What Equity investors look for in a business proposition

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In determining whether to make an investment equity investors are looking for a ‘return on their investment’. The level of the return they will want will vary, depending upon amongst other things the stage of the business cycle and the market sector that the business is in. In simple terms investors will look to double their money in two to five years with the higher returns sought for investments in those companies that are perceived as having higher generic risks.

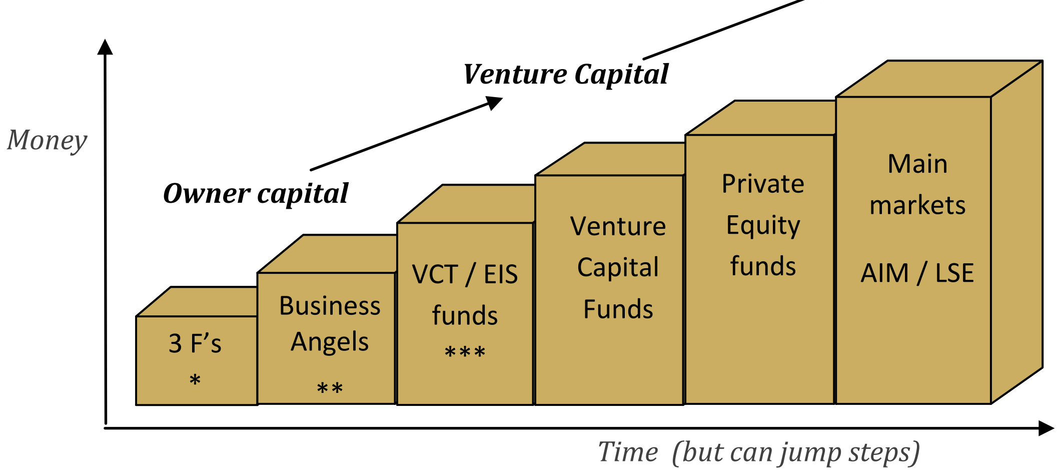
Equity investors are looking for a return on their investment based upon two elements,

- an income and
- capital growth.

It is in capital growth that the spectacular gains can be made but to realise these gains investors must be able to ‘exit’ the business within a realistic timeframe.

Within a mature market such as the UK there are many different sources of equity funding for businesses for each stage of their growth cycle. Businesses, when seeking funding, need to target investors who are interested in their business type and sector. Many early stage funds are backed by government money (or tax incentives) to encourage investment in what are in statistically terms higher risk investments.

Who are equity investors – simplified equity escalator



Basic investment rules for investors

1. When a business is in a **growing market sector** there is more chance that the business itself, even if it only holds its market share, will grow and capital appreciation will result for the investor. As a first rule then investors will look for growth markets.
2. Even in a growth market some form of perceived ‘competitive advantage’ must be available for the business to attract above average returns for an investor. As a second rule therefore the investor will look for ‘**differentiation’, a USP**.
3. Thirdly and most importantly if there is a growing market and a product / service with some form of competitive advantage the investor wants a **management** team who can deliver the opportunity for them. The third rule is management. It is the management who will deliver the returns that the investor wants.
4. An investor is likely to gain his greatest return from capital appreciation and so he wants a way to realise his investment – **an exit route**. This is usually via trade sale or market quotation. This could also be via further rounds of investment or buy out by management but these are rarely the intended routes at time of the investment.

* 3 F’s = Founder, family and friends (occasionally referred to as 4 F’s when adding Fools)

** Business Angels often use SEIS & EIS tax incentive schemes or invest via Crowd Funding schemes

*** VCT / EIS Funds = Specific funds established by pooling funds of private business angel clients to take advantage of tax incentives.

Suggested outline structure for an investment proposal for potential investors

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The Plan (twelve to fifteen pages long, so it can be scan read in under ten minutes). Supporting detailed information attached as appendices.

1. **Executive Summary (one / two pages – to be read in under 90 seconds)**
   - The key selling points – stress the potential
   - State your funding requirement
   - Highlight the financials
   - Outline exit plans and opportunities
   - Can it stand alone as a "taster"?
   - Must capture the reader's interest as it may be all they read.
2. **Company Background**
   - Sets the scene
   - Why the company was founded / Key milestones
   - Location & Ownership
3. **Products & Marketplace**
   - Product description – remember brevity and clarity
   - Don't get too technical – the reader is unlikely to know, or want to know, the exact technical details at this stage
   - Who are your customers? / Who are your competitors? / Who are your suppliers?
   - Key market drivers
4. **Strategy**
   - A chance to really set yourself as the "product"
   - Comment upon routes to market
   - Comment upon future product development – standing still is moving backwards
   - Explore any potential strategies and explain why a particular route has been chosen
   - Outline goals, aims and objectives
   - Why will customers buy your product and how will they know about it

Possible alternative motivations for investors

1. At an early stage: A Business Angel 'buying a job'; can work for both parties if they fill a key management function and put in the hours for fair pay.
2. Supporting a local cause – quasi philanthropic; although this is likely to be a filtering methodology rather than the main driver for an investor.

5. **Management**
   - Outline key directors, managers, staff and advisers
   - Outline roles and responsibilities, plus the skills and experience they have to fulfil the role
   - Include CVs in your appendices
   - Don't be afraid to admit to any "holes" – this is expected and the investor would rather you admit it
   - Discuss incentives for employees / management, retention and succession of key staff
6. **Financials**
   - What is your funding requirement?
   - Summarise & analyse your projections
   - Keep your financial model in the appendices
   - Outline the key assumptions
   - Be realistic - don't be too cautious or overly optimistic
   - Remember that investor will be happier if you outperform your plan than if you under perform
7. **Risk Analysis**
   - Strengths, Weaknesses, Opportunities, Threats
   - Be frank – if the investor perceives weaknesses and threats that you don't, he may take a dim view of management.
   - Be realistic, although focus on your strengths.
   - Be aware of current economic drivers and general trends and how they impact upon your business – an investor may not know much about the business but he will know about the economy and is likely to have done some limited research on the market.
8. **Other Points**
   - Consider whether to place a value on your business – it is unlikely an investor will agree with your valuation, so you are at best limiting the price he will pay for his equity, at worst frightening him away with an unrealistic valuation. Perhaps it is best to get him in the door first but different investors have different preferences on this point (you will need a valuation for crowd funding) and so it helps to have some inside information here. Similarly, be wary in proposing an investment structure.
   - Be prepared to be questioned on everything in the plan and support any views and opinions – you will be challenged