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## **Analysis of Entrepreneurial Start Ups**

### **– A Perspective from an Investment Viewpoint**

This article shows, in which respect a business plan is important, what should be the content of the business plan and what else do entrepreneurs have to take into consideration when starting up a business and looking for funds.

#### **Introduction**

When analyzing, what start ups do need the most, we come pretty quick to the conclusion, that adequate funding, i.e. the raising of funds to foster the phase of the start up and the first few years, is most needed and seems to be the biggest issue for young entrepreneurs. This holds true for secondary phases of strong growth or restructuring necessities of a company as well.

The topics of creditworthiness of the company or the representatives of the company, i.e. the young entrepreneurs, as well as of the rating grade are pretty close to the thought of how to get funds. First of all those two topics have to be regarded and considered, then we can move on to the third part, and gather some advice for the appointment with the bank (or the investors).

#### **Start up or growth or restructuring: Money needed**

There can be identified three phases of business start ups, before they come into existence. The first phase is the generation of the business idea. This is a concise technical solution for an actual and/or perceived problem of consumers, that has a chance to incur some profit on a market. The scope of the problem or advantage for the consumer, the technical solution and the potential of the market do exist as a rough idea of the entrepreneurs. The first point and idea of the entrepreneurs is a clear and concise value for the customer that their product or service will render. Thinking further ahead will bring the entrepreneur to the question of the size of the potential market that will be or is intended to be attacked. If the size is deemed to be sufficient, the next analysis will

focus on the level of innovation, which ought to be on an acceptable level, i.e. on a defined higher level as existing solutions of competitors. The technical and procedural feasibility and profitability under cost and earnings calculations should be part of the first rough estimation of the business idea.

The second phase is the most important phase, because it deals with the composition of the business plan. The business plan is the instrument to precisely lay down the idea and convince possible investors to invest their money into the (risky!) enterprise of the entrepreneur. It has to be set up under thorough considerations about the future of the company as well as the market.

We can identify different occasions, various reasons, multiple addressees and some necessary content of business plans. Let us focus on the occasions first: Not only in the case of start ups, but as well when a major extension of the business, amalgamations, mergers, or resizing are intended, an amount of capital is required, that can not be funded by operative cash flow. Thus more equity and debts – in a reasonable mixture – have to be acquired. Thus we arrive at the reasons for a business plan: Venture capitalists, investors, banks, pension funds and the like have to be convinced, to put their money either as equity (e.g. during an IPO) or as loan into the enterprise. Another reason for setting up a business plan is part of the risk management an owner of a company should periodically execute: Due to a thorough and in-depth look at the company, the strengths and weaknesses as well as the outside world, that pose threats and provide opportunities, we conduct a SWOT analysis, which should be an elemental part of the strategic controlling and management of a company.

What does a good business have to present and in which form? First of all, the business plan has to be convincing, reliable and has to show the feasibility of the project. This can be reached by an outstanding clarity in terms of numbers and figures (i.e. budget plans, ROI etc.). The technical terms and description should be understandable even for lay people (as investors often are economists rather than technicians). So always keep in mind the marketing-formula “KISS” which stands for “Keep it simple and short”. By being objective in the presentation, the business plan convinces by matter-of-factness and is the optical figurehead of the project.

Especially the following aspects have to be dealt with in the description of the project, as investors do search for answers to their questions. One point is a competent and experienced management. Of course, young entrepreneurs do not have live- or business experience, but they can look for competent support, e.g. by hiring consultants or interim managers. Investors want to see a clearly describable and, if possible, quantifiable value for clients with clear ideas about the best

channels of distribution and about the current and future competition as well as about market growth. Thus a thorough market research has to be done before setting up a business plan. Taking care about the product or service: The innovative amount and the protection of the intellectual property rights have to be checked and stated in the description. A careful evaluation of strategic chances and risks with a definitive view at the potential for profit should be included in the analysis.

The required financial amount of the business has to be calculated very carefully. On the one hand the start up should not overestimate the budget, as the funds are usually very costly, as start ups bear a higher risk, thus making the investors require a higher risk premium, or higher ROI – and this is independent of the characteristic of funds, so both loans and share capital bears a higher burden. On the other hand, the funds should not be calculated to short, as impediments and unforeseen events