09 Deals and Financing for Incubator Clients

Trainee Manual Part 1

International Finance Corporation
World Bank Group
infoDev
Innovate. Connect. Transform.

*info*Dev
c/o the World Bank Group
1818 H Street
Washington DC 20433
USA

www.idisc.net
www.infodev.org/businessincubation

infodev@worldbank.org

Introduction to the Training Program

www.infodev.org
www.idisc.net

INTRODUCTION TO THE TRAINING PROGRAM

This is the trainee manual for Module 9 Part 1 – out of 11 modules in total - of *info*Dev's State-of-the-Art Business Incubation Training Program for Business Incubator Managers in Developing Countries.

*info*Dev (www.infodev.org) is a research, capacity building and advisory services program, coordinated and served by an expert Secretariat hosted by the World Bank Group. It helps developing countries and their international partners use innovation and information and communication technologies (ICT) effectively as tools for poverty reduction and sustainable social and economic development. *info*Dev is a leader in business incubation of technology-enabled enterprises. *info*Dev's global business incubation network reaches close to 300 business incubators, more than 20,000 small and medium enterprises, and has helped create over 200,000 jobs across 87 developing countries.[1]

*info*Dev has found that high quality leadership is a key factor determining the probability of success for an incubator. *info*Dev therefore seeks to increase the capacity of business incubation managers – and their stakeholders – through one-on-one technical assistance, regional and topical peer-to-peer networks, the bi-annual Global Forum on Innovation and Entrepreneurship, and its web-based networking and knowledge-sharing tool www.idisc.net. This training program was designed in direct response to repeated requests from *info*Dev's technology entrepreneurship community for an in-depth business incubation training program relevant to the developing country context.

This training program is the first-of-its-kind, drawing from the lessons, models, and examples in business incubation from across Africa, East Asia and the Pacific, Europe and Central Asia, Latin America & the Caribbean, Middle East & North Africa, and South Asia. More than 30 experts contributed directly to the writing of the training modules, and the materials were tested with more than 300 professionals in developing countries all of whom provided inputs to the final design.

This training program is designed for business incubation managers and other business incubation stakeholders wishing to increase their understanding and know-how of the business incubation process. It consists of 11 training modules ranging from basic introductory topics designed for professionals new to business incubation, to specialized topics such as Technology Commercialization and Virtual Business Incubation Services.

[1] Source: *info*Dev activities from 2002 to 2009 - http://www.infodev.org/en/Article.473.html

The modules include:

SUITE 1 – BUSINESS INCUBATION BASICS

Module 1 – Business Incubation Definitions and Principles

This module provides an introduction to business incubation. It introduces key definitions and presents the main principles and good practices of business incubation. It aims to equip current and future incubator managers and policy makers with the knowledge, skills and understanding of the fundamentals of business incubation in order to effectively foster and encourage businesses.

Module 2 – Business Incubator Models, Including Success Factors

This module aims to illustrate various business incubator models based on practical examples of incubators from all over the world. The ultimate goal of this module is to empower current and future incubator managers with a thorough understanding of the various business incubator models and their critical success factors as well as to help them identify the best model to adopt for their own incubator to be successful.

SUITE 2 – BUSINESS INCUBATOR OPERATIONS

Module 3 – Planning an Incubator

This module, which divided in two parts, covers assessing the feasibility and designing the business model for an incubator. The first part is aimed at providing a thorough understanding of developing a feasibility study. This includes the steps to undertake a pre-feasibility study, the components that it should address, as well as how to gauge the market need and decide whether an incubator is the most appropriate solution. The second part of the module focuses on business planning to establish the incubator business model.

Module 4 – Marketing and Stakeholder Management

This module is designed to support efficient and effective communication of the incubator with key customers and other stakeholders based on a good understanding of the market place. This is important since it will help the incubator to establish and increase its reputation as a sustainable organization that fulfils its mission.

The first part of the module focuses on identifying, assessing, and reaching customers/ stakeholders, as well as potential ally organizations providing business support services to enterprises; while the second part is dedicated to defining the incubator's value proposition and engaging marketing channels.

Module 5 – Financing an Incubator

The first part of this module aims to guide current and future business incubator managers through mastering the incubator's financial data (such as costs and revenues) in order to enable them to identify the financing needs of the organization as well as to explore potential sources of financing.

Building on the first part, the second part of the module is dedicated to demonstrating, to current and future business incubator managers, how to develop a fundraising strategy and to monitor the financial performance of an incubator.

Module 6 – Managing the Incubator

This module provides current and future business incubator managers with an overview of sound management practices for a successful incubator.

The first part addresses the topics of incubator policies and governance and the second part is dedicated to operations and human resources management.

Module 7 – Monitoring, Evaluation and Benchmarking

This module aims to provide incubator managers with the required information, skills and insights to develop their own monitoring and evaluation system and to carry out benchmarking activities.

The first part of the module is dedicated to helping the incubator manager understand the added value of monitoring and evaluating the performances of his/her incubator; defining relevant and adequate performance indicators; and exploring how to monitor and evaluate, notably by studying existing tools and methodologies.

The second part focuses on empowering the business incubator manager to use the data collected through monitoring and evaluation activities to compare the business incubator's performance with those of similar organizations.

SUITE 3 – ADVANCED INCUBATOR MANAGEMENT

Module 8 – Implementing a Mentoring Program

This module provides, in its first part, a conceptual framework for gaining a thorough understanding of the mentoring process and its purposes from three perspectives: that of the business incubator, the mentor, and the mentee.

The second part of the module focuses on how to implement a mentoring program.

Module 9 – Deals and Financing for Incubator Clients

This module aims to provide a thorough understanding of the alternative sources of financing for incubator clients by notably describing programs and processes that will enable the incubator manager to assist his/her clients in accessing financing.

The first part focuses on preparing incubatees to engage in the process of accessing financing while developing the capacity of the incubator to assist incubatees in accessing financing. The second part of the training module explores financing from the perspective of both the incubatees and the incubator.

Module 10 – Technology Commercialization through Incubation

This module describes technology commercialization divided in two parts. The first relating to challenges and lessons learned associated with this process as well as how to manage expectations regarding the results of technology commercialization. This part also concerns the role of the incubator in facilitating technology commercialization in the pre-incubation phase.

The second part of this module focuses on the role of the incubator in technology commercialization in both the incubation and the growth phases.

Module 11 – Setting Up Virtual Services

The first part of this module provides a conceptual framework for understanding virtual services. It is designed for current and future business incubator managers who are considering virtual incubation either as a stand-alone business model or as part of their overall incubator service portfolio to extend their current service offering.

In its second part, the module aims to guide current and future business incubator managers and help them to decide if virtual incubation is the right solution for their incubator. The module then explores the most common challenges and how to address them.

Figure 1 groups the modules by preferred level of experience and suggested module sequence.

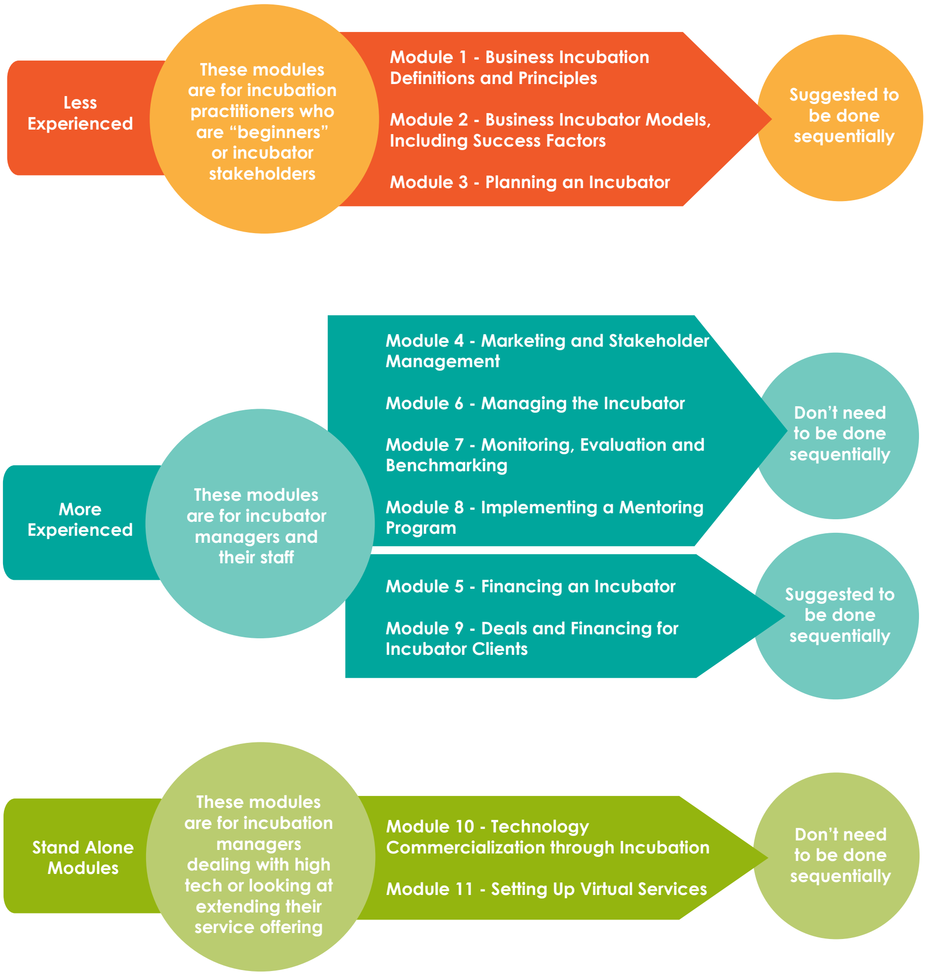


Figure 1 – Module Selection and Sequence

Acknowledgements

ACKNOWLEDGEMENTS

The training curriculum was developed by the following consortium under the direction of *info*Dev:

European Business & Innovation Centre Network

- Robert Sanders, Head of International Projects
- Julia Brethenoux, Project Manager

Babson College

- Mark P. Rice, Frederic C. Hamilton Professor for Free Enterprise

Sociedade Portuguesa de Inovação, S.A.

