Venture investors tend to specialise on specific **stages of development** of ventures (Fig 6). They are also often **geography and industry specific**.

Figure 6 – Stages of financing in venture capital

| | |
|---|---|
| **Seed stage - R&D:** transition from the idea/project stage to the set up of a company and an early prototype. | Capital can come from own funds (bootstrapping): *crowdfunding, seed capital funds, grants and subsidies from governmental agencies, grants and prizes from foundations, friends and family, business angels/angel investors, incubators and accelerators.* Often incubators do not provide capital in cash but in-kind (services, material, etc.). |
| **Early stage - Demonstration:** reach a functional prototype, establish industry contacts, and gather early feedback from prospects, business partners and suppliers. | Same sources as 'Seed stage', plus *venture capital funds and family offices*. Often referred as rounds A and B. Soft capital via advice, contacts (introductions to suppliers, prospects, production partners, distribution partners), mentoring. |
| **Mid stage - Deployment/Diffusion:** industrialisation of production and going to market. | Sources are *venture capital funds, family offices, corporate venture capital and corporations. Public agencies* may match amounts from private sector. Often referred as rounds C and D. Soft capital includes advice, strategic directions, international contacts, and initial advice on exit. |
| **Later stage - Commercial maturity:** diversification, expansion and internationalisation to reach a key position on market. | Sources *venture capital funds, family offices, corporate venture capital, corporations, possibly sovereign wealth funds and funds active in pre-IPO and lending sources*. Often referred as rounds E and above. Soft capital includes advice, Board membership , strategic directions, international contacts, exit, IPO. |

*Source: authors.*

## Summary - sources of capital: durations, expected return, pros & cons

Table 4 provides a list of the main sources of capital, as well as the usual features attached to these sources, such as the usual duration of investment and the expected returns by the investors.

Table 4 – Summary: sources of capital, duration of investment and expected returns from investments

| Resource gap | Sources of capital for ventures | Usual duration of investment | Expected returns | Pros (+) and Cons (-) |
|---|---|---|---|---|
| Capital supply for for-profit ventures | Bootstrapping / innovator's savings | 10+ years | Variable (circumstances will determine how long savings are tied up) | + Perfect alignment of interest<br>- Lack of external 'soft capital' input<br>- Amounts usually limited |
| | Business angels / angel investors (BA) seed capital accelerators incubators | 7+ years | 20-25%+ | + Patient investors with specific knowledge<br>+ Eager to coach and advise<br>- Amounts usually limited (50-100 K EUR)<br>- Often focused on specific sectors (such as IT)<br>- Often limited in their geographical reach |
| | Corporate investments | Potentially unlimited | Variable, above the corporation's cost of equity | + Amount potentially significant (from a few million to 30-50 mn EUR or more)<br>+ Able to provide additional resources (branding, network, know-how)<br>- Essentially active in later stage financing<br>- Limited to the corporate's sector of activity<br>- Possible conflicts of interest<br>- Potentially limiting in the expansion of start-ups (notably when dealing with corporate's competition)<br>- Ultimate aim is to acquire the start-up |
| | Corporate venture capital (CVC) | 5-10+ years | 15-20%+ | + Significant amounts available from early to late stage financing<br>+ Provides access to select resources (corporate and VC-style)<br>- Variable level of involvement and strategic interest<br>- Possible conflicts of interest if CVC invests in start-ups competing with mother company<br>- Possibly embeds non-financial targets, possibly conflicting with start-ups aim |
| | Equity crowdfunding | Potentially unlimited | Unknown (estimated: 10-20%) | + Relatively straightforward access source of financing<br>+ Usually provides word of mouth/viral marketing benefits (if applicable)<br>+ Limited involvement in the governance of the start-up<br>- Limited amounts provided<br>- Low level of success rate (completion) of fund raising campaigns<br>- Essentially adapted to consumer goods projects requiring one round of financing<br>- Limited to no expertise, advice or support provided<br>- Scattered resulting ownership difficult to manage |

| Resource gap | Sources of capital for ventures | Usual duration of investment | Expected returns | Pros (+) and Cons (-) |
|---|---|---|---|---|
| Debt supply for for-profit ventures | Family offices (FO) | Potentially unlimited | Estimated at 15-25%+ | + Long term investing<br>+ Potentially providing significant amount all along the development of the company<br><br>- Difficult to access / secretive<br>- Involvement in the governance can be significant<br>- Shifts in strategy of the FO (generational change) can be difficult to handle<br>- Expertise of FO executives can be variable |
| | Stock exchange | Potentially unlimited | 10%-15%+ | + Significant amounts raised<br>+ Visibility and credibility enhanced<br>+ Cheaper access to resources (bonds, debt) once public<br>+ Shares can be used as a purchasing tool<br><br>- Accessible only once the company has reached a certain level of development<br>- Being listed does not guarantee access to further capital increase<br>- Public scrutiny can be difficult to manage |
| | Venture capital funds (VC) | 5-7 years | 20-25%+ | + Available from early to later stage<br>+ Industry focused, with solid network<br>+ Usually provide significant expertise and 'soft capital'<br><br>- Very demanding source of capital (terms of investment, reporting)<br>- Finance only project fitting in a specific industry, with a certain growth plan and with a clear exit scenario<br>- Often narrowly geographically focused |
| | Convertible debt | 5-8years | 12-18% | + Relatively flexible source of debt capital<br>+ No involvement in governance<br>+ Amounts can be significant<br><br>- Relatively expensive for the start-up<br>- Only available for start-up with a certain level of maturity (history of positive cash flows)<br>- No soft capital input<br>- Requires significant recurring disclosure<br>- Requires stable and predictable cash flows<br>- Requires a significant cash payment at the term of the debt (hence an exit) |
| | Bank loans | 4-6 years | 4-7% | + Resource which is relatively cheap<br>+ No involvement in governance<br><br>- Very strict covenants<br>- Usually requires significant collateral<br>- Only limited to a certain amount and to finance certain projects (typically: acquiring a machine)<br>- Only available for companies with a certain level of maturity (history of positive cash flows)<br>- No soft capital input<br>- Requires significant recurring disclosure<br>- Requires stable and predictable cash flows |

*Source: authors. Each source of financing is not necessarily available at every stage of development of a company. Certain sources of financing are available only in certain jurisdictions. Returns are measured as internal rate of return for equity, gross of any cost or fee; and as interest rates for debt.*

## Compensation of sources of capital, support and advice

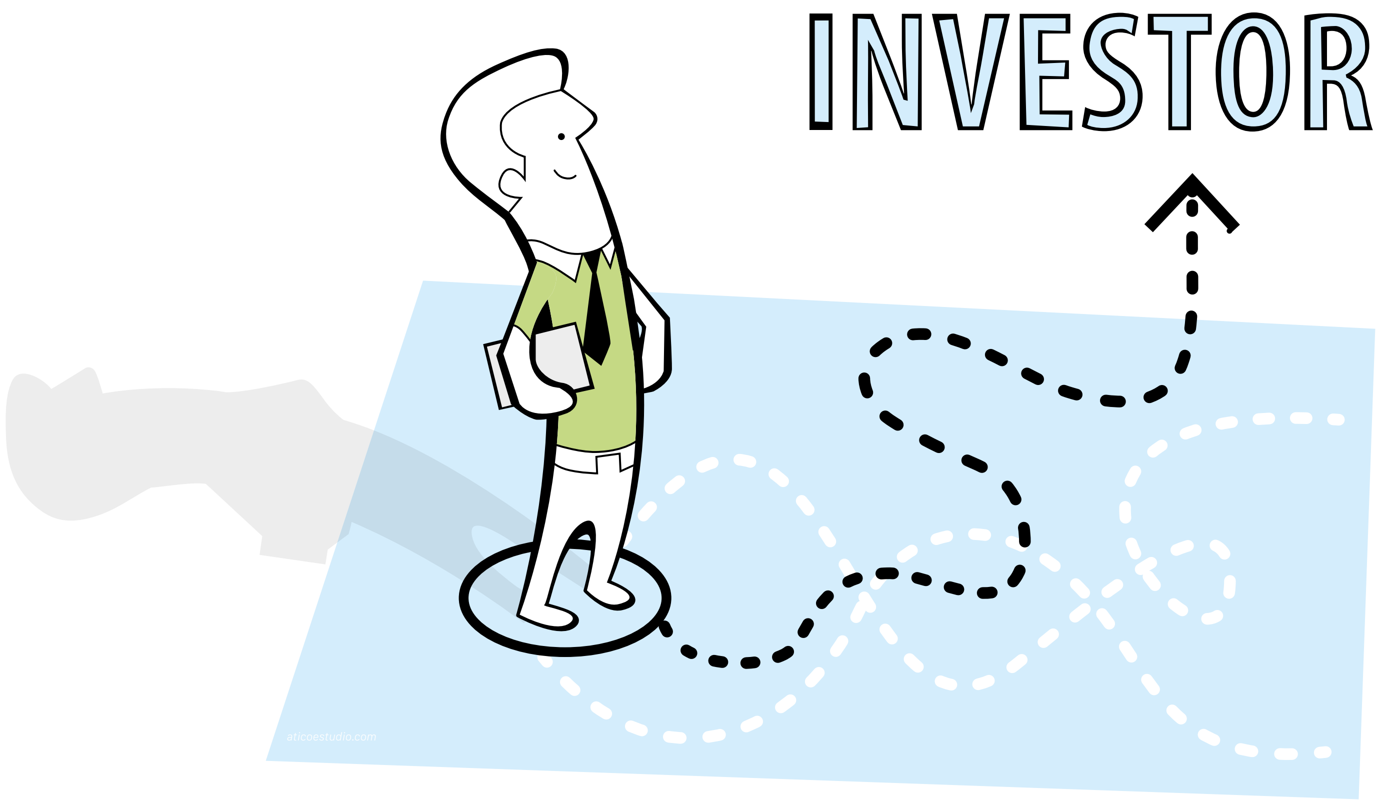
Sources of capital, support and advice are compensated in different ways. Table 5 provides a description.

