What Equity investors look for in a business proposition

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.

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

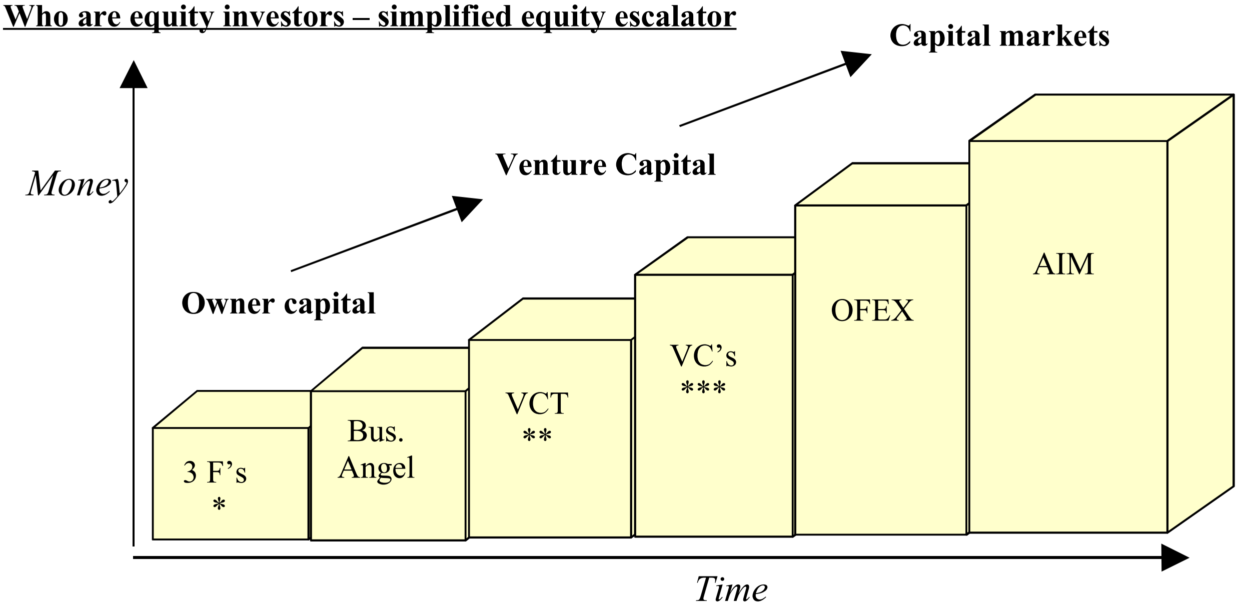
- an income and
- capital growth.

It is in capital growth that the spectacular gains can be made but to realise these gains they must be able to 'exit' the business at some stage.

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. Additionally this could be via further rounds of investment or buy out by management but these are rarely the intended routes at time of investment.

Who are equity investors – simplified equity escalator



* 3 F's = Founder, family and friends (occasionally referred to as 4 F's when adding Fools)
** VCT = Venture Capital Trust – specialised form of VC
*** VC = Venture capitalists

Outline suggested structure for an initial investment proposal to potential investors

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

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 he reads or at least be used to prioritise plans

Company Background
- Sets the scene
- Why the company was founded / Key milestones
- Location & Ownership

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

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

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 VC would rather you admit it
- Discuss incentives for employees / management, retention and succession of key staff

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 if the VC invests he will be happier if you outperform your plan than if you under perform

Risk Analysis
- Strengths, Weaknesses, Opportunities, Threats
- Be frank – if the VC perceives weaknesses and threats that you don't, he may take a dim view of management.
- Be realistic, though focus on your strengths.
- Be aware of current economic drivers and general trends and how they impact upon your business – a VC 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

Other Points
- Consider whether to place a value on your business - a VC is unlikely to agree with your valuation, so by putting a number in the plan, 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 VC's have different preferences on this point 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