- Augusto Medina, President
- Mark Spinoglio, Senior Consultant
- Douglas Thompson, Senior Consultant
- Nuno Gonçalves, Consultant

*info*Dev wishes to thank its innovation and entrepreneurship community, including those who provided material for and whose names appear in the case studies. In particular, *info*Dev wishes to thank the following individuals for their contributions to developing this training curriculum:

- Seth Ayers ICT – Policy Specialist, *info*Dev
- Michel Botzung – Business Edge Manager, International Finance Corporation
- Alistair Brett – Cottingham Associates LLC, Consultant Member of the Science Technology Innovation Global Expert Team, The World Bank
- Raimund Broechler – Senior Delivery Manager, Intrasoft
- Valerie D'Costa – Program Manager, *info*Dev
- Heinz Fiedler – infoDev Regional Facilitator for the Middle East and North Africa
- Han Fraeters – Manager, The World Bank
- Steve Giddings – *info*Dev Regional Facilitator for the Africa region
- Stephen Hampson – Managing Partner, Powerhouse-Ventures
- Jane Hill – Venture Partner, Powerhouse-Ventures

- Sheila Jagannathan – Senior Education Specialist (E-Learning), The World Bank Institute
- Natasha Kapil – Private Sector Development Specialist, The World Bank
- Anthony Lambkin – Task Manager, Low-Carbon Innovation Program, *info*Dev
- Gideon Maas – Co-Director of the Institute of Applied Entrepreneurship at Coventry University, United Kingdom
- Kiragu Maina – Senior Operations Officer, International Finance Corporation
- Siobhan McQuaid – Project Director, ABÚ International Project Management
- Mustapha Mezghani – *info*Dev Regional Facilitator for Africa
- Mark Nielsen – Senior Advisor, Business Edge Management Training, SME Management Solutions, International Finance Corporation
- Ellen Olafsen – Operations Officer, *info*Dev
- Edward Rubesch – Director, Technology Licensing Office National Science and Technology Development Agency, Thailand
- Tania Saba Mazraani – Director, Technology & Health, Berytech, Lebanon
- Jill Sawers – *info*Dev Innovation and Business Incubation Consultant
- Stefan Schandera – *info*Dev Regional Facilitator the East European and Central Asian region
- Julian Webb – *info*Dev Regional Facilitator for Asia
- Cesar Yammal – *info*Dev Regional Facilitator for Latin America and the Caribbean
- Krzysztof Zasiadly – *info*Dev Innovation and Business Incubation Consultant
- Sylvia Zulu – SME Toolkit Program Manager, International Finance Corporation

Module Index

www.infodev.org
www.idisc.net

TABLES AND FIGURES

Module Objectives

The objectives of this module are to (1) provide a thorough understanding of the alternative sources of financing for incubator clients and (2) to describe programs and processes that will enable the incubator manager to achieve the following:

- Help incubatees develop fiscal discipline and financial management systems;
- Introduce incubatees to alternative sources of financing;
- Educate incubatees with respect to the typical terms, conditions and risks associated with the various sources of financing;
- Enhance the readiness of incubatees to engage with different sources of financing; and
- Connect sources of financing and financial expertise to the incubator.

TRAINEE TRAINING OBJECTIVES

Through this module, a trainee who is an incubator manager, a volunteer financial counselor (e.g. from the incubator board of advisors), a coach or a staff member within an incubator, can understand and put into practice the above objectives. By the end of this training, the trainee will understand how to:

- Engage with incubatees in developing expertise related to financial management and accessing financial resources;
- Identify and connect incubatees to potential sources of financing within the incubator's ecosystem;
- Support the development of additional sources of incubatee financing; and
- Establish processes for connecting incubatees to potential sources of financing.

Introduction to this Module

New ventures do not typically have all the resources they need to proceed, nor are they likely to get them handed to them. That means they will need to be adept at “resource acquisition”.

For incubatees, this means accessing resources in the innovation and entrepreneurship ecosystem, typically using the incubator as an intermediary. These resources could include:

(a) expertise - through the incubator’s know how network;

(b) facilities for research, development, prototyping and /or production – through the incubator and its sponsors, and possibly through potential suppliers or early adopter customers;

(c) investment – through friends and family, angel investors, venture capitalists, pre-payment for goods and services by early adopter customers and a broad range of self-supporting techniques.

Incubatees are typically in the pre-venture, start up, or survival modes of operation. For many or most client companies, cash flow is negative during the period in which the entrepreneur is trying to figure out how to create a sustainable business. They graduate when they have progressed past survival, and have achieved some degree of sustainability – either as a stable small business or as an enterprise in the initial growth phase. The major issue is that frequently, the entrepreneur does not understand the importance of exercising fiscal discipline to grow a sustainable business and only pays attention when faced with a financial crisis. Hence, when incubator clients fail to graduate from the pre-venture / start-up / survival modes to sustainability, in most cases they do not fail spectacularly. They simply run out of money due to their lack of fiscal discipline before they figure out how to succeed - and abandon their ventures.

Fiscal discipline includes both managing cash flow and understanding when and how to acquire investment to cover negative cash flow. This module is designed to help incubator managers understand how to engage incubatees in understanding and implementing fiscal discipline, in order to reduce the rate of companies that fail to graduate. The following components in Part 1 and Part 2 will help incubator managers develop understanding and support mechanisms so that they can be effective in counseling clients and in connecting them with external resources. Module 9 is a valuable complement to Module 8 of the current training program, “Implementing a Mentoring Program”, as it addresses one of the major challenges most incubator clients must overcome.

Component 1
(Part 1 Training):

Preparing Incubatees to Engage in the Process of Accessing Financing

COMPONENT INDEX

Section 1.1: Understanding Common (and Typically Inadequate) Patterns of Incubatee Cash Flow Management

Section 1.2: Financing Requirements at Different Stages of Business Development and Associated Risks

- **Section 1.2.1:** Conception
- **Section 1.2.2:** Firm birth
- **Section 1.2.3:** Growth Phase

Section 1.3: Identifying Alternative Sources of Incubatee Financing

- **Section 1.3.1:** An inventory of Available Sources of Financing for Incubates
- **Section 1.3.2:** Challenges and Opportunities of Financing Entrepreneurs in Developing Countries
- **Section 1.3.3:** Different Sources of Financing – What to Watch For
- **Section 1.3.4:** Different Sources of Financing – What Are The Risks?

Section 1.4: Conception and Firm Birth Financing During a Credit Crunch

COMPONENT OBJECTIVES

This component is designed to ensure that trainer and trainees share a common conceptual framework and terminology regarding (1) cash flow management for incubator clients - including acquisition and management of debt or equity financing and (2) the incubator's process for assisting incubator clients in accessing financing.

Upon completion of this component, trainees should understand the most important aspects of cash flow management for an incubator client as a function of stage of the venture and as a function of the larger economic context in which the incubator and its clients are operating. In addition, trainees should be able to identify alternative sources of financing for their clients.

Section 1.1: Understanding Common Patterns of Incubatee Cash Flow Management

Incubatees must understand what "cash flow" is and why cash flow management is crucial for the business' success.

Cash flow refers to the flow of cash into and out of a company. It can therefore be described as the lifeblood of a business. It has to be analyzed in detail in the business incubator's financial plan to be adequately and efficiently managed.

Indeed, cash flow needs to be managed so that the company has sufficient cash available to sustain itself on a daily basis. Hence, cash flow management generally refers to the process of managing the flows of cash into and out of a company to ensure that the company does not run out of cash, and risk going out of business for lack of cash resources.

The SME Toolkit dedicates a whole section to Bookkeeping and cash flow management[2] where incubatees may find interesting articles on the most important aspects of cash flow and cash flow management as well as different helpful worksheet templates.

Most incubatees will self-finance their start-up and, if successful, will achieve sustainability - achieving breakeven and financing their costs of doing business by generating sufficient cash flow from sales of their products and services. For the minority of incubatees that are able to acquire external financing, demonstrating skill in cash flow management will be an important pre-requisite for securing financing. Unfortunately, most incubatee entrepreneurs have never been in business previously and frequently have had a very limited experience with financial management, beyond whatever experience they may have with their personal finances. Hence they may start up with some cash on their balance sheet, typically from personal savings and /or from family and friends. They usually spend what they think they must in order to be a "legitimate" established business, buying computing and telecommunications equipment and office furniture, getting company brochures and business cards printed, paying for business lunches or spending money creating product prototypes and so forth. If they have not defined a spending plan that will take them to breakeven before they run out of cash, there is a high risk they are heading for a financial crisis that will threaten the survival of their business.

[2] Source: SME Toolkit.org - http://www.smetoolkit.org/smetoolkit/en/category/915/Bookkeeping-Cash-Flow-Management

One of the key responsibilities of an incubator manager is to communicate the following truths to incubatees.

- Even if they are a legal entity and are performing some of the functions of business, they are not established until they can demonstrate financial sustainability.

- Cash is king. If you run out of cash, you're out of business.

- Cash flow is queen. Cash flow is the lifeblood of a business. Cash flows out of a business to pay for the costs of doing business; cash flows into a business because customers are willing to pay for the goods and services the business can provide. Positive cash flow sustains a business - negative cash flow cannot be sustained indefinitely and will sooner or later result in the closing of the business.

- Investors under certain conditions will be willing to provide debt or equity capital based on confidence that the business can provide them an appropriate return on investment.

Helping incubatees understand and succeed in executing financial management processes is an important role for an incubator. This can be accomplished through counseling by the incubator staff and by networking with expertise in the incubator's extended network, as is discussed in some detail in Annex 2: Building Better Businesses through the 3R (Regular Rigorous Review) Program. Annex 3: Financial Plans for Early Stage Companies also provides some useful guidance for generating pro forma financial statements including some examples.

A very helpful exercise might be for the incubatee to carry out the "Accounting and Cash Flow" training provided by the SME Toolkit.[3] The trainee is guided step by step towards the establishment of the company's business plan, specifically through the definition of the 3 major financial statements, i.e. the balance sheet, the income statement and the cash flow balance through the cash flow control method.

[3] Source: SME Toolkit.org - http://www.smetoolkit.org/smetoolkit/en/content/en/83/Accounting-and-Cash-Flow

Section 1.2: Financing Requirements at Different Stages of Business Development and Associated Risks

Section 1.2.1: Conception

In this phase of business development, the entrepreneur may have little or no physical assets that can be pledged as collateral for a loan. However, that doesn't mean the venture has no assets. The entrepreneur may have savings that can be used to get the business started; they may have a job that can generate cash which can be invested in launching the business; they may have friends and family willing to commit resources to support the entrepreneur; and may have personal assets that can be pledged (e.g. equity in a home) in order to secure a loan from a lending institution. However, the incubator needs to continuously impress upon the entrepreneur that self-funding and using the resources of friends and family usually have limitations, and hence driving the business to break even or positioning the business to be attractive to investors is essential to keeping the business going. Furthermore, financial resources should be carefully conserved and expended only to achieve sustainability on a cash flow basis or to make the business attractive to investors.

Often, in this phase, the primary activities of the business are engaging in the process of developing, prototyping and testing the product or service; attracting early adopters who will participate in the testing process; and identifying and cultivating an initial target market for the product or service.

Section 1.2.2: Firm birth

In this phase, the company needs to complete the transition from the processes required for product /service development, prototyping and testing of a target market – which were the focus of the conception phase and focus on acquiring paying customers and producing the products /services it offers to meet demand. In those cases for which it is impossible or unlikely that the business can attract investors, the entrepreneur must achieve financial sustainability before the available resources are consumed. In those cases for which the business may be attractive to investors, the entrepreneur needs to achieve sufficient progress so that a proposal can be crafted that will convince an investor.

Section 1.2.3: Growth phase

Some businesses may achieve sustainability and - by design or by necessity - stop growing and remain small businesses. If they are financially viable and meet both financial and non-financial objectives of the entrepreneur, this is a perfectly acceptable outcome. However, for incubators trying to significantly impact on regional economic development, it will be growing businesses that will generate the most jobs and have the greatest economic impact. The growth phase typically requires resources beyond those required to simply sustain the business – for development of new products and services, and for expanding the customer base of the business.

***info*Dev commissioned a study on "Financing Technology Entrepreneurs and SMEs in developing countries: Challenges and Opportunities"[4] which examined in particular the financing gap Small and Medium-Sized Enterprises (SMEs) from developing countries face at different stages of development. The survey's outcomes are summarized as follows:**

- Financing needs voiced by firms in the *early stages of development* vary significantly, depending upon the specific nature of the business, but in most cases requirements do not exceed US$100,000. These are amounts often compatible with recourse to friends and family, complemented with some personal loans and with some financing from public schemes.