Table 5 – Sources of capital, support and advice, their role and type of compensation

| Business investors and advisors | Definition and role | Compensation |
|---|---|---|
| Seed investor, business angel/angel investor | Initial investment in a venture, may be among an entrepreneur's family and friends. This may be a one-time investment to help launch the business or an on-going injection of money to support and carry the company through early stages. | Equity stake in the company (target: capital gains) |
| Family offices | Private wealth management advisory firms who gather and invest funds from ultra-high-net-worth investors. | Equity stake in the company (target: capital gains) |
| Venture capitalists, corporate venture capital | Institutional investors supporting small companies from early to late stage. They may also provide advice, contacts and expertise in marketing, finance, management and strategy. CVC can provide technological expertise and coaching, access to suppliers and commercial networks | Equity stake in the company (target: capital gains) |
| Crowdfunding | Use of small amounts of capital from a large number of individuals (wider public) to finance a new business venture via Internet. | Equity stake in the company (target: capital gains) |
| Accelerator | Fixed-term programs, comprising mentorship and educational components and often culminate in a public pitch event or demo day. | Service fee and/or equity stake in the company (target: capital gains) |
| Incubator | Provide access to material resources, offer networking opportunities and access to advice and services. | Fees and/or equity stake in the company (target: capital gains) |
| Lawyers | Provide legal and tax advice to ventures. | Service fee |
| Placing agents | Assist the companies with finding potential investors. | Success fee + possibly flat service fees ('retainer') |
| Business advisors | Advise on start-ups management. | Service fee and/or equity stake in the company (target: capital gains) |

*Source: authors.*

A list of "Business investors and Advisors" (accelerators, angel investors, corporate venture capital, equity crowdfunding, family offices, Incubators, lawyers, matching events, placement agents/fundraising advisors, venture capitalists, accelerators and Incubators outside of Europe within the innovative energy sector) can be found in Exhibit 2.




# Building Block 5

## How to best approach investors?

> *Approaching investors successfully requires preparation, patience and a clear understanding of their mindset and priorities. Building trust is central to closing the transaction and to a fruitful future cooperation.*

The entrepreneur needs to carefully and methodically prepare his/her fund-raising process. This will help bridging efficiently the knowledge gap to convince the investor of the opportunity of investment and ultimately build the necessary trust with investors. As investors are constantly approached with opportunities, they have put in place a rigorous process of analysis and selection of potential investments. To avoid losing time and resources, entrepreneurs need to concentrate only on investors with whom their chances of success are optimal and ensure that they stand out compared to competing opportunities.

### How the investor looks at it

Investors analyse and select opportunities thoroughly, to reach due diligence before moving to investment.


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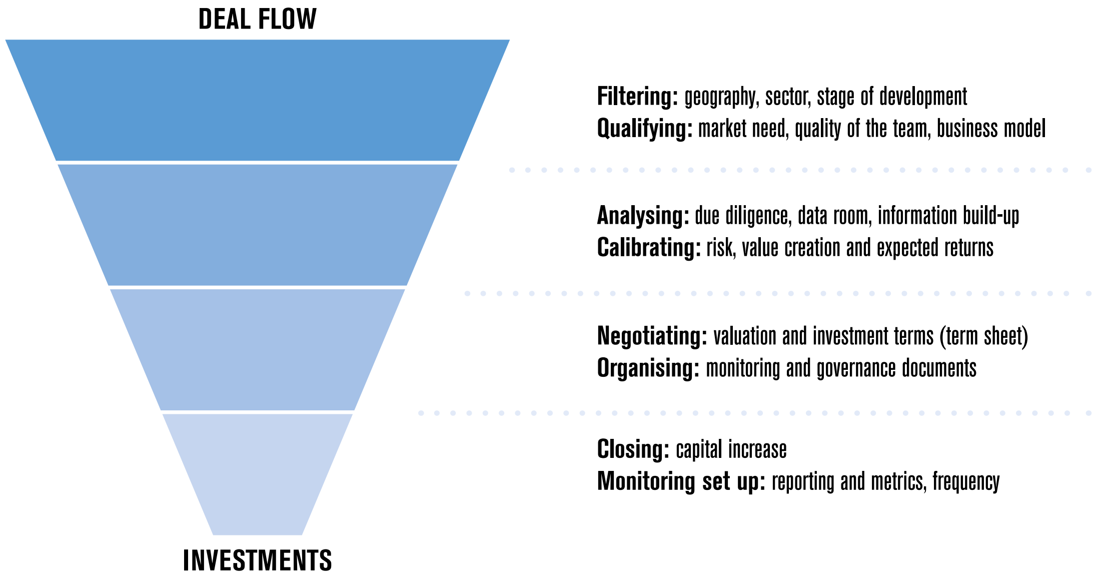
Figure 7 – The process of filtering investment opportunities




*Source: adapted from C. Demaria, Introduction to private equity.*

## How the entrepreneur should approach investors

### 1. Preparing the ground: attending industry events and networking

Attending **targeted networking events** is a common way to network and meet investors. This can be improved by:

- Carefully selecting the events. Smaller technology/industry events are often better targets than larger investor gatherings;
- **Making presentations**, is advisable;
- **Winning technology/industry awards** allows the venture to stand out;
- **Preparing a short pitch** before the event;

Exhibit 2 references some of the major events.

### 2. Active preparation: listing prospective investors

Innovators should take the time to, **make a list of prospective investors**:

- Understand **investors' focus** (stage of development, industry/technology, geography, size amount of fund dedicated, etc.);
- Look at **recent investments** of investors (if a direct competitor is already in the portfolio, the investor may be left out as he is unlikely to invest in two competing businesses).

Exhibit 2 provides a substantial list of investors and information supporting this initial approach.

### 3. Getting introduced: networking and introducers

Getting **introduced** to an investor **via a trusted third party** (business partner, board member, corporate finance specialist, lawyer, accountant, etc.) provides a significant advantage. This demonstrates that a level of trust is already established and considerably enhance the chances of success.

In the absence of extensive network, entrepreneurs can use:
- an advisor for a fee, for example a fund-raising specialist, or placement agent; or
- accelerators in exchange of a percentage of ownership in the firm.

Such organisations will also help to structure the documentation, and prepare the entrepreneur for the transaction.

### 4. Pitching

This aims at:
- **Presenting the venture;**
- **Learning about investors** beyond their official policy.

To get a better sense of the investor's:
- **Approach and philosophy** of investment;
- Degree of **knowledge** of their **industry**;
- Level of **commitment** and involvement **once invested**;
- Investment **horizon** (in years);
- Type of **previous investments** (concrete examples).

The actual **involvement** of investors in their investment may **vary significantly** (simple **Board** attendance **to an active monitoring** with participation to steering committees to influence the management).

### 5. Going into due diligence

The preparation of a **"due diligence pack"** (with documents listed below in entrepreneur's "Needed materials") upfront by the entrepreneur will ease and accelerate the due diligence:
- Reduce time spent in answering requests;
- facilitate **the investors' and the entrepreneurs'** work; and
- Help improve credentials.

**The due diligence exercise** is a **communication** as much as an **audit process**. It is organised to help you and the investors understand how you respectively work today and could work together in the future. Approaching investors is the start of an on-going dialogue between innovators and investors, which continues with the negotiation of the terms of investment and the valuation (see Building Block 6).

The target of innovators in fundraising is to guide capital providers from the innovator's **vision** to the **market need being** addressed. This market need is fulfilled by the **team** thanks to its **novel approach which** leverages a **specific technology**. The project or start-up will require a **certain amount** to reach a **specific target** ('milestone'), and this amount will be spent along a specific **budget**.