- The financing gap is much more severe for firms in the *development and first-expansion phases*, because they need larger amounts of capital—they are seeking investments that range from US$100,000 to $1,000,000. Enterprises at these stages of development, although already in business and sometimes trading profitably, still do not have a sufficient track record to be accepted as a credible borrower by commercial banks. At the same time, the majority of venture capitalists consider these amounts to be too small to justify the high 'transaction costs' associated with full-fledged equity investments. Credit guarantee schemes could be used to facilitate access to bank lending, and quasi-equity—especially in the form of shareholder loans and revenue/profit sharing arrangements—could be a useful alternative to 'straight equity' deals. However, these instruments are not available in most of the developing countries surveyed.

[4] Source: *info*Dev - Financing Technology Entrepreneurs & SMEs in Developing Countries:
http://www.infoDev.org/en/Publication.542.html

Section 1.3: Identifying Alternative Sources of Incubatee Financing

A highly evolved innovation and entrepreneurship ecosystem has a plethora of sources of financing. This is evident in the advanced regions of entrepreneurial activity in the world, perhaps best represented by Silicon Valley in the United States. Sources of financing in Silicon Valley include the following:[5]

Section 1.3.1: An Inventory of Available Sources of Financing for Incubatees

Personal financing

- **Personal assets,** i.e. personal belongings of value (e.g. house, car).
- **Home Equity Loan,** i.e. when the borrower uses the equity in his/ her home as collateral.
- **Retirement account,** i.e. an account that provides some tax advantages for retirement savings.
- **Credit cards,** i.e. a facility under which the card holder can borrow money for payment based on his/ her promise to reimburse afterwards.

Internally generated financing

- **Cash flow of the business** is the flow of cash into and out of a company notably from cash generating activities.
- **Balance sheet management** is adequate management of the business' financial assets and liabilities, including identification of any issues (efficient management implies: slow on payables; fast on receivables; inventory depletion).
- **Sale /use of assets** means the sale of business product(s), service(s).
- **Converting receivables into cash** is a method to credit and collect payments from customers in a highly efficient way in order to shorten the collection period which starts with a sale (credit sales) which in turn creates a receivable (money due to the business), and ultimately converts into cash.

continued on next page

[5] These are described effectively and in excellent detail in New Venture Financing by Howard H. Stevenson, Michael J. Roberts. Jan 08, 2002. Prod. #: 802131-PDF-ENG. Harvard Business Publishing.

Grants

- **Research grants (or contracts) from government agencies or other local, national government or international agency grants,** are awards of financial assistance to carry out specific activities towards a general purpose (e.g. job creation).

- **Grants from foundations** are also awards of financial assistance, but the financial resources come from foundations.

Equity

- **Friends and family** may want to invest in a relative's business.

- **Employees** may want to invest in the company that employs them.

- **Angel investors /angel networks** are typically high net worth successful individuals[6] who make private equity investments in early stage companies either on their own or as part of informal or formal groups and typically provide lower, more flexible investments than venture capitalists.

- **Venture capital firms** are typically composed of one or more general partners that raise funds from limited partners that provide most of the capital and that professionally manage the investment process. They often invest in higher risk ventures with an expectation of above normal rates of return to balance the risk from the portfolio of investments.

- **Private Equity Placements** are investments in businesses that are not publicly traded on a stock exchange market or invested as part of buyouts of publicly traded companies.

- **Corporate investors** often acquire control of other businesses.

- **Initial Public Offering (IPO),** is a sale of equity (stock) in a business for the first time to individual and institutional investors in the public markets that are typically highly regulated by one or more government agencies, i.e. a stock exchange (as opposed to private transactions with individuals and institutions.)

- **Private investors** (may include business advisers such as lawyers and accountants becoming new business shareholders).

continued on next page

[6] Idem

Debt

- **Supplier** (or landlord) **credit** is a situation in which the supplier postpones payment of the supplies provided.

- **Pre-payment by customers** occurs when the customer pays before the service/ product provision.

- **Equipment leasing,** is an agreement giving a business owner the right to use equipment for a specified period of time.

- **Bank loans** entail the redistribution of financial assets over time, between the lender (bank) and the borrower (business) through:
    - *Cash flow financing* (short term debt; line of credit; long term debt).
    - *Asset-based financing* (accounts receivable; inventory; equipment; real estate loans; personally secured loans).

- **Institutional investors, insurance companies, pension funds** are organizations acting as highly specialized investors on behalf of others to invest a large amount of money in businesses.

- **Loans from or guaranteed by government agencies,** are an amount of money (the principal) borrowed from a government agency to be paid back later by the business (borrower) (e.g. SBA loans).

Sources of financing and the conditions under which they will be made available to entrepreneurs vary by country, by region and by culture. Hence an important element of this training module is an exercise that causes participants to identify sources of financing that are currently available to their incubatees. (See the exercise 9.1 at end of this training manual.) This exercise can be extended to generate ideas about sources of financing that are not currently available, but which should be developed to support a more vibrant innovation and entrepreneurship ecosystem. The issue of filling gaps with respect to sources of financing in the innovation and entrepreneurship ecosystem is discussed in Component 4 – part of the Part 2 training segment of this Module.

The sources of funding that will be most commonly pursued by incubators that are not located in regions that have highly evolved innovation and entrepreneurship ecosystems are indicated in Table 1.

STAGE OF ENTERPRISE DEVELOPMENT	SOURCES OF FINANCING	COMMENTS
CONCEPTION	Friends and family, government grants, self-funding from savings or from other revenue generating activities.	For some ventures – particularly technology-based ventures – government grants to support research might be available. But for most ventures, the entrepreneur must depend on very careful cash management.
FIRM BIRTH	All of the above – PLUS cash flow management, including favorable terms from suppliers and pre-payment by customers, angel investors and debt financing if collateral is available.	Cash flow management is still the primary source of funding. However, if the entrepreneur has established a measure of credibility and a track record, it may be possible to attract angel investors and favorable terms from suppliers and customers.
GROWTH PHASE	All of the above – PLUS equity investing from professional investors and private investors (i.e. shareholders), bank loans if collateral is available, equipment leasing and corporate investors.	If the entrepreneur has established a pattern of growth and credible performance, it may now be possible to attract professional investors. Capital intensive companies may be able to attract bank loans. Government grants and loans may be available for incubatees generating new jobs.

Table 1 - Sources of Financing as a Function of Incubatee Stage of Development

Section 1.3.2: Challenges and Opportunities of Financing Entrepreneurs in Developing Countries

*info*Dev's "Financing Technology Entrepreneurs and SMEs in developing countries: Challenges and Opportunities"[7] study explores the financing gap faced by technology entrepreneurs and SMEs from developing countries in detail. The document highlights the difficulties of SMEs, particularly micro and small enterprises, in developing countries in obtaining the necessary financial resources to effectively grow their businesses. Particular attention is given to SMEs operating in the information and communication technology (ICT) industry and in ICT-enabled (ICTE) activities for which the challenge of accessing growth capital is particularly acute because these firms possess few tangible assets that can be leveraged as collateral for loans. The challenge is best illustrated by the high difficulties faced by SMEs seeking US$50,000 to $1 million to scale up their businesses and attract private capital markets.

As commented within the study, access to traditional growth capital, including debt and equity, is often prohibitively costly, due to such factors as insufficient legal and regulatory policies, and inadequate financial markets.

[7] Source: *info*Dev - Financing Technology Entrepreneurs & SMEs in Developing Countries - http://www.infoDev.org/en/Publication.542.html

The study focuses on four main obstacles that may prevent SMEs from obtaining adequate financing:

1. The existence of marked **informational asymmetries** between small businesses and lenders, or outside investors;

2. The intrinsic **higher risk** associated with small scale activities, because they operate in a more competitive environment, and because they have less capacity to withstand adverse developments;

3. The existence of sizeable **transactions costs** in handling SME financing; and

4. The **lack of collateral** that typically characterizes SMEs.

In developing countries, these problems are often exacerbated by institutional factors, such as limited legal protection offered to creditors and investors and lack of an appropriate information infrastructure (e.g. credit bureaus and similar structures).

As far as types of financing are concerned, if we focus on equity and debt financing, the study identified that:

• The availability of equity financing varies greatly across the countries surveyed. India has a sizeable venture capital industry, with dozens of funds in operation, including both domestic and international operators. In addition, private initiatives are supplemented by a variety of publicly-funded schemes, often targeted at innovative sectors, such as ICT and biotechnology. On the other hand, in Sub-Saharan Africa and in some other countries such as Peru, venture capital is either non-existent or in its infancy, and the few equity financing facilities in existence are usually the result of donor or government-sponsored initiatives.

• In most of the countries surveyed, the attitude displayed by commercial banks toward SME is relatively conservative. However, in recent years commercial banks' efforts to serve the SME segment have increased, with the launch of new products and the adoption of more flexible operating modalities.

• In parallel, 'micro-enterprise' banks have shown a tendency to scale-up their operations, and some now offer short and medium-term loans of about US$100,000, sometimes relying on soft collateral (personal guarantees or guarantees on receivables). The problems encountered with commercial banks are partly mitigated by the existence of government financed lending schemes designed either to support ICT/ICTE firms specifically, or to support innovative enterprises in a more general sense. This is especially true in Brazil, where various government bodies and development finance institutions are actively involved in the provision of loans. Examples of credit lines or re-financing facilities are also found in India, Senegal, Argentina and the Philippines. The amounts made available through these facilities typically range from US$50,000 to $500,000. There are usually relatively favorable repayment conditions—typically, duration of five years or more, with a one or two-year period of grace).

• Another solution is the use of credit guarantees, which facilitates access to debt financing by replacing at least partly the need for tangible collaterals. Credit guarantee schemes targeted at ICT/ICTE firms and other innovative enterprises operate in Brazil and India. In Morocco, Argentina and the Philippines ICT/ICTE enterprises can access, sometimes at preferential conditions, 'generalist' credit guarantee funds.

Section 1.3.3: Different Sources of Financing – What to Watch For

When exploring the alternative sources of incubatees' financing in developing countries, the following aspects should be kept in mind:

Guaranteed loan programs are typically programs under which financial institutions provide loans to ventures that are guaranteed (totally or in part) by a third party, which could be a government agency, a donor or a development bank. Guarantees are part of a financial support system that may be privately organized or government backed. This support system might be available in some developing countries and should therefore be taken into consideration when exploring the different possibilities for incubatee financing.

Another possibility to envisage is the model adopted by some incubators who take equity investments in their incubatees. An example of this procedure in action is Raizcorp[8], a South African based business incubator. Raizcorp assist their clients in getting financing through various ways.

• They provide soft financing to their clients by absorbing up to 75% of their incubatees' monthly costs (through the various services they offer as part of their incubation process) to assist them with cashflow management;

• They assist their incubatees with any capital raising requirements through their links to various Venture Capitalists and Private Equity stakeholders; and

• They take a minority equity stake (33.3%) in all their incubatees in exchange for a contractual agreement which ensures Raizcorp works to increase their incubatees' profitability. If it is unsuccessful, then Raizcorp hands back the equity at no cost and write offs any outstanding Raizcorp fees. To date, no one company has ever invoked this guarantee.

Too often, venture capitalist is envisaged as a common financing mechanism for start-ups. On the contrary, early-stage businesses (i.e. pre-start up and start-up companies) attract few venture capital investments. This is largely due to the high transaction costs associated with small investments – the venture capitalists prefer to invest large sums in slightly later stage companies as these companies are not only less risky, but can absorb substantial investment as they grow their operations.

[8] Source: www.raizcorp.co.za

• According to the MoneyTree Report produced by PricewaterhouseCoopers and the National Venture Capital Association (NVCA), based on data from Thomson Reuters[9], venture capitalists in the US invested $17.7 billion in 2.795 deals in 2009, marking the lowest level of dollar investment since 1997. Venture investments in 2009 represented a 37% decrease in dollars and a 30% decrease in deal volume from 2008. Early Stage investments fell by 13% in terms of dollars and 17% in terms of deals in 2009 to $4.6 billion into 883 deals.

• The European Private Equity and Venture Capital Association (EVCA) published in July 2009 a Special Paper on the annual activity statistics for the private equity and venture capital markets of Central and Eastern Europe (CEE)[10] in 2008.[11] The document records that in 2008, €186 million were invested in 100 companies, representing 2.7% of the total venture investment in the region. Later stage venture accounted for two-thirds of the value invested by venture capitalists in CEE. In Europe as a whole, later stage ventures secured 60% of the value invested by venture capitalists and represented 42% of the companies in which venture capitalists invested in 2008.

In many countries, angel investors and professional equity investment firms do not yet exist. In this case, the owners of prominent family enterprises may in some cases assume the role of angel investors.

Section 1.3.4: Different Sources of Financing – What Are the Risks?

It is also important to consider the risks associated with the various potential sources of financing for incubatees. Acquiring financing is a process that takes time, energy and precious cash – and there is no guarantee that the process will result in a positive outcome. Table 2 provides some insights into the risks associated with various categories of financing sources for incubatees.

[9] Source: www.nvca.org/

[10] CEE includes the countries of Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, FYROM, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia and Ukraine.

[11] Source: http://www.evca.eu/knowledgecenter/latestdata.aspx?id=500

TYPE OF FUNDING	RISKS
FRIENDS AND FAMILY, SELF-FUNDING FROM SAVINGS OR FROM OTHER REVENUE GENERATING ACTIVITIES.	May not be able to generate sufficient cash in-flow to sustain the venture until it reaches break even. It is all too common for incubatees to run out of cash before they figure out how to become a sustainable business and achieve breakeven. Furthermore the expectations from this group of funders can sometimes be unrealistically high both in terms of expected return and period for the expected return.
GOVERNMENT CONTRACTS, GRANTS, AND LOANS	1. The process of securing the funding may take too long. 2. The process may consume too much of the entrepreneur's time and cash. 3. The activities required to fulfill the government requirements may be misaligned with the needs of the venture. 4. May allow the entrepreneur to justify ignoring the real needs of the venture.
ANGEL INVESTORS	Items 1 and 2 above, PLUS: • May not have sufficient resources to fund later stages • May lack the expertise that the entrepreneurs need from their investors.
SUPPLIERS OF DEBT	Items 1 and 2 above, PLUS: • The incubatee may not be able to service the debt, which may trigger liquidation. • Without sufficient collateral, debt financing is not likely an option. • Managing the relationship may be too time-consuming relative to the value gained.
PROFESSIONAL EQUITY INVESTORS	Items 1 and 2 above, PLUS: • Misalignment is all too common. Investors may be focused on a quick and profitable exit. • The investors may drive out the entrepreneur and install their own management team.

Table 2 - Categories of incubatee financing vs. risks

Section 1.4: Conception and Firm Birth Financing During a Credit Crunch

In a credit crunch, the amount of debt and equity financing available for entrepreneurial firms diminishes and the process of securing it becomes more difficult. This happens because investors become more cautious, even to the extent that they may be unwilling to invest until the economy shows signs of recovery. The result is that they introduce more stringent terms for entrepreneurs and thus the process of securing financing takes longer and requires a more rigorous due diligence process. The incubatee seeking financing from traditional sources will need to position itself to be more attractive to investors compared with other seekers of capital. Given the fact that most incubator firms are in the early, high risk phase of their evolution, the odds of securing traditional risk capital are low. Hence, the following strategies will be important for the survival of incubatees.

- It is even more important to exercise financial discipline in management of cash flow, including minimizing expenditures, driving aggressively toward revenues and striving to achieve breakeven as quickly as possible. This is particularly critical because the incubator firm's customers will seek to enhance their own prospects for surviving the economic downturn by minimizing and/ or delaying expenditures and by stretching out the time until they pay their suppliers for goods and services delivered.

- On the other hand, established firms that downsize their workforce during an economic downturn may be looking for opportunities to outsource a part of their enterprise's business activities to suppliers that can deliver them at a lower cost than the firm can do internally. Incubator firms should be analyzing the actions of established enterprises to uncover these opportunities.

- Even in an economic downturn, some firms have the financial capacity and the strategic commitment to make expenditures that will enable them to come out of the economic downturn poised for rapid growth, thereby widening the gap between themselves and their competitors who hunker down during the economic storm. As suggested in the previous item, incubator firms should seek opportunities to work with firms that adopt an aggressive posture during the economic downturn. Even if a supplier arrangement is marginal during the downturn, the incubatee then is positioned to grow with the customer when the economy turns around.

- If the incubator firm has existing investors, the entrepreneur needs to pay special attention to them in order to give these investors confidence that the incubator firm can and will survive the credit crunch. Why? If the investor has confidence in the incubator firm, then the investor may choose to provide additional investment in order to preserve the potential for an eventual return on the initial and subsequent investment. On the other hand, if the investor does not have confidence in the incubatee, then the investor may opt to write off the investment rather than risk further investment. This decision not only eliminates that current source of financing, but the investor's decision sends a negative signal to other potential investors.

• The incubatee should carefully follow government actions to lessen the impact of the credit crunch, as these actions may result in opportunities for the incubator to access new business or new sources of financing.

• Finally, the incubatee should do everything possible to assemble additional sources of short-term capital that can provide a margin of safety from those most committed to seeing the incubatee survive. These might include family and friends; suppliers and customers; and even current employees.

COMPONENT CONCLUSIONS

In order to increase the probability of survival and success for its participating companies, the incubator needs to push them to develop an appropriate level of sophistication with respect to financial management. At a minimum, this means that each incubatee needs to be diligent about projecting and tracking cash flow (revenues vs. expenses) to ensure that the company does not inadvertently run out of cash and be forced to go out of business. In addition for those companies needing to access capital to support operations or growth, the incubator can and should play a valuable role in educating incubatees about the sources of financing and the process of accessing financing, as well as in helping them develop the skills necessary for engaging in this process successfully. This component has been designed to help incubator managers and other members of the incubator management team establish a common knowledge base for this topic and a shared framework for using it.

Component 2
(Part 1 Training):

Developing the Capacity of the Incubator to Assist Clients in Accessing Financing

COMPONENT INDEX

COMPONENT OBJECTIVES

This component is designed to ensure that trainees (1) can provide effective guidance to incubator clients regarding cash flow management, particularly with respect to the use of financial management templates and tools and (2) can recruit and manage (volunteer) mentors that have expertise in cash flow management and/ or acquisition of financing for the incubator's extended network.

Section 2.1: Building Capacity within the Incubator Staff, Including a Review of Financial Management Templates and Tools

Given the shortcomings of most incubatees with respect to financial management and investment processes, it is easy for incubator staff to hide their own shortcomings with respect to these competencies. The place to start when aiming to increase capacity in this area, therefore, is in the incubator hiring process. Those responsible for hiring the incubator manager, typically the incubator's sponsor or board, should be sure that the manager has sufficient financial literacy. In turn, the incubator manager needs to make sure his /her staff that are expected to provide counseling to incubatees also demonstrate financial literacy. Additionally, it will be helpful to have one or more members of the incubator advisory board (or board of managers) with a reasonably sophisticated knowledge in this domain and the time and willingness to support the incubator staff.

Even with adequate capacity, it is useful for the incubator to provide periodic re-training that engages the staff of the incubator with experts in the incubator's extended network in reviewing principles, practices and management tools. This not only serves to refresh the capabilities of the staff with respect to financial discipline, but also builds relationships that the staff can use to draw on the expertise of its network. Training seminars can be provided by professional volunteers from the business community (accountants, financial advisers, bankers, equity investors) or by volunteers from local colleges or universities (professors of accounting or finance). In addition there are numerous highly useful publications which can be acquired and reviewed.[12]

In the case study presented in Annex 2, related to a financial management program implemented at Rensselaer Polytechnic Institute (The Regular Rigorous Review Program), the volunteer assigned pro bono by a major accounting firm to support the incubator required participating incubatees to provide six basic financial statements: balance sheet, cash flow statement, income (profit and loss) statement, budget, accounts receivable (aged) and accounts payable (aged). Participants in the Regular Rigorous Review Program were all required to use the Quicken software package from Intuit to generate the statements, and the volunteer from the major accounting firm helped each participating incubatee set up the financial management system. Obviously, other tools are available. It will be most useful for the incubator to rely on experts in the incubator's extended network to develop a comparable plan and to recommend a set of tools that can be used in the process of mentoring incubatees about financial management.

[12] For example, the lead author of this module has found the Merrill Lynch publication: "How to Read a Financial Report" to be particularly practical and useful. See http://www.ml.com/philanthropy/ipo/resources/pdf/howtoreadfinreport.pdf. Other resources may need to be accessed to ensure information is aligned with local regulatory requirements and commonly accepted business practices.

Section 2.2: Engaging Outside Experts in Order to Build Capacity for Supporting Incubatees in Cash Flow Management and the Acquisition of Financing

Generally, incubator staff should have sufficient literacy with respect to financial management and investment processes in order to provide effective counseling to incubatees; however, it is unlikely that they will have the levels of expertise that may reside within individuals that are part of the incubator's extended network. Here it is assumed that the incubator has used the process described in Module 8 to develop an extended network, and that included in this network are individuals with expertise in financial management, tax accounting, valuation, acquiring government and foundation grants and debt and equity financing – ideally from the perspectives of the investor and the investee. Below are a variety of approaches for engaging outside experts to support incubatees in cash flow management and the acquisition of financing.

Section 2.2.1: Ad-hoc Intervention

It should be expected that crisis intervention may be required. For example, an incubatee may be faced with filing their first tax return for the business and be looking for coaching through the process. An incubatee may be about to begin the process of contacting potential investors and may be seeking help in valuing the firm, or in creating a budget. An incubatee may be short on cash and be seeking help in dealing with creditors and /or in collecting receivables. Particularly if the incubatee's need for assistance is urgent and critical, the incubator staff may not wish to take the risk of starting a developmental process that may not address the immediate need in a timely way. Hence, the incubator needs to be able to call on the appropriate experts in its extended network to deliver a timely response to incubatee's needs.

Section 2.2.2: Developmental Intervention

Ideally crises should be avoided altogether, or the frequency of their occurrence should be minimized. This is unlikely to happen if that preferred outcome depends solely on the capacity of the incubatee, given the lack of experience in financial management and in acquisition of financing that is typical of most incubatees. It is possible to develop the financial management capabilities of incubatees by engaging experts from the incubator's extended network in training seminars. Of course, these will only be effective if incubatees attend and hence the incubator manager needs to build that expectation into requirements or expectations for admission to and continuing membership of the incubator. A similar process should be established for those incubatees who will not be self-financing and who will be seeking outside financing.