Investors will operate a **due diligence** on the innovators, their **technology** and their **venture** to gain a **deep understanding** of the **investment opportunity** and establish a c**ommon ground for** a future **cooperation**.

### Importance of trust

During due diligence, innovators and investors will build the trust necessary for an efficient cooperation. Innovators have therefore to prepare carefully their fund-raising process.

Overall it is essential to understand that ***"establishing trust"*** with the potential investor is important in the building up to the transaction, during the transaction but more so for the cooperation that there will be between the company and the investor for the duration of investment (typically five years or more).

Trust may mean refraining from being too optimistic about the future of the venture in pitch and communications.

### "In the words of": Per Resen Steenstrup of Resen Waves (an innovative company in the field of wave energy)

Wave and tidal is a typical example of a sector which had large amounts of investments pre-crisis and now has difficulties to find investors. For Per, the most important thing is to develop a long-term relationship with investors. He would not want to squeeze out the most of an investor: for him, it is better to build a good relationship with an investor with the right mentality.

## Needed material

We highly recommend getting into the meetings well prepared. This should be done with a set of materials and documentation to support the communication and application for funding. Below is a list of communication and documentation material you might consider taking with you.

i) In terms of communication:

### b. Nice to have:

i. **Video introduction** (60 to 90 seconds), especially in targeting crowdfunding platforms.
ii. Testimonials (written, video, audio), from partners, clients and beta-testers of the product/service (to complement the presentation).
iii. Any additional content that confirms the credentials and credibility of the innovators, their project, their technology and their achievements.

### a. Must-have:

i. An **'elevator pitch'**: innovator's vision to answer a market needs, delivered in a clear and attractive, to catch attention to lead to formal meeting.
ii. A **set of presentations** (short version for 10-15 mn; and long version for 45 mn), detail the elevator pitch with factual information a clear thread, to be understandable by non-specialists.

ii) In terms of documentation:

### c. Nice to have:

i. A **technological white paper**, on the essence of the innovation.

ii. A **series of case studies**, on how and why the product/service meet the need of specific clients/users.

### b. Highly recommended:

i. A **reference list** past business partners, employers and collaborators, who can provide a fair and relatively objective perspective on the innovators' performance and personality.

ii. A **list of current and prospective business partners (including suppliers)**. With a solid knowledge of the technology and product/services. This is a valuable signal of trust and a very important one for capital providers.

iii. A list of patents (pending of granted) and academic papers.

### a. Must-have:

i. A **non-confidential teaser**, short paragraphs on the gist of the project differentiating factors to convince to accept a meeting.

ii. A **non-disclosure agreement** (NDA), to any third party.

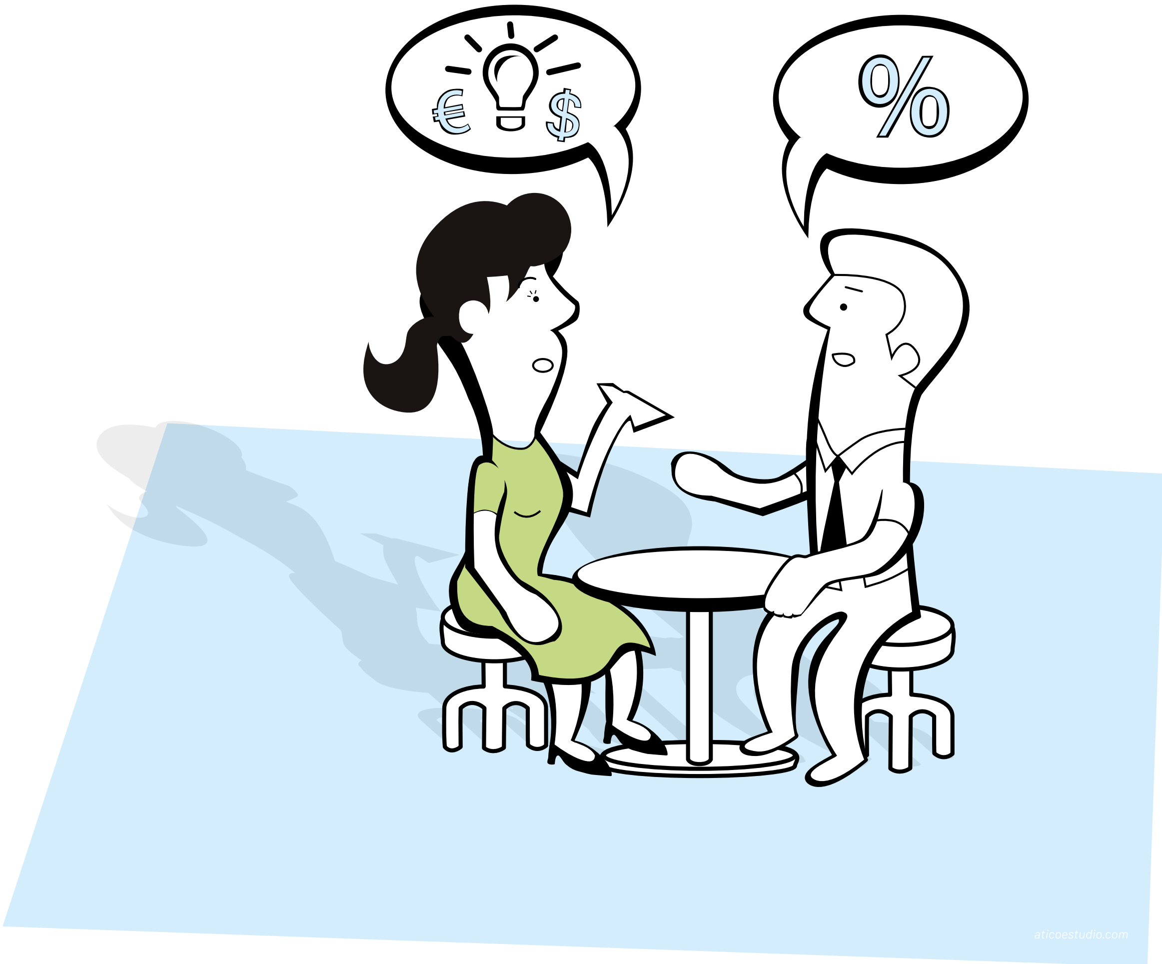
iii. A **complete and detailed business plan**, a 360-degree perspective to the reader on the project/start-up. See section on business plan.

iv. A complete **market study**. This is a must have as it validates information in other documents in particular the Business Plan (the market potential) which is often the main reason why start-ups fail (in 42% of the cases). This should include:

1. quantitative assessment (via a strategic marketing analysis) of the market potential, a precise and measurable mapping of the market.
2. A qualitative assessment (for example through a panel or survey method) of how product/service are adapted to clients/users needs.
3. A competitive assessment, addressing questions of sales cycles, of pricing and of relative positioning of existing offers.

v. A **list of current and prospective clients ('pipeline')**, with a grading to indicate the progression of each until signature/completion which demonstrate their understanding of their prospective clients and to communicate with them.

vi. A **list of investors** and a capitalisation table (see above section), as well as a history of the rounds with amounts raised and associated valuations.




# Building Block 6

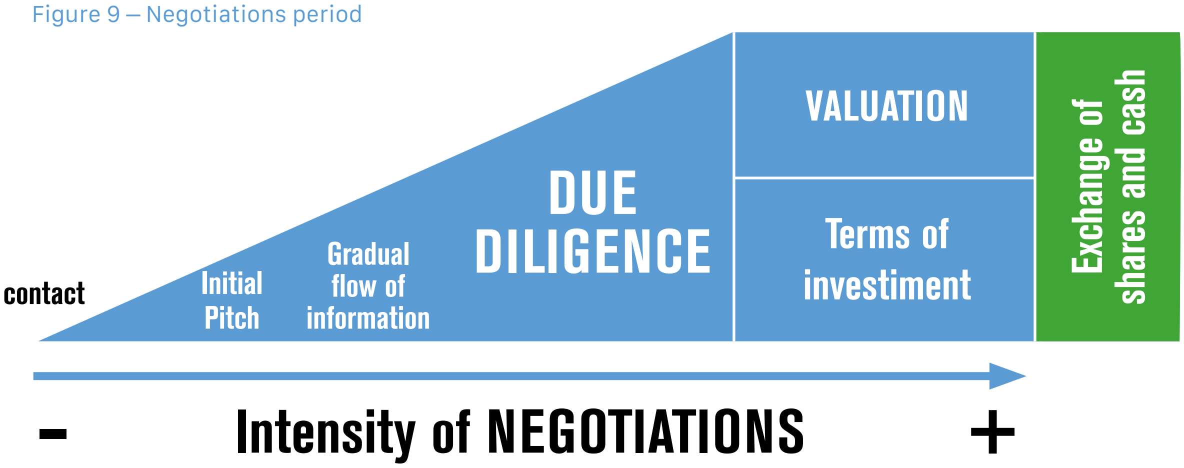
## Valuations and negotiations

> *Venture valuation and negotiations go hand in hand with resulting in the set-up of percentages of ownership and the definition of the terms of investments.*

### Negotiations

Negotiations start as soon as there is a dialogue between the investor and the entrepreneur. Such negotiations are usually based on the theoretical value of the company and the due diligence process.