Section 2.2.3: Establishing Incubatee Advisory Boards

The incubator should assist each incubatee in establishing a board of managers or advisers. Included among the members of the incubatees board should be experts who can demand that the incubatees practice financial management and provide the board members with an appropriate set of financial statements prior to each board meeting. (The expert should either be willing to provide coaching, or alternatively to help recruit a coach for this purpose). It should be noted that most incubatees either don't have an advisory board or have one populated with friends and family who have neither the capacity nor inclination to challenge the entrepreneur. Ideally the board will also include an individual with experience in fundraising, either as an entrepreneur or as an investor. That said, it is unlikely that a single board member will have experience with all the possible sources of financing, in which case the incubator and members of the advisory board should be prepared to find and engage additional expertise in the incubator's extended network on an as-needed basis.

Section 2.2.4: Practice

The incubator should seek out investors (potential suppliers of debt, equity and grants) who are willing to engage with incubatees on a trial basis – specifically to give incubatees the opportunity to practice their pitches, to learn about the expectations of investors and to get friendly feedback – all as part of the process of preparing incubatees to seek investment.

The purpose of all this activity, described in Component 2, is to increase the skills, sophistication and capability of incubatees in effective financial management of their enterprises and in preparing them to engage successfully with investors. However, the incubator management must also recognize that this activity is competing incubatees' time and attention among a number of other activities. Equally critical tasks, e.g. completing development and testing of a product or service; and acquiring customers, are also demanding their attention. Unless the incubatee is successful in the carrying out tasks required to generate cash flow, having an effective financial management system won't be of much value, nor will be being prepared to engage investors. Hence, it is important that the incubator keeps the process of developing financial literacy among incubatees as simple and efficient as possible.

COMPONENT CONCLUSIONS

This component has focused on developing the support system of incubator staff, including the extended network of experts and the incubatee advisory boards that can accelerate the development of financial literacy among incubatees. This support system and its associated process should help incubatees increase the odds of avoiding failure as a result of lack of financial discipline and should also increase the odds of incubatees gaining investment when and if this is warranted.

Case Studies

www.infodev.org
www.idisc.net

Financial Management Training for Incubatees

Incubator Name: RPI Incubator
Sector: University-Based Technology Business Incubator
This Case Study Examines: Implementation of a pilot project testing the use of financial management systems as the basis for a formal mentoring program.
Date: December 2009

PART I

SUMMARY

Problem

For many or most client companies, cash flow is negative during the period in which the entrepreneur is trying to figure out how to create a sustainable business. Frequently, the entrepreneur does not understand the importance of exercising fiscal discipline and only pays attention when faced with a financial crisis. When incubator clients fail to graduate from the pre-venture /start-up /survival modes to sustainability, in most cases they do not fail spectacularly. They simply run out of money before they figure out how to succeed - and abandon their ventures and return to a job or to education. (Excerpt from the Introduction to this module)

Solution

Establish a monthly review program engaging a team of professional advisers that require the incubatee to submit standard financial statements prior to the review. Gain the commitment of the incubatee to the process by negotiating transfer of a small equity position to the incubator and payment of a nominal monthly fee.

PART II

BACKGROUND

See Annex 2 for a comprehensive report on the pilot project.

TIMELINE OF EVENTS

This approach to dealing with the ongoing challenge of getting incubatees to exercise financial discipline was pilot tested in 1991-1992 in the RPI Incubator Program with significant initial success.

OUTCOME AND CONCLUSIONS

Though the program exceeded expectations of most of the participants (incubator manager, mentors and incubatees), during the transition from the incubator manager who launched the program and his successor, the program was suspended and never restarted. To be successful over the long term, it would require the ongoing sponsoring and championing of the incubator manager and a flow of companies through the program. Based on the experience in the pilot program, six to twelve months in the program should be a sufficient commitment from incubatees, who thereafter should be transitioned to their own board of managers or advisers.

PART III

LINKS

N/A

REFERENCES

This material for this case study was contributed by the manager of the case study incubator. His report of the program, presented at the 1992 International Conference on Business Incubation, is included in Annex 2.

Investment Readiness of SMEs in South-East Europe

Incubator Name: Southeast European Network of Start-Up Centers and Incubators (SENSI)
Sector: Youth focused business incubator
This Case Study Examines: Start-up's investment related needs in the Former Yugoslav Republic of FYROM, Serbia, Montenegro, Bosnia, Kosovo, Romania, Armenia and Bulgaria.
Date: May 2009

PART I

SUMMARY

Problem
The availability of risk capital finance for early-stage businesses is in general very limited, especially in regions such as the South-East of Europe.

Solution
YES Foundation Skopje carried out a project called 'Investment readiness of the MSME sector in South-East Europe' in cooperation with the Dutch Foundation SPARK and with the support of the SENSI and ECAbit networks in order to support the creation of a regional Business Angel Network. As a result of the project, the report BRIDGING THE GAP - Access to Risk Finance for Early-Stage SMEs in Southeast Europe discusses the current situation with risk capital in the region, tries to identify the major reasons for such situation, and attempts to offer recommendations for promoting access to risk finance for SMEs in the region. In doing so, frequent references and comparisons are made to the situation in the European Union as a desired final destination of all the countries in the SEE region.

PART II

BACKGROUND

The non-profit Youth Entrepreneurial Service (YES) incubator in Skopje (FYROM) was founded in 2007. It targets the youth population and works primarily in the ICT sector. It has a number of goals, including creating jobs, raising the awareness of potential entrepreneurs, decreasing the brain drain, and developing the ICT industry. Its 600m2 space includes 21 offices, meeting rooms, a kitchen, and parking. At the end of 2009, the incubator had 16 clients, employing 44 individuals.

YES incubator offers free consulting services and assistance to potential incubatees as well as seed capital, trade facilitation, financial management training, business information.

The Problem – Finding Financing for Incubatees

Incubatees at YES incubator are not in an ideal position to attract investment from external sources. They lack the experience and know-how needed to lure investors. YES incubator's constant search for donors and capital to sustain its own operations puts strains on the time it can provide its incubatees. Additionally, YES incubator's own inexperience in this field and the poor economic realities of FYROM place incubatees at a disadvantage when attempting to attract investors.

In confronting this problem, YES incubator with the SENSI and ECAbit networks saw that there was a vacuum in FYROM regarding investment-readiness research. Most articles simply pointed to the lack of capital and angel investors, but there was no research regarding strategies employed or best practices in the area.
To rectify the lack of information and investors in the area, YES - in cooperation with the Dutch Foundation SPARK and with the support of the SENSI and ECAbit networks - launched an investment-readiness project with the aim to increase the capabilities of incubator managers and clients in the field of investment and financing innovative SMEs as well as effective application of ICT in this area. The project kicked off in October 2008. Since then, the project has been surveying incubators around the region.

The data collected, from which the bulk of the project's finding are derived, comes from around 70 interviews. The project published its results in January 2010.

Conclusions

Signs point to the need to establish a regional system aimed at attracting investments, Venture Capital funds, and angel investors. Currently the lack of a developed network and personal expertise in attracting funds has hampered success. The small size and population of FYROM limits the total financial pool from which to draw potential investors. A regional approach gives all incubators in the area and their incubatees a larger pool to potentially attract funding from, as well as a larger financial network made up of many incubators from which to fund training programs, bring in experts, and provide for other solutions.

TIMELINE OF EVENTS

- YES was founded in 2007.
- The investment readiness project began in October 2008 and has been studying the problem of insufficient resources and experience regarding incubatee financing.
- The report summarizing the project's findings and recommendations was published in January 2010.

OUTCOME AND CONCLUSIONS

This case study illustrates how an incubator found that a problem it was experiencing, sourcing financing for its incubatees, could be used as an opportunity from which to launch an extensive survey of the difficulties the incubator and its stakeholders were facing. The results gathered in a final report provide guidance about next steps which should hopefully result in concrete action items and a critical path aimed at resolving the difficulties YES incubatees face when attempting to solicit financing from investors.

PART III

LINKS

Yes incubator website: http://www.yesincubator.org.mk/EN/index.php
Yes *info*Dev profile: http://www.idisc.net/en/Incubator.122.html
iDISC article: http://www.idisc.net/en/Article.38951.html
Report available at: http://sensi.biz/content/view/237/84/
SENSI network website: http://sensi.biz/
ECAbit network website: http://www.ecabit.org/
SPARK website: http://www.spark-online.org

REFERENCES

The material for this case study was gathered from a phone conversation with Mr Ljupco Despotovski, incubator manager of YES Incubator, on October 11th, 2009.

The importance of financial support for early stage ventures

Incubator Name: Technological Incubator Program
Sector: Technology based incubators
This Case Study Examines: Technological Incubator Program in Israel
Date: December 2009

PART I

SUMMARY

Problem
A market may be full of very skilled people with brilliant business ideas, but most of these cannot be implemented if nobody invests in these very early stage ventures.

Solution
In Israel, the government set up the "Technological Incubator Program" to develop innovative technological ideas into start-ups and lead them towards their first round of private investment.

PART II

BACKGROUND

In the early 1990's, Israel faced a massive immigration wave of people from the former USSR countries. The population of Israel increased by 10% in 5 years. A large part of the immigrant population was academically skilled people with thorough technological knowledge and products ideas that could potentially be marketable.

At that time, the Israeli government already supported Research and Development activities in established companies but NOT in the preliminary phase of venture development. Hence, the government took the initiative to set up a program, the "Technological Incubators Program" based on the business incubation model and aiming to develop innovative technological ideas generated from the people living in Israel into start-ups in order to lead them towards their first round of private investment. Originally, this program was initiated to respond to the needs of the immigrant population (70% of the supported projects' initiators were immigrants). However, the program has always been a general one so that it could carry out several missions:

- To enable new immigrants to develop their commercial product and establish a startup;
- To increase the development of peripheral regions;

- To strengthen minorities;
- To support specific technological areas; and
- To enhance the entrepreneurial culture within the population, especially young people.

The main target of the program has always been and is still the following: to create an instrument that will support the very early stage innovative technological ideas so that they become ready for private investment and do not disappear, but instead become established companies.

24 Business Incubators operate under this program. They are spread over the whole country. The incubators involved have been selected to take part in the program because they meet the following criteria:

- They are all independent legal entities;
- The general manager is a skilled and experienced person;
- The Board of managers is composed by experienced people coming from the industry and academia;
- They are sector focused and linked to research institutes;
- They are equipped with suitable facilities for R&D activity, some of them are sector focused and most of them collaborate with research institutes; and
- They provide technological, financial, administrative and logistical support to projects.

The incubators involved in the program carry out 3 kinds of activities.

1. Screening to choose ideas

The incubators are in charge of evaluating the technological ideas presented to them to identify the projects with potential and hence which projects to support through the program. The projects should respond to the following criteria – they should be:

- Product oriented;
- Rooted in research & development;
- Innovative and unique;
- At early stage; very high risk level;
- Representing a significant potential market;
- Feasible with available resources; and
- An individual initiative.

2. Support to initiators

The incubators assist the promising projects' initiators in building teams to further develop their innovative technologies and be selected to take part in the program. The incubators offer the following services to the entrepreneurs:

- Appropriate facilities for R&D;
- Financing;
- Central administrative services (secretarial, accounting, legal, acquisition);
- Management assistance;
- Professional guidance;
- Business direction;
- Assistance in commercialization;
- Inter-tenant synergism; and/or
- Sharing existing infra-structure.

3. Government Assistance

Once the project is accepted in the program, the business incubator applies to the government office in charge of the program to get the project supported. (85% of the projects presented by the business incubators are accepted by the government office).

The support from the government consists of providing the company with a zero risk grant or a loan of 85% of the funds required to develop the project, that is to say on average $0.5 million (for biotech projects, $0.75 million). These funds aim to support the incubator for 2 to 3 years within the incubator. The remaining 15% of funds required to develop the project have to come from private sources. In the last 8 years, these 15% are coming from the incubator which takes an equity share of generally 50%. Each incubator supports an average of 10 projects.

The first investment from the government is of crucial importance for the company to become attractive to private investors. Indeed, at a very early stage of development, the ventures are not ready yet for private investment and hence, no other sources of funding are available for these early stage companies. As a consequence, there has been a constant battle to secure the government's financial support for innovative technological projects within its budget. In the last 10 years, the total contribution from the government has been stabilized to $35 million per year to support innovative companies through this program.

Building on the strength of the program, the business incubators assist the projects they support in getting private stakeholders to invest in the businesses.

TIMELINE OF EVENTS

1991: Establishment of the Technological Incubators program in Israel.

2008: The founder and CEO of the program, Mrs Rina Pridor, retires.

OUTCOME AND CONCLUSIONS

By creating a general instrument implemented by business incubators all over the country, the Israeli government developed a program that suits all parts of its population. If the instrument was first thought to support immigrant entrepreneurs, it has now proved to be a scalable model meeting the whole population's needs and expectations.

Also, the success of the program is easily monitored by measuring the quantity and size of private investment allocated to innovative projects. It is worth mentioning that over the last 6 years; more than 60% of the projects supported by the program received private investment at the end of their 2-3 years of incubation and have become sustainable businesses. They usually graduate within a 5 year period of incubation and once they have graduated, they manage to raise private investment corresponding to five times the government loan.

PART III

LINKS

http://www.pridor.com

REFERENCES

The material for this case study was contributed by the founder and former General Manager, Mrs Rina Pridor. The information above is extracted from firsthand experience and personal involvement in the development of above tools.

Contact details:
rina@pridor.com

Bibliography

www.infodev.org
www.idisc.net

CONTENT REFERENCES

BusinessDictionary.com – Agency Risk
http://www.businessdictionary.com/definition/agency-risk.html

BusinessEdge-me.com
http://www.businessedge-me.com/cms.php?id=about_be_contacts

European Private Equity & Venture Capital Association (2009) - Central and Eastern Europe Statistics 2008 – An EVCA Special Paper
http://www.evca.eu/knowledgecenter/latestdata.aspx?id=500

Encyclopedia of the Nations – Malaysia, Economic development
http://www.nationsencyclopedia.com/Asia-and-Oceania/Malaysia-ECONOMIC-DEVELOPMENT.html

Europe INNOVA - European Coaching Innovation Standard
http://archive.europe-innova.eu/index.jsp?type=page&lg=en&classificationId=5180&classificationName=ACHIEVE&cid=5118

EUConnect – Video Vault
http://www.euconnect-video.co.uk/new-dawn-cafe/video-vault-1.htm

*info*Dev - Financing Technology Entrepreneurs & SMEs in Developing Countries
http://www.infoDev.org/en/Publication.542.html

*info*Dev - Monitoring Evaluation and Impact Assessment Study
http://www.idisc.net/en/Page.MEIA.Study.Overview.html

*info*Dev
http://www.infodev.org

Merrill Lynch, How to Read a Financial Report
http://philanthropy.ml.com/ipo/resources/pdf/howtoreadfinreport.pdf

National Venture Capital Association (US)
http://www.nvca.org/

SME Toolkit.org – Accounting and Cash Flow
http://www.smetoolkit.org/smetoolkit/en/content/en/83/Accounting-and-Cash-Flow

SME Toolkit.org – Bookkeeping & Cash Flow Management
http://www.smetoolkit.org/smetoolkit/en/category/915/Bookkeeping-Cash-Flow-Management

SME Toolkit.org – Business Plans
http://www.smetoolkit.org/smetoolkit/en/category/922/Business-Plans

SME Toolkit.org – How to Fix Your Business
http://www.smetoolkit.org/smetoolkit/en/content/en/2840/How-to-Fix-Your-Business

SME Toolkit.org – Preparing Financial Statements - Basic Concepts
http://www.smetoolkit.org/smetoolkit/en/content/en/92/Preparing-Financial-Statements-Basic-Concepts

SME Toolkit.org – Try it Yourself
http://www.smetoolkit.org/smetoolkit/en/content/en/799/Try-it-Yourself

Stevenson, Howard H. and Michael J. Roberts (2002) - New Venture Financing, Product #: 802131-PDF-ENG, Harvard Business Publishing, Cambridge MA

Raizcorp
http://raizcorp.co.za

Tiruchirappalli Regional Engineering College
http://www.trecstep.com/

Wikipedia – Ethanol Fuel in Brazil
http://en.wikipedia.org/wiki/Ethanol_fuel_in_Brazil

Wikipedia – Islamic Banking
http://en.wikipedia.org/wiki/Islamic_banking

Wikipedia – Content of a Business Plan
http://en.wikipedia.org/wiki/Content_of_a_business_plan

SUGGESTED FURTHER READING

Bygrave, William and Andrew Zacharakis (2004) - The Portable MBA in Entrepreneurship: Chapter 5, John Wiley and Sons, Hoboken

Entrepreneur.com – Business Plans
http://www.entrepreneur.com/businessplan/

Inc.com – Business Plan Building, Section by Section
http://www.inc.com/guides/write_biz_plan/20660.html

*info*Dev - Promoting Private Sector Investment and Innovation
http://www.infoDev.org/en/Publication.11.html

*info*Dev - Scaling Up Innovation and Entrepreneurship in Developing Countries: The Role of Private Sector Finance
http://www.infoDev.org/en/Publication.177.html

Rich, Stanley and David Gumpert (1985) - Business Plans that Win $$$, Harper and Row, New York

Rogers, Steve (2002) - The Entrepreneurs Guide to Finance and Business: Chapter 5, McGraw Hill, New York

Sahlman, William (1997) - How to Write a Great Business Plan, Harvard Business Review, Harvard Business Publishing, Cambridge

Timmons, Jeffry, Zacharakis, Andrew and Spinelli, Stephen (2004) Business Plans that Work, McGraw Hill, New York

Annex 1: Business Plan Outline

From Try It Yourself to Creating an Effective Business Plan section:
http://www.smetoolkit.org/smetoolkit/en/content/en/799/Try-it-Yourself

- Introductory Elements
- Business Description
- The Market
- Development & Production
- Sales & Marketing
- Management
- Financials

Annex 2: The Regular Rigorous Review Program

www.infodev.org
www.idisc.net

(Presented by Mark P. Rice at the 1992 National Business Incubation Association Annual Conference Austin, Texas)

Introduction: Anchoring Review to Financial Performance

Without anchoring review to the concrete reality represented by financial performance, it is very difficult to determine if the problems identified by the entrepreneur are the real problems of the company, or the most important ones. Most entrepreneurs operate independently of the financial dynamics of their businesses, until and unless they are forced to do otherwise. In most cases, they view financial statements as a necessary evil and only as a basis for tax reporting. Seldom do they use financial statements as the basis for managing their businesses.

What's the Right Software Package?

The right software package is the one the entrepreneur is willing to use. Given the importance of peer networking, it also makes sense to encourage the use of a common package so that the entrepreneurs can help each other.

Although long term it is not anticipated that the use of a common software package by all incubatees will be required, Quicken was specified for use by the participating companies during the trial phase of this program for several reasons. Quicken is inexpensive, relatively easy to use and is fast becoming ubiquitous. Intuit, the maker of Quicken and a sponsor of the 1992 NBIA Conference, has recently come out with a package designed specifically for small businesses entitled QuickBooks.

How to Get the Entrepreneur to Produce the Required Financial Reports

The financial reporting capacity of each of the companies was addressed through three mechanisms:

1. **Relationship with Coopers & Lybrand**

   A relationship with the national and local offices of Coopers & Lybrand through their Emerging Business Services Division was established. C&L has provided the assistance of a junior accountant under the direction of a managing accountant to assist the companies with financial reporting.

2. **Connection to Rensselaer's School of Management**

   During the Spring '92 semester, student teams in the capstone accounting course in our School of Management adopted companies and worked with them on their financial record-keeping systems and on their facility with Quicken.

3. **Participation of an Incubator Company (Kent Consulting)**

   One of the incubatees, Kent Consulting, is attempting to develop a user interface to make it easier for entrepreneurs to get started on Quicken. As part of the development effort for this product, Peter Kent provided training and assistance to the participating entrepreneurs to help them up their learning curves.

Even with all these intervention mechanisms aimed at helping companies implement a financial reporting system, results so far have been mixed. Only one of the eight companies has progressed to the point of being able to produce all six suggested financial statements. Some of the participants still have not even been able to consistently produce a P&L and a balance sheet.

The Costs and Benefits of Implementing the 3R Program

The costs are rather obvious. Implementing the program requires a significant amount of staff time, not so much for the review sessions, but rather for the coordination and management of the process. In particular the entrepreneurs need to be stimulated to do their part and the participants in the review panel need to be coordinated.

On the positive side, in spite of marginal achievement of the overall program goals so far, each of the participating companies has received some significant benefit from the process and has recognized that benefit. To some extent, the incubator staff has gained greater facility with managing the process and has discovered ways to enhance the benefits of the program.

The Review Panel(s)

In general review meetings have been held with companies monthly during the initial three to four months, and thereafter a quarterly review schedule is adopted. The core group of reviewers has included the Incubator Director, Mike Signor (a manager from C&L), and Bill St. John, the School of Management professor in charge of the capstone accounting course. In addition a local investment banker and several other members of the Rensselaer staff and faculty have participated on occasion. So far the review meetings have gone very well, in spite of the difficulties in achieving consistent financial reporting.

After the experimental phase is completed (probably within the next six months), multiple review boards will be formed. Initially it was anticipated that most or all incubatees would eventually be included in the program. (That concept is being reconsidered given the variable responsiveness of the entrepreneurs.) If multiple review boards are created, each panel would only be expected to be responsible for one periodic half day meeting with one cohort of three to four companies.

Survey Results

In April 1992 the participating entrepreneurs were asked to fill out a survey to provide feedback on the 3R Program. The following ratings were used to indicate the value received from the 3R Program in the areas listed in the summary table on the next page:

0 Some counseling or advice was offered but had little or no impact on the entrepreneur of the business.

1 The assistance that was provided caused the entrepreneur to think through his/her performance and the performance of the company in the areas related to the help received.

2 The assistance caused the entrepreneur to make changes in the way the entrepreneur or the company performs.

3 The changes made a significant impact on the performance of the entrepreneur or their business.

Table A11.1: Survey Results Re. Evaluation of the 3R Program by the Entrepreneurs

Ratings by Company #

ACTIVITY	#1	#2	#3	#4	#5	#6	#7
FINANCIAL MANAGEMENT	2	3	2	2	1	2	0
TAX ISSUES	2	0	1	3	0	1	0
LEGAL ISSUES	0	0	0	1	0	2	0
MARKETING SALES	2	2	0	1	1	2	1
PRODUCT DEVELOPMENT	0	3	0	0	1	1	0
PEOPLE ISSUES	1	2	0	1	1	2	0
GENERAL MANAGEMENT (STRATEGIC PLANNING)	3	3	1	2	1	2	1

Notes Regarding Survey Results

1. One of the first four companies in the program never made it past the first meeting. The principals in the venture split into two companies, one for R&D and the other for all other functions, and executed a licensing agreement. Therefore they did not fill out the survey, leaving the number of responses at seven.