Figure 9 – Negotiations period




*Source: authors*

The end investment is reflected in the combination of the valuation and of the terms of investment.

### "In the words of": David Smyth of Oxford PV (commercialising a new technology for thin-film solar cells)

For David, raising funds via VC funds and CVC was not a successful venue, but large investors such as Legal & General Capital, Statoil and Winston Capital supported Oxford PV. Their approach was a combination of luck, relationships and direct calls. **Negotiations and the valuation** were done jointly and collectively. This was efficient as investors then came in under the exact same terms. This was particularly important for smaller investors.

### Valuation

The **valuation** used for capital increase (and sale of new shares) is the **result of a negotiation** between the current owners of the venture and new investors. The due diligence process structures and supports the negotiations, leading to the final valuation.

**The basis of valuation is often established by corporate finance formulas**. Three methods can be used as a starting point (see Fig. 10).

Figure 10 – Three methods of valuation

**Theoretical Valuation Methods**

**Listed comparables (or 'multiples') method** - consists in finding companies (listed on stock exchange or not listed) with a known valuation (for listed companies = total number of shares x share price), comparable to the venture (industry, geography, clientele, etc.). Then scale down this known valuation using ratio of turnovers, or products output (ex. Electricity output), or other indicator to the size of our venture. See Exhibit 1 Insert 20 p 60 for a practical example.

**Intrinsic future value (discounted cash flows)method:** the method make sense if the venture is foreseen to produce positive cash flows within 3 years. Projections of future cash flows for the venture are made (consistent with business plan) over 5 to 7 years. Then the present values of such projected cash flows and a terminal value are calculated using a discount rate and added together to represent a value of the venture. Future cash flows being uncertain and the discount rate hard to estimate, this method should not be exclusively relied on for young ventures. See Exhibit 1 Insert 21 p 62 for a practical example.

**Net asset value method:** This method consists in adding up the market value of the different assets of the company, from tangible (property, machinery, vehicles…) to intangible (patents, brands, etc.) ones. Such asset values can be difficult to estimate.

*Source: authors*

These methods are not mutually exclusive and **may be used jointly**. The difficulty is that these formulas are ill-adapted to start-ups.

These three methods can be combined to provide a range of valuations. The different parameters used for the calculation can vary (+ or – 10%) and the value of the venture recalculated, to better estimate the range of valuations and understand the most impactful parameters. A weighted average of the method can also be produced while allocating higher weighting to a particular method (for instance, a young venture may rely more heavily on numbers coming from the "comparables" method).

For example, a very early stage venture with no turn-over and negative cash-flows which plans to generate sales in 18 months and expects a profitability in 40 months could be valued using multiples from listed comparables to which market practice (from the experience of the authors) applies a discount of 50% to 70%.

It is advised that innovators **seek advice** in their **valuation** exercise if they are not familiar with this exercise or do not have the resources to gain this expertise.

Within certain countries (Denmark for instance), industry associations or other local bodies may play the role of an independent third party who can help calculate such valuation.

The participants in the negotiation influence themselves the valuation exercise[9]: it has been proven that past successes and a high reputation lead to better valuation terms for investors[10], but also for ventures in subsequent rounds of financing[11]. The size of investors also plays a role in the negotiation, as they can reinvest in subsequent rounds of financing and have a higher bargaining power as they can make bigger investments.

[9] While industry and investment stage have no impact on the performance of start-ups, having VC owners creates a difference of 11.2% in terms of performance, according in Fitza, M., Matusik, S. and Mosakowski, E., 'Do VCs matter? The importance of owners on performance variance in start-up firms', Strategic Management Journal, No. 30, 2009, pp. 387-404.

[10] 'Offers made by VCs [venture capitalists] with a high reputation are three times more likely to be accepted, and high-reputation VCs acquire start-up equity at a 10-14% discount', quoted from Hsu, D., 'What do entrepreneurs pay for venture capital affiliation?', The Journal of Finance, Vol. 59, No. 4, August 2004, pp. 1805-1844. This is confirmed by Heughebaert, A., and Manigart, S., 'Firm valuation in venture capital financing rounds: the role of investor bargaining power', Journal of Business finance and Accounting, Vol. 39, No. 3-4, April-May 2012, pp. 500-530: 'University and government VC firms, which have comparatively greater bargaining power, negotiate lower valuations compared with independent VC firms. The valuations of captive VC firms equal those of independent VC firms'. According to the authors, University and captive VC firms generate a specific deal flow, which is proprietary. As a matter of comparison, public (or governmental) VC firms usually support niche markets which generate low level of competition from captive or independent VC firms.

[11] 'Switching lead venture capitalists (VCs) is not uncommon during the course of entrepreneurial firms' development. Companies with upwardly revised perceived quality are more likely to switch to more reputable VCs. Further, companies that switch VCs obtain larger capital infusion and higher pre-money valuation. However, companies that switch to more reputable VCs accept smaller investment size and lower pre-money valuation in follow-on rounds', quoted from Cumming, D. and Dai, N., 'Why do entrepreneurs switch lead venture capitalists?', Entrepreneurship theory and practice, Vol. 37, No. 5, September 2013, pp. 999-1017.

### Managing valuation uncertainties

In some cases, there are ways around the difficulty of placing a value on a business.

- At seed stage, some investors may simply invest through a convertible loan (the loan may be repaid in shares), thus postponing the actual valuation to a later round of financing, once the company has grown and is easier to value.

- Also, post valuation, to better control the uncertainties of the valuation exercise, **innovators and investors could set up stock options to (in effect) adjust their relative ownership of the venture post investment** (see the section on Percentage of ownership below); as well as governance rights to monitor and control the evolution of the venture. These options can be combined to a loan to the venture by investors (see Fourth Building Block).

### "In the words of": Andrew Morton, business angel

Andrew relies on his own research and contacts to source deals. Andrew warned of the risk of failure due to **valuations deemed too high** too early which may kill the prospects of raising future rounds of financing. Pushing products too fast to the market while **burning cash**, and running out of cash when sales are not there is crucial. Finally, he emphasised that although **mutual trust** is critical, it can unravel very quickly.

## Percentage of ownership and capitalisation table

**Percentages of ownership** is central to the company's management. Majority[12] in economic ownership is different from actual political rights, as:

- Some shares might bear **multiple voting rights**, while others **bear none**;

- Groups of investors can be formed to influence decisions and request a **representation at the Board**;

- Investors can also negotiate **veto rights** for certain strategic decisions. These decisions can be economic

[12] Such as simple majority (50% of voting rights + 1); qualified minority (for example 25% or 33% of voting rights) or majority (for example 66% or 75% of voting rights); double majority (majority of voting rights and majority of groups of investors); specific majority (majority of voting rights excluding founders') thresholds.

(expenses above a certain threshold may require pre-approval), managerial (the recruitment of C-level executives is subject to approval) or strategic (the acquisition or sale of an activity has to be approved).

Number of shares and percentages of ownership are summed up in a **capitalisation table** (see Table 6). This table shows ownership before any dilution from pending stock options and new shares created for the capital increase. But the table should also be calculated **once stock options**[13] **are exercised ('fully diluted')**. As stock options can be exercised in multiple scenarios (which can be exclusive or not), there are in effect multiple 'fully diluted' ownerships. The table shows the number of shares and percentages before the effect of stock options (Total (current)) and with stock options; effect (Total (diluted)).

Table 6 – Example of capitalisation table

| Category | Name | Common shares | % | Options* to common | % | Common fully diluted | % | Series A | % | Options* Series A | Total (current) | % | Total (diluted) | % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Investor | A | - | - | - | - | - | - | 100 | 66.7% | 100 | 100 | 27.0 | 200 | 37.7 |
| Investor | B | - | - | - | - | - | - | 50 | 13.3 | - | 50 | 13.5 | 50 | 9.4 |
| Founder | C | 100 | 45.5 | 10 | 16.7 | 110 | 36.7 | - | - | - | 100 | 27.0 | 110 | 20.8 |
| Founder | D | 100 | 45.5 | 10 | 16.7 | 110 | 36.7 | - | - | - | 100 | 27.0 | 110 | 20.8 |
| Employee | Pool | 20 | 9.0 | 20 | 33.3 | 40 | 13.3 | - | - | - | 20 | 5.5 | 40 | 7.5 |
| Available | | - | - | 20 | 33.3 | 40 | 13.3 | - | - | - | - | | 20 | 3.8 |
| **TOTAL** | | **220** | **100** | **60** | **100** | **300** | **100** | **150** | **100** | | **370** | **100** | **530** | **100** |

**Stock options are not necessarily exercised or triggered: this depends on particular events and/or decisions of holders of stock options.*
*Source: authors.*

**Stock options** are an **incentive instrument** for the management and the team of the venture[14].

New investors' stock options can **rebalance the percentage of ownership** of investors in the advent that some targets are not reached.