2. Companies #1, #2 and #3 completed their sequence of monthly meetings at the end of 1991 and had their first quarterly meeting in April 1992.

3. Company #4 came into the program two months into the first sequence as a replacement for the early dropout and continued with the monthly meetings with the second cohort of four companies.

4. Companies #5, #6 and #7 started the program in January 1992. Company #7 skipped one of the monthly meetings and indicated in the survey that it was too early to rate the value of the program because of the discontinuity in its participation.

Conclusions Regarding Survey Results

As expected, with the exception of company #7 which has not yet implemented the financial management system, all other participants recognized an impact in the area of financial management. Most encouragingly, all seven companies cited the value of counseling regarding overall management and strategic planning for their firms. In addition, six out of the seven participants specifically acknowledged the impact in the area of sales and marketing.

In addition to the opportunity to rate specific functional areas, the survey questionnaire also asked the open-ended question: "In what ways has the 3R Program been helpful to you?" With the exception of company #7, which had not yet gotten up to speed with financial accounting, all the participants cited the importance of developing an accounting system and the capacity for financial management. In addition four of the seven companies also recognized the stimulus to focus on other management issues as well.

The survey questionnaire also asked: "In what ways has it (the 3R Program) not met your expectations with respect to being helpful to you?" Two of the three firms in the first group to enter the program cited the need for continuity after transitioning from monthly to quarterly meetings. Three firms recognized shortcomings in the original version of Quicken. (None of the firms yet has experience with QuickBooks.) Finally two of the firms indicated their desire for greater appreciation for the problems of very small businesses. Responses to the final question regarding recommendations for improvements indicated a desire for even greater intensity in terms of communication, and frequency and depth of review.

Recommendations and Observations

1. Segmenting the Population of Incubatees

As the pilot phase of this program winds down, one of the fundamental questions that must be answered is whether or not all incubatees should be expected to participate in the program. On the one hand this may be the best way to move all the companies up their learning curves. This program insures at least some minimal level of interaction with all participating companies. On the other hand, what happens when a company simply doesn't do its part, or doesn't show up? The initial reaction might be that the company should be booted from the program. However, many incubators can't afford to give up companies that pay their rent, given the financial pressures on their own incubator budgets.

An alternative strategy may be to limit the program to those companies that are committed to proactive participation and that are responsive. This strategy would explicitly recognize at least two other groups of companies: those that have matured beyond this program (anchor tenants) and those that haven't yet matured with respect to capacity and willingness to respond to intervention, and who therefore do not represent an adequate potential return on the investment of time by the manager. The companies in these two groups may still be good incubator tenants and may benefit from the passive interventions related to the incubator environment without taking up a significant amount of the incubator manager's time.

2. Building Capacity for Dealing with the Nuts and Bolts of Bookkeeping

This is not as simple as it looks. In spite of multiple forms of assistance available to incubatees, it is difficult to get them to invest the time and dedicated intensity to make the bookkeeping process routine. This difficulty will likely be ameliorated as better packages emerge and as more incubatees get up to speed and become sources of peer counseling about bookkeeping and the software packages.

In some cases it may be better to push the company to engage a bookkeeper, where they can afford it. Then the entrepreneur will focus on using the results to consult with the members of the review panel about managing the business from a financial perspective.

3. Creating Multiple Advisory Panels

It seems reasonable to expect that most volunteers will not be willing or able to commit more than a half day a month to this process. Therefore recruiting enough volunteers to complement the incubator staff on the review panels becomes both a necessity and an opportunity. With respect to opportunity, if the program is well run and the entrepreneurs are responsive, then this is a very productive way to put volunteer time to good use. In most communities there will be no shortage of accountants, lawyers, bankers, consultants and successful entrepreneurs who can be recruited. The more difficult challenge is managing the logistics.

4. Pushing Companies to Create Their Own Advisory Boards

If the process works well, then the companies should be motivated to create their own advisory boards, or Boards of Directors, which can operate independently of the incubator. If this happens, then the logistical burden is removed from the incubator staff. Ideally, if the company is still in the incubator, the incubator manager may want to continue participating as a way of keeping current on the issues facing the company.

Overall Conclusion

The 3R Program, in spite of the administrative challenges it presents, has shown significant potential as a proactive intervention mechanism. If effectively implemented, it can provide:

- A means to decrease the time dedicated to less effective forms of intervention,
- A vehicle for more effective utilization of network volunteers, and
- A more effective form of direct intervention (i.e., counseling and networking) for stimulating participating companies to improve their overall management of efforts to address their own particular critical success factors.

Annex 3: Financial Plans for Early Stage Companies

www.infodev.org
www.idisc.net

Mr. Santinelli is the founder of Dakin Management, a strategy consultancy focusing on small to medium size businesses. He was previously a partner with North Bridge Venture Partners, where he began his investing career in 1998. North Bridge is a leading seed and early stage venture capital firm headquartered in Waltham, Massachusetts. His investment interests ranged from communications, wireless, software and Internet infrastructure.

Financial Plans for Early Stage Companies

Developed by Babson Professor Angelo Santinelli
January 26, 2009

Agenda

- The Background
- The Approach
- The Numbers
- The Presentation
- The Mechanics

2

The Background

- What are investors looking for?
  - Market opportunities
  - Product ideas
  - Quality management teams
  - Attractive returns on capital
- A financial plan will display this to the investors
  - Clear and concise presentation
  - Components which logically support one another
- It must convey confidence and realism
  - Pie in the sky won't sell
  - The numbers are estimates -- they will change
  - Know your details and your assumptions fully
- It must be strategically compelling and operationally achievable

3

What Investors Want To Understand from Financials

- How much cash is required to get to Cash Flow Break Even?
- Cash – to - Accomplishment Ratio
  - Cash required to get to next round of funding
  - Plan for a "step up" in valuation
- Reality Check
  - Staffing plan
  - Revenue ramp
  - Comparables
- Revenue and Cost Drivers
  - Leverage in plan
  - What can go right?
  - What can go wrong?

4

The Approach

- Fully detail all assumptions
  - Some factors will change, some will not. Need to adjust
  - Say your assumptions "out loud". Test them with your team
- Prepare a full set of financials (P&L, B/S, C/F)
  - Look two years forward, one year back
  - Prepare it by Month, Present it by Quarter and by Year
  - Resist making high level assumptions when building the plan
- Put together "The Book" and hand it out
  - Will gives investors a degree of comfort
  - A handy reference guide for management to measure progress
  - Provides structure and discipline at operating decision points
- What you have not thought of -- will emerge.
- What you have assumed -- will be magnified.

5 © Angelo Santinelli 2009

Bottoms Up and Tops Down

- Build revenues and costs from smallest units
- Determine revenue drivers
  - # of customers
  - Amount purchased
  - Pricing
  - Frequency
- Validate assumptions
- Do same for costs
- Build-Up Plan

- Find comparables in analogous industries
- Run various scenarios
- Compare common cost percentages to industry averages
- "Sniff Test"

6 © Angelo Santinelli 2009

+ The Numbers

- Income Statement
  - Orders and Revenue
    - Timing of when they begin
    - Trajectory of growth ramp
  - Cost of Revenues
    - Fixed costs
    - Variable costs
  - Operating Expenses
    - Staffing and Payroll
    - Know your company and what you need
    - Occupancy and Fixed Costs
      - Rent, Utilities, insurance, etc
      - Compliance (tax, acctg, legal)
      - Depreciation and amortization

- **Balance Sheet**
  - ***Accounts Receivable***
    - **How long to collect the cash?**
  - ***Inventory***
    - **How much in stock? Turnover?**
  - ***Accounts Payable***
    - **What can wait, what cannot?**

CASH

7

+ Balance Sheet Example

	12/31/2006	3/31/2007	6/30/2007	9/30/2007	12/31/2007
Assets					
Current Assets:					
Cash & cash equivalents	$ 11,101,167	$ 9,208,543	$ 6,610,608	$ 4,923,674	$ 4,236,005
Accounts Receivable	1,883,736	675,000	1,175,000	1,675,000	2,200,000
Inventory	185,498	109,278	167,716	239,140	239,140
Prepaid Expenses & Other assets	116,047	116,047	116,047	116,047	116,047
Total Current Assets	13,286,448	10,108,868	8,069,370	6,953,861	6,791,192
Equipment, furniture & fixtures	2,004,554	2,407,054	2,707,054	2,829,554	2,952,054
Accumulated Depreciation	(800,524)	(987,441)	(1,197,844)	(1,418,544)	(1,639,982)
Equipment, furniture & fixtures, net	1,204,030	1,419,613	1,509,210	1,411,010	1,312,072
Other Assets / Deposits	31,128	31,128	31,128	31,128	31,128
Total Assets	**$ 14,521,606**	**$ 11,559,609**	**$ 9,609,708**	**$ 8,395,999**	**$ 8,134,392**
Liabilities & Stockholders' Equity (Deficit)					
Current Liabilities:					
Accounts Payable	$ 453,214	$ 311,685	$ 281,928	$ 308,195	$ 281,648
Accrued Expenses	270,006	270,006	270,006	270,006	270,006
Accrued Compensation	213,424	213,424	213,424	213,424	213,424
Deferred revenue - Service	371,235	417,537	567,509	776,452	1,076,696
Deferred revenue - Product	874,494	411,600	692,100	972,600	1,234,200
Total Current Liabilities	**2,182,373**	**1,624,252**	**2,024,968**	**2,540,677**	**3,075,974**
Common Stock	353	353	353	353	353
Additional Paid in Capital	52,298	52,298	52,298	52,298	52,298
Preferred Equity - Series A	6,055,838	6,055,838	6,055,838	6,055,838	6,055,838
Preferred Equity - Series B	10,099,001	10,099,001	10,099,001	10,099,001	10,099,001
Preferred Equity - Series C	14,957,205	14,957,205	14,957,205	14,957,205	14,957,205
Accumulated Deficit-prior (Retained Earnings)	(10,225,445)	(18,825,461)	(18,825,461)	(18,825,461)	(18,825,461)
Accumulated Deficit-current	(8,600,017)	(2,403,876)	(4,754,492)	(6,483,911)	(7,280,815)
Total Shareholders' Equity (Deficit)	**$ 12,339,233**	**$ 9,935,357**	**$ 7,584,741**	**$ 5,855,322**	**$ 5,058,418**
Total Liabilities & Shareholders' Equity (Deficit)	**$ 14,521,606**	**$ 11,559,609**	**$ 9,609,708**	**$ 8,395,999**	**$ 8,134,392**