[13] Right to purchase or sell an ownership stake in a company at a specific price within a certain period of time.
[14] Sometimes shares are granted directly to employees as a compensation. This is called 'sweat equity'.

## Shareholders' agreement

A **shareholders' agreement**[15], is usually in place between the owners of the company. This document is amended when new owners join in. For that purpose, a **'term sheet'**[16] (summing up the proposed terms of investments) is circulated between the existing shareholders and the new shareholders to reflect the state of the negotiations (especially during due diligence).

Investors usually have a precise idea of what should be included in the shareholder's agreement. Entrepreneurs are advised to hire the services of a lawyer with reasonable experience with start-ups and if possible the energy sector.

Mandate to discuss the term sheet is usually given to the management of the venture, while the **lead investor** represents prospective investors. For attractive ventures, there may be multiple syndicates of prospective investors. This means multiple competing term sheets leading to firm offers, including valuation, and specific terms of investment (especially, political rights).

Besides **voting** and **veto rights, Board representation** and **qualified majorities**, other investment terms may include:

- **Information rights**: detailed regular information (monthly brief and others);
- **Liquidation preference**: privileged access to proceeds of sale of assets (if failure of the venture), or of the venture (in case of trade sale);
- **Anti-dilution**: protects an investor from ownership dilution;
- **Pre-emption rights** (or **right of first refusal**), **transfer restrictions**, and **subscription preference**: these grants existing shareholders priority over the sale of shares. Transfer restrictions prevent any indirect transfer, for example that shares are pledged, gifted or used as collateral for a loan. Subscription preference provides existing shareholders the right to buy new shares created by the venture before they are sold to third party investors;
- **Tag-along** rights: minority shareholders are offered the same terms and conditions as the majority shareholders upon the sale of their shares;
- **Drag-along** rights; ensure that if a majority shareholder sells its stake, minority shareholders are forced to join the deal (at the same terms and conditions). In case of refusal, the minority may have to acquire the shares of the majority shareholders at a price at least equivalent to the one offered;
- **Non-compete** clause: entrepreneurs cannot start (or join) a competing business (this may be limited in time, two to four years).

Upon closing of the capital increase, the term sheet that is accepted becomes an "investment and subscription agreement"[17]. The shareholders agreement is amended accordingly.

[15] A sample shareholders agreement can be accessed here: https://www.seca.ch/Templates/Templates/VC-Model-Documentation.aspx.
[16] A sample term sheet can be accessed here: https://www.seca.ch/Templates/Templates/VC-Model-Documentation.aspx.
[17] A sample investment and subscription agreement can be accessed here: https://www.seca.ch/Templates/Templates/VC-Model-Documentation.aspx

**"In the words of": Charles Reynard of Eversheds**

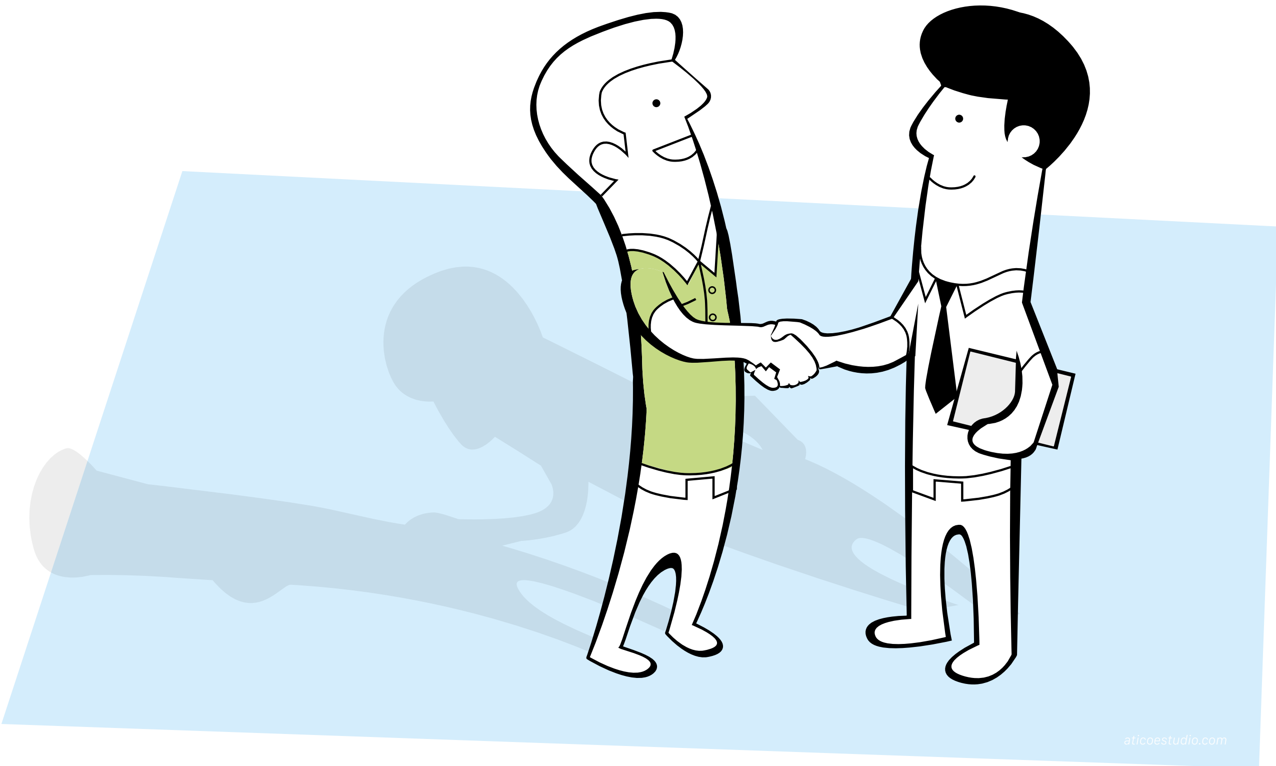
Charles Reynard places a special emphasis on intellectual property (IP) risks which are particularly present for venture going to market. This is an area where larger law firms bring real added value. Exit is another stage where such firms have definite role to play.

## Limits and enforceability

A **shareholder's agreement** is a contract **enforceable in court**. However, **in practice** going to court is expensive and usually does not bring a timely solution. **Mutual trust** is often what makes a **fruitful relationship** between entrepreneur and investor.

As part of building this trust, the shareholder's agreement should be **precise and unequivocal.** However, there is a limit to the level of details beyond which the shareholder's agreement is difficult to manage. Very detailed terms of investments will not compensate an insufficient (or complete lack of) trust and a lack of trust may lead to the conclusion that there is no investment possible.

An alternative to setting up a complex shareholders agreement is to use convertible debt and stock options. These two types of financial instruments allocate shares to their holder in the future. However, until these are converted into shares they do not give any political right to their holders.



# Building Block 7

## Post closing of fundraising (communication, governance and next steps)

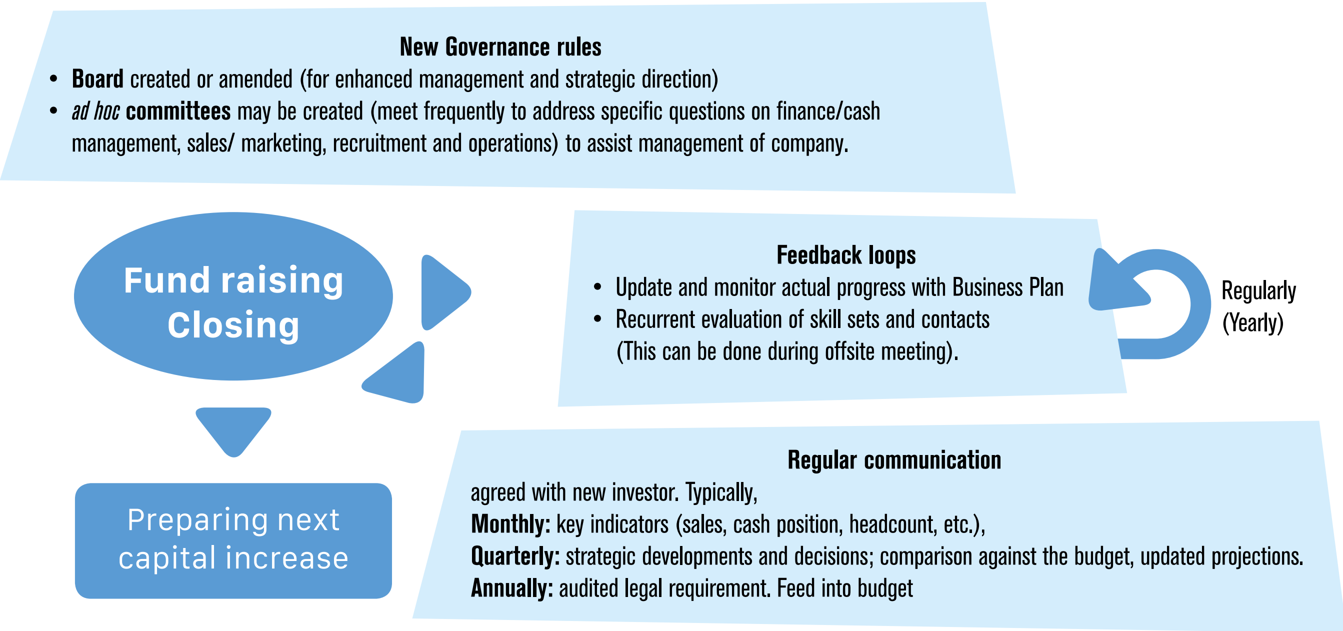
> *The closing of a fundraising process marks the beginning of a new phase of life for the company with new shareholders and new rules.*

The trust established with new investors should be maintained for an effective and beneficial long-term cooperation.

The management is presented with a new shareholding structure, and therefore, the company post capital raising transaction must adapt to:

- A New Governance set up;
- A New Communication set up;
- Setting up of feedback loops; and
- Preparing for the next financing event.

Figure 11 – Post fundraising processes




*Source: authors*

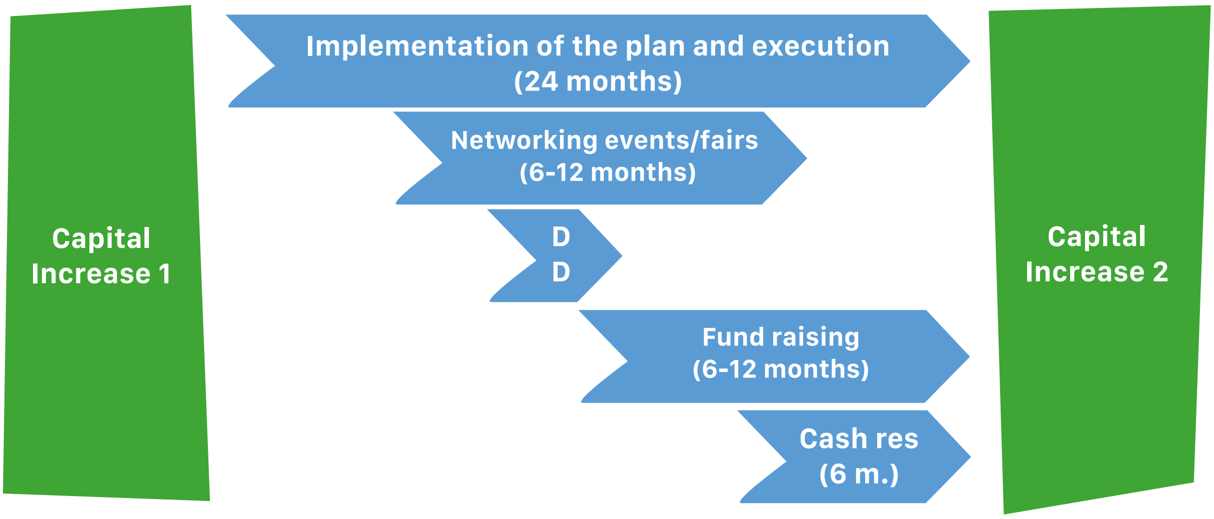
### Next rounds of fund raising

Documentation prepared for the new communication can often be reused for the next financing raise.

Capital increase happens typically every 24 months and need to be actively prepared early. A typical timing is shown below:

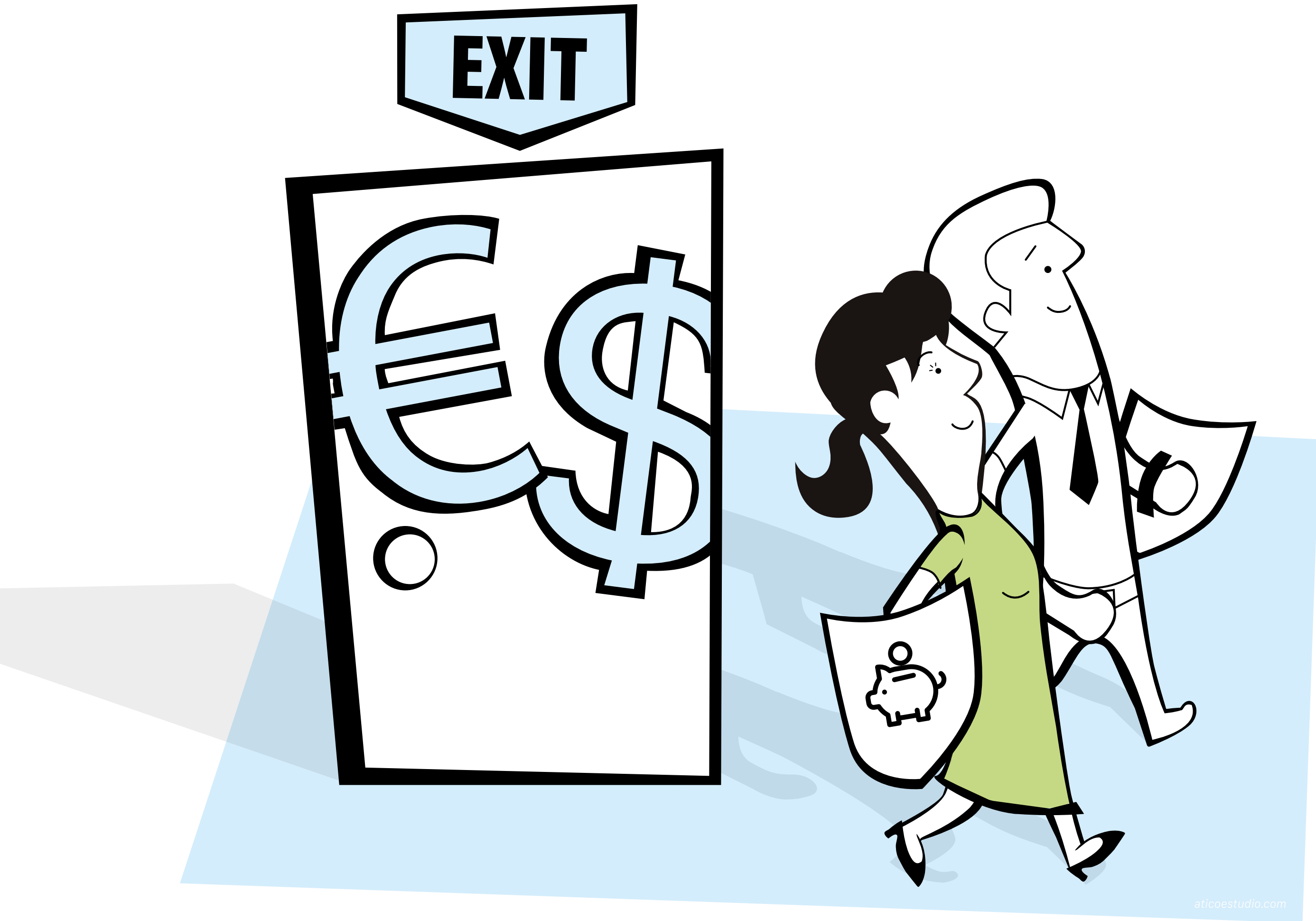
After completing a fundraising, it is worth to start working on the next one by networking, continuously updating the "Due Diligence Pack" and tracking performance (and progression towards the milestones set previously). Figure 12 describes the actions which happen concurrently between two fundraising operations.

Figure 12 – The fundraising cycle




*'DD' refers to due diligence pack preparation (3 months). For illustrative purpose only..*
*Source: authors.*

Rule of thumb: entrepreneurs should always keep a minimum **cash position** of **six months**' worth of **burn rate**.




# Building Block 8
## Prepare a potential exit stage early

> *Innovators are advised to prepare any potential exit scenario of their capital providers as early as possible, notably when they draft their shareholders' agreement.*

**What to think about?**

It is difficult to plan for every possible exit case, a few main scenarios emerge; partial or total exit, from insiders or outsiders. The type of exit has a lot of consequences on the future of the venture and on the status of innovators

Figure 13 – Exits of insiders or outsiders

Selling part of the company is either done to investors within the company (insiders: employees, funders) or investors external to the company (outsiders).