8

+ Income Statement Example

	2006		2007				
	Actual Q406	Actual FY'06	Plan Q107	Plan Q207	Plan Q307	Plan Q407	Plan FY'07
Bookings	1,533,000	3,607,605	1,200,000	2,200,000	3,200,000	4,400,000	11,000,000
Revenue							
Product	723,509	2,405,618	1,483,400	1,589,500	2,439,500	3,478,400	8,990,800
Maintenance	143,003	359,188	133,698	180,028	271,057	359,757	944,539
Services/Other	4,332	11,782					
Total Revenue	870,844	2,776,588	1,617,098	1,769,528	2,710,557	3,838,157	9,935,339
Cost of Goods Sold							
Product	87,661	313,565	179,711	218,556	335,431	478,280	1,211,979
Operations	64,038	181,169	65,516	65,808	66,010	65,916	263,249
Customer Support	54,153	117,607	110,926	151,105	152,191	160,862	575,084
Warranty/Other	16,911	26,489	3,075	7,153	10,978	15,653	36,859
Total COGS	227,107	655,337	359,228	442,623	564,610	720,710	2,087,171
Gross Profit	643,737	2,121,251	1,257,870	1,326,905	2,145,947	3,117,447	7,848,169
	74%	76%	78%	75%	79%	81%	79%
Operating Expenses							
Sales	961,748	2,681,451	1,181,068	1,258,787	1,344,923	1,449,556	5,234,335
Business Development			67,111	71,838	81,931	94,024	314,904
Marketing	373,773	1,227,393	371,001	280,882	371,518	278,267	1,301,667
Sales & Marketing Worldwide Total	1,335,520	3,908,845	1,619,180	1,611,507	1,798,372	1,821,848	6,850,906
Engineering	1,826,907	6,665,424	1,828,630	1,839,495	1,849,939	1,865,699	7,383,764
General & Administration	160,366	588,498	213,936	226,519	227,055	226,804	894,313
Total Operating Expenses	3,322,792	11,162,767	3,661,746	3,677,521	3,875,366	3,914,351	15,128,984
Profit(Loss) from operations	(2,679,055)	(9,041,516)	(2,403,876)	(2,350,616)	(1,729,419)	(796,904)	(7,280,815)
Other (Income) Expenses							
Interest Income	(146,978)	(445,226)					
Total Interest (Income) Expense	(146,978)	(445,226)					
Other Expenses	3,270	3,726					
Total Other (Income) Expenses	3,270	3,726					
Pretax Profit(Loss)	(2,535,347)	(8,600,017)	(2,403,876)	(2,350,616)	(1,729,419)	(796,904)	(7,280,815)
Taxes							
Net Profit(Loss)	(2,535,347)	(8,600,017)	(2,403,876)	(2,350,616)	(1,729,419)	(796,904)	(7,280,815)

9 © Angelo Santinelli 2009

+ Cash Flow Statement Example

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	FY 2008
Operating activities					
Net Income/ (Loss)	(1,680)	(1,691)	(1,438)	(1,017)	(5,826)
Depreciation and Amortization	65	74	81	91	311
(Incr)/ Decr in accounts receivable		(325)	(94)	(360)	(780)
(Incr) /Decr in inventory	(25)	(25)	(25)	(25)	(100)
(Incr)/ Decr in prepaid/other assets	(50)	(50)			(100)
Incr/ (Decr) in accounts payable	20	20	20	20	80
Incr/ (Decr) compensation accrual		47			47
Incr/ (Decr) expense accruals					
Incr/ (Decr) other liabilities	11	(6)	(6)	(6)	(6)
Cash fl ow from operations	(1,659)	(1,955)	(1,462)	(1,297)	(6,373)
Investing activities					
Acquisition of fi xed assets	(111)	(112)	(120)	(108)	(450)
(Incr)/ Decr in Other LT assets					
Net cash used in investing activites	(111)	(112)	(120)	(108)	(450)
Financing activities					
Proceeds from issuance of stock					
Net cash provided by fi nancing activites					
Net increase (decrease) in cash	(1,770)	(2,067)	(1,582)	(1,405)	(6,823)
Cash at the begining of period	5,930	4,160	2,093	512	5,930
Cash at the end of period	4,160	2,093	512	(893)	(893)
Summary Cash Burn					
Cash collections			830	1,265	2,096
Cash disbursements	(1,770)	(2,067)	(2,412)	(2,670)	(8,918)
Net cash burn	(1,770)	(2,067)	(1,582)	(1,405)	(6,823)

10 © Angelo Santinelli 2009

Staffing Plan Example

- Current Headcount
  - 34 full time employees as of December 2007
- Executive Hires planned for 2008
  - Vice President, Engineering – planned for Q1
  - Vice President, Sales – planned for Q2
  - Vice President, Marketing – planned for Q1
- Hiring Growth Will be Derived From Business Needs
  - Customer success in Q1 will dictate pace of hiring in Q2-Q4
  - Engineering current staffing sufficient to achieve 2008 product deliverables
  - Emphasis on Customer facing staff in 2008 (Sales, Marketing, Customer Service)

By Function	Actual Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008
Manufacturing	0	0	0	0	0
Worldwide Sales	2	3	5	7	8
Worldwide Marketing	0	1	2	4	5
Worldwide Customer Support	2	3	3	4	4
Product Development	26	28	28	28	28
General and Admin	4	4	4	4	4
Total Company	34	39	42	47	49

11

Building Models: Alternative Approaches

Bottom Up

- Build revenues and cost from smallest units
- Determine revenue drivers
  - # of customers
  - Amount purchased
  - Pricing
  - Frequency
- Validate assumptions
- Do same for costs
- Build-Up Plan

Top Down

- Find Comparables in analogous industries
- Run various scenarios
- Compare common cost percentages to industry averages
- "Sniff Test"

12

Managing Cash Flow

- Cash is the lifeblood for any business
- Must efficiently and effectively control activities that make and burn cash
- Activities such as:
  - Maintain optimal levels of cash
  - Collect payments quickly
  - Disburse cash slowly
  - Hire wisely - too fast and you burn too much, too slow and you hamper development and sales
  - Raise capital at best terms possible

13

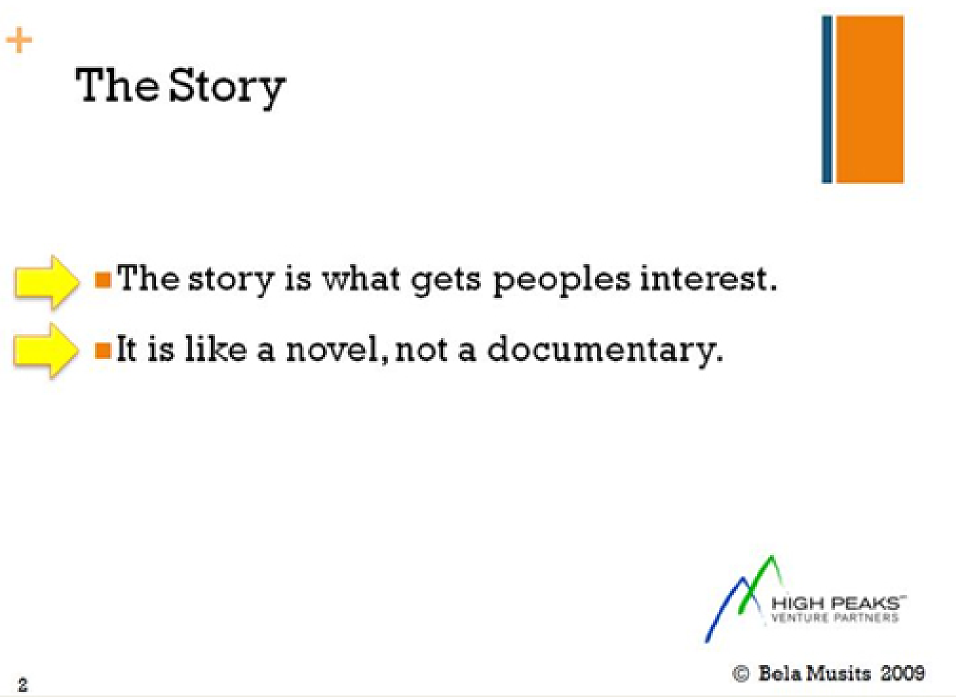
Final Thoughts

- Multiple Models and Scenarios are required
  - Three versions (Aggressive, Moderate, Conservative) is good
  - Do not present all versions – but have them ready to discuss
  - Choose the most important variables and change only them
    - Too many moving parts will add confusion, not clarity
- Be nimble
  - Long term commitments can be very costly
  - Be prepared to make course corrections when necessary
  - Always know your options and don't be afraid to act
  - Test the effects of these changes before implementing
- Communicate with your team
  - Tell them what they need to know – they can help
  - Communicate facts
  - Be judicious – too much info among employees can be disruptive
- Communicate with your Board of Directors (or Advisers)
  - Don't expect them to make operational decisions for your company
  - Communicate facts - always

14

Annex 4: The Story & the Plan


Bela Musits is Managing Director of High Peaks Ventures, and previously served as the Director of RPI's Incubator Program. Mr. Musits has founded two venture-backed companies and has held senior management and technical positions at the corporate research labs of IBM and GE. At IBM, he managed the successful spin-off of IBM technology, serving as co-founder and president of a computer-guided robotic surgery company. He raised over $17 million in capital and positioned the company for a successful IPO in 1997.
The Story & The Plan:
Or how to explain your business to your grandmother & raise money.
Developed by Bela Musits
Managing Director, High Peaks Venture Partners
HIGH PEAKS
VENTURE PARTNERS
© Bela Musits 2009


The Story
The story is what gets peoples interest.
It is like a novel, not a documentary.
HIGH PEAKS
VENTURE PARTNERS
© Bela Musits 2009
2

Elements of The Story

- The Product
  - Not the technology. (An invention does not make a company) (Without money, there is no company)
  - Not your idea.
- **But ….**
  - What are you going to put into a box at the end of the day that UPS is going to pick-up and deliver to your customer?
  - What problem are you solving for your customer?
  - Why is the customer going to buy it?

HIGH PEAKS VENTURE PARTNERS

3

Elements of The Story

- The Market
  - Not that there are 400 billion potential customers.
  - Not that you have no competition.
  - Not that you are the lowest selling price.
- **But ….**
  - What does your customer look like?
  - Who are the first 5 people you are going to call on?
  - Market dynamics
  - What is the competition going to do?

HIGH PEAKS VENTURE PARTNERS

4

Elements of The Story

- The Team
  - Not that you are smarter then everyone else.
  - Not your life history.
- **But ....**
  - What is the teams relevant experience?
  - Who is going to be king?
  - What draft picks do you need?

HIGH PEAKS™ VENTURE PARTNERS

© Bela Musits 2009

5

Elements of The Story

- The Financials
  - Not that you are going to be a $2 billion company in 5 years.
  - Not that you have better gross margins than everyone else.
  - Not that your SG&A cost are lowest in the industry.
- **But ....**
  - How fast can you really grow?
  - What are your real COGS?
  - Make it believable!

HIGH PEAKS™ VENTURE PARTNERS

© Bela Musits 2009

6

Elements of The Story

- The Financials
  - Not that you are going to be a $2 billion company in 5 years.
  - Not that you have better gross margins then everyone else.
  - Not that your SG&A cost are lowest in the industry.
- **But ....**
  - How fast can you really grow?
  - What are your real COGS?
  - Make it believable!

HIGH PEAKS™ VENTURE PARTNERS

7

Elements of The Story

- **Product or service** – Makes the sale
- **Market opportunity** – Closes the deal
- **Entrepreneurial team** – Defines the terms
- **Financials** – Maintain your credibility

HIGH PEAKS™ VENTURE PARTNERS

8

Remember

When you are raising capital, your company is your "product".

HIGH PEAKS™
VENTURE PARTNERS

9

*info*Dev
c/o the World Bank Group
1818 H Street
Washington DC 20433
USA

www.idisc.net
www.infodev.org/businessincubation

infodev@worldbank.org