**EXIT TO**

**Insiders**

1. Employees
   - Typically collectively less than 5% of company
   - Either **buy back** from company, OR
   - Propose sale to **existing shareholders**, OR
   - **Wait** for opportunity of **buyer**
   - Can be fast, within 1 month

2. Funders
   - Own large proportion of company, can be more than 50%
   - **Buy back** only possible for small proportion (usually max of 5% of company)
   - Propose sale to **existing shareholders** (usually at discount of 10% to 30%) , they usually have priority, OR
   - **Wait** for opportunity of **buyer (purchase of large number of shares especially dependent on company development and stability).**
   - No real organized secondary market to sell existing shares.

**Outsiders**

1. Investors, see diagram below.

2. Other capital providers
   Mostly lenders. The shareholders agreement can pre-emptively limit the right of such new shareholders.

*Source: authors*

Figure 14 – Types of exits to outside investors[18]

For outsiders, a number of different types of sales will be possible

**Trade sale ('industrial exit')** the most common exit

- A new investor buy shares as the company has reached a new stage of development (different investment round).
- Can be done via an intermediary (corporate finance boutique, investment bank).
- The transaction happens using **"Building Blocks 4, 5 and 6"**.

**Sale to management (OBO/MBO)**
The management may buy back the shares of the company, sometimes using a loan (LBO). This requires to value the company independently and to find a buyer.

**Buy-out by financial investor**
When the company is profitable and stable enough, an investor may buy the whole company using loans. Loans are repaid using dividends from the company.

**Exits to Outside Investors**

**Initial public offering (IPO) -**
listing on a stock exchange

- This only applies to company of certain size and fit other criteria.
- This a well organised process which requires hiring an investment bank and can take up to one year.
- Often existing shareholders are not allowed to sell shares during lock up period and passed this period must coordinate with other shareholders to avoid movements in share price.

**Secondary sale, sale of existing shares to existing or new investors**

- This is usually done at a discount, due to the category of shares held, the fact that existing shares are part of existing shareholders agreement and existing options may mean a future dilution of shareholding.
- In some cases, the management is not supportive of such sale.
- Existing shareholders often have a priority on such shares. Therefore finding an independent buyer may be necessary to fix the share price.

*Source: authors*

Usually, the larger the proportion (via grouping of existing shareholders) of the company is sold, the more lucrative the deal is, proportionally. The new shareholders value the fact of getting hold at once of a large proportion of the company. For instance, company value for a transaction may fetch higher if collectively sellers cover, say 60% of the company rather than only 30%. This is especially true when majority stake holding is reached.

[18] **LBO** refers to a leveraged buyout. The investor in effect acquires the whole company thanks to its own capital and to debt contracted for this acquisition (the whole venture is the collateral for this loan). The venture is expected to pay future dividends to repay the loan contracted by the financial investor. This exit path is therefore limited to companies that are profitable and stable enough to pay interests and the principal contracted to acquire them. OBO refers to an owner buyout, which is a form of LBO in which some of the current owners of the company acquire the company in full. MBO refers to a management buyout, which is a form of LBO in which some of the current management of the company acquire the company.

# Glossary

> *Note: definitions have been adapted and tailored to the content of the current document. Some definitions might be broadened or aim at different concepts in other contexts.*

**A Round**
Capital increase operated by professional investors (such as venture capital funds) in a venture that was previously financed by founders and/or business angels. The shares created in exchange of the capital increase are then labelled 'Series A'.

**Accelerator**
Fixed-term programs providing to entrepreneurs' services such as mentorship, advice, education and access to investors. These programs can be public or private efforts. In the latter case, the promoter of the program can be remunerated by a percentage of ownership in the venture.

**Acqui-hire,** also known as Talent acquisition.
Combination of 'acquisition' and 'hiring', it is the process of buying a company first and foremost to retain and integrate its employees in the acquiring entity. Often, the current product, service or operation is of little to no interest to acquirer.

**Angel investor**, see *Business angel*

**Asset-backed loan**
Loan that is guaranteed by a direct claim on specific assets of a company.

**Bankruptcy**
Situation where a company cannot pay its short-term liabilities.

**Board of directors**
Group of individuals, which usually include founders and major investors, who have a fiduciary responsibility to the well-being and proper guidance of a venture. The board is regularly elected by the community of shareholders.

**Bootstrapping**
Means of financing a venture by resources that are not equity from traditional sources, nor debt. Bootstrapping is often associated with venture financing by the founders' savings and resources.

**Burn rate**
Rate at which the company spends cash over a given period (usually on a monthly basis).

**Business angel**
Independent wealthy individual backing business concepts or early stage businesses, by investing his/her money and often providing soft capital. This informal investor participates at very early stage often through seed financing.

**Business model**
Description of how a company creates, delivers and captures value, and ultimately makes money.

**Business plan**
Document that describes the innovator's vision, the market need, the offering, the business model, the marketing and sales strategy, the technology, the competitive landscape, and financial data (past and projected).

**C-level officers**
Senior management who have titles beginning with "chief" such as chief executive officer (CEO), chief operations officer (COO), and chief financial officer (CFO), etc.

**Closing**
Signing of a contract by investors binding them to invest a certain amount of capital in a venture.

**Co-investment**
Syndication of a financing round or investment by other capital providers alongside a venture capital fund.

**Collateral**
Assets that a borrower pledges against a loan, and on which the lender has a claim until the loan obligation is fully paid off.

**Common stock**
Shares held typically by the management and the founders, to which are associated usually the standard features: one voting right, and one dividend right.

**Comparable**
Publicly traded company with similar characteristics to an unlisted venture, which is currently being valued.

**Control**
Situation of an individual or an entity which owns more than50% of the equity of a venture (absolute control) or the largest portion of shares compared to other shareholders (relative control).

**Convertible debt**
Hybrid financial instrument that combine features of debt and equity financing. The loan allows the lender to exchange the debt for common shares in a company at a pre-determined conversion ratio. A convertible debt is therefore the combination in a single instrument of a loan and a conversion right (an option). This conversion right can be exercised by the lender or bought back by the company. In the first instance, the lender makes a profit when the company is sold by selling its shares. In the latter case, the company buys back the option and the lender cashes in capital gains.

**Corporate finance boutique**
Specialized financial intermediary that provides services to companies, such as capital raising, mergers and acquisitions, restructuring, debt structuring, and advisory

**Corporate venture capital**
Venture capital provided by the captive investment fund of corporations.

**Co-sale right**, see Tag-along right.

**Crowdfunding**
Collection, often through an Internet website or social media, of small amounts of capital from a large number of individuals to finance a project or a business. Equity crowdfunding is aiming at financing ventures (usually at seed or very early stage). Crowdlending is aiming at providing loans to individuals or businesses.

**Data room**
Physical or virtual location where potential buyers/investors can review confidential information about a company. This may include detailed financial statements, contracts, intellectual property and other legal and tax documents.

**Double bottom line**
Refers to both the conventional bottom line (measure of financial performance) and to the second bottom line (measure of a positive social impact).

**Deal flow**
Number and/or rate of new proposals presented to a given investor (such as a venture capital fund).

**Debt financing**
Cash borrowed by a business to finance itself. Debt can be divided in different categories, depending on its flexibility and the risk taken by the lender. The riskiest form of debt can be convertible into equity (see Convertible debt).

**Dilution**
Reduction of the fraction of the equity owned by current shareholders that is associated with a new financing round.

**Discount**
Reduction of the value of a private company compared to the value of a similar listed company, to take into account differences. Size, liquidity of the stock, diversification of product/service lines and difference of geographical coverage are a few factors of discount of a private company.

**Discount rate**
Interest rate used to determine the present value of a series of future cash flows.

**Discounted cash flows (DCF)**
Valuation method whereby the present value of all future free cash flows of a venture is calculated.

**Divestment**, see exit.

**Down round**
Financing round of a venture done at a lower valuation than the previous one.

**Drag along right**
Provision of the shareholders agreement according to which the majority of shareholders can force other shareholders to sell their shares along them and at the same conditions.

**Due diligence**
360-degree investigative process performed by investors during which an organisation or a company is assessed in details in its strengths and weaknesses by a potential capital provider with a view to invest or lend.

**Early stage**
State of a company after seed stage (at which it has no proven concept); but before it generates revenues (later stage). The company is usually developing a prototype or is beta-testing (early stage); or is launching commercial operations.

**Enterprise value**
Total value of a business, representing the price at which it can be sold.

**Equity**
Ownership interest in a venture, usually in the form of stocks or shares.

**Equity financing**
Financing provided by an investor to a business or an organisation in exchange of ownership rights.

**Exit**
End of the relationship between a capital provider and a business or an organisation. The nature of the exit will normally be agreed before the capital is provided. The timeframe of the exit can be agreed upon at the outset, or left open. This timeframe often depends on the commercial success of the business.

**Exit strategy**
Action plan to determine how the capital provider will end the relationship with the business or the organisation in the best conditions possible.

**Expansion capital**
Financing of a private company in its last round(s), typically 3rd round and above. Once a company is established, has a sound basis to grow and is showing signs of profitability, expansion capital provides the resources to finance the business to profitability.

**Financial sustainability**
State of a business at which it collects sufficient revenues to cover the full cost of its activities.

**Financing round**
Provision of capital by investors to a venture. Since venture capital is usually provided in stages to match milestones of development, a venture will typically receive multiple rounds of financing over the years.

**Follow-on funding**
Financing rounds that follow an initial round of financing (an A round).

**Free cash flows**
Cash flow of the firm available for investments or projects. It is usually measured as operating cash flows less capital expenditures and taxes.

**Fund raiser**, see Placement agent.

**Grant**
Refundable or non-refundable capital (under the form of cash, material or immaterial assets) provided to a business or an organisation without conferring any form of claim or ownership to the donor.

**Growth capital**
Sale of equity in a private venture which is usually cash-flow positive or break even, to increase production capacity, finance working capital, open subsidiaries abroad, launch new product/service line, make acquisitions or undertake any other transformative operation.

**Incubator**
Organisation supporting innovators developing business concepts or new technologies until a formal incorporation occurs, and usually the company raises its early rounds of financing (such as seed stage and Series A). It provides office and production space, as well as some additional services helping innovators to transform a concept into a venture.

**Initial public offering (IPO)**
Process in which the stocks of a firm start trading on a formal stock exchange.

**Intellectual property**
A venture's intangible assets, usually comprising patents, know-how, software, copyrights and trademarks. Intellectual property can be legally protected (patents) or not (know-how).

**Internal rate of return (IRR)**
Calculation performed by investors to assess their performance, which consists in discounting a series of investment flows so that the net present value of the series comes down to zero. The resulting rate is the internal rate of return (it is usually annualized).

**Investment**
Use of capital with the expectation of making positive future returns, which are expected to be financial, and sometimes social and/or environmental.

**Investment bankers**
Executives of financial institutions specialized in the issue of new securities (debt, equity or associated financial products), as well as their distribution and trading.

**Investment multiple**
Calculation performed by investors to assess their performance, and which consists in adding the proceeds from their exits and/or the current value of their holdings and divide this sum by the amount they contributed.
IRR, see Internal rate of return.

**Later stage**
State of a company at which it is marketing a product and is expanding its production, marketing and sales capacities. The company typically has achieved significant revenues compared to its competition, and is approaching cash flow break even or positive net income.

**Lead investor**
Member of a syndicate of capital providers that organises and manages the investment process of an investment round on the account of the pool of co-investors until the closing. It is usually one of the largest capital providers in the given investment round.

**LBO - leverage buy-out**
The acquisition of another company using significant borrowed money. Assets of the two companies acquiring and acquired are used as collateral for the loans.

**Liquidation**
i) Process of selling an investment and achieving liquidity for an investor. Specific liquidation rights can be negotiated by investors prior to a capital increase.
ii) Process of selling the assets of a bankrupt company. Also called a write-off by investors.

**Liquidation rights**
In a preferred stock, provision that insures that the holder has preference over common (and possibly other preferred) stocks with respect to the proceeds associated with the liquidation of an investment. An investor with a liquidation right of 2x would receive twice its investment upon a liquidity event before any other investor received anything.

**Liquidity event**
Transaction during which shares are sold in exchange for cash or shares in another company.

**Lock-up period**
Time during which stockholders are not allowed to sell their holding of a public company, usually after an initial public offering. Investment bankers usually recommend that this period of time reaches 180 days for significant shareholders (1% of ownership or more) to manage an orderly exit of investors and support a fair pricing of the stocks.

**Market capitalization**
Value of a listed company usually calculated by multiplying the number of its shares by the current price per share.

**Merchant banking**
Financial advisory activity that focuses on corporate finance, that is advice on fund raising, investing, mergers, acquisitions and complex financial structuring. This can include investments in ventures by the financial institution itself.

**MBO (management buyout)**
The management team purchases the assets and operations of the company they manage.

**Mid-stage, also referred to as Middle stage**
State of a company when it is generating revenues from its product or service.

**Multiples**
Valuation methodology comparing listed and private companies, in terms of ratio of enterprise value to a financial metric such as earnings before interest and taxes (EBIT) or sales. The results are usually discounted to take into account significant differences between listed and private companies.

**Non-Disclosure Agreement (NDA)**
Legally binding document issued by innovators or ventures to protect the confidentiality of their ideas and processes when disclosing those to qualified third parties.

**Option**
The right, but not the obligation, to buy shares at a set price (or range of prices) in a given period or in the advent of specific events.

**Placement agent**
Individual or company specialized in finding investors willing and able to invest in ventures.

**Pitch**
Concise presentation of a vision, a market need, a product/service and a business model, delivered to potential investors.

**Pre-money valuation**
Result of the multiplication of price paid per share in a financing round and the shares outstanding before the financing round.

**Post-money valuation**
Result of the multiplication of price paid per share in a financing round and the number of shares outstanding after that financing round.

**Pre-emption right**
Obligation of exiting investors or the company to offer shares to current investors (or the company) at fair market value (often determined by a third party) prior to selling them to new investors.

**Preferred stock**
Class of equity stocks that has the preference over common stocks in terms of specific features such as liquidation, veto or voting rights.

**Private company**
Company that is privately owned, that is not listed on the stock exchange.

**Public company**
Company listed on a stock exchange.

**Realisation**, see exit.

**Rights**, see Ownership rights

**Right of first refusal**, see Pre-emption right.

**Round of financing**, see financing round.

**Scalability**
Characteristic of a business that entails that sales and income can grow more rapidly than the expenses and complexity of the business.

**Secondary operation**
Sale or acquisition of shares of a privately held company by one investor to another.

**Seed capital**
Financial resource used for the initial investment in a venture, usually to support the launch of the company, its proof of concept and initial product development.

**Seed financing**, see seed capital.

**Soft capital** (also known as non-financial support)
Support provided by investors to the ventures they are involved in, under the form of advice, know-how, expertise, contacts, network and other form of non-financial skills used to improve the performance of their investment.

**Shareholders agreement**
Contract between the co-owners of a firm, defining their different and respective duties, privileges, rights and protections. It can include provisions such as pre-emption rights, tag-along and drag-along clause.

**Share**, see Stock.

**Start-up**
'Organisation formed to search for a repeatable and scalable business model' (Steve Blank).

**Stock**
Unit of ownership of a company that entitles its owner to political (voting) and economic rights. A share corresponds to a unit of equity of a given company. Common shares usually provide their owner to a simple voting and dividend right. Preferred shares provide their owners to specific rights (such as multiple voting rights and/or privileged dividend rights).

**Stock option**
Right to purchase or sell an ownership stake in a company at a specific price within a certain period of time.

**Strategic investor**
Capital provider that is a relatively large corporation and is interested to have access to a specific technology, product or service in order to achieve strategic goals.

**Sweat equity**
Shares granted to individuals or organisations in exchange of work rather than an investment under the form of capital. Sweat equity is usually transferred to founders or employees.

**Syndication**
Joint purchase of shares of a venture by two or more investors.

**Tag-along rights**
Provision protecting the rights of minority shareholders and which allows them to sell their shares under the same conditions offered to the majority of shareholders.

**Term sheet**
Preliminary document circulating between current and prospective investors, outlining the terms of an investment (that is the price per share and the rights granted to the prospective investors, if any). The term sheet usually results in the amendment of the shareholder's agreement.

**Trade sale**
Form of exit for investors during which the venture is sold to a corporation. It is the equivalent of a merger or an acquisition.

**Triple bottom line (TBL)**
Combination of financial, social and environmental accountability for a company.

**Valuation**
Method(s) determining the value to a company, such as discounted cash flows or net present value.

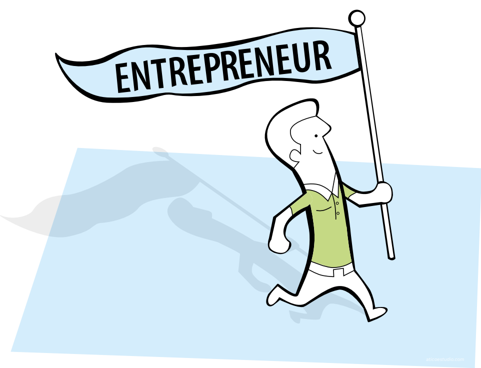
**Venture**
Effort involving risk, danger and luck, which can translate into a speculative business or enterprise.

**Venture capital**
Pool of capital that is independently managed by a dedicated fund manager, investing in new privately held high growth companies.

**Venture philanthropy**
Long-term investment through soft capital and capital injection (using a wide range of instruments from grants, debt to equity and hybrid instruments) undertaken to generate social impact measured along double or triple bottom line criteria.

**Voting right**
Legal entitlement of a shareholder to participate in the decisions taken in the affairs of the company.
Weighted average cost of capital (WACC)

**Write-off**
Decision to change the value of an investment to the value of zero.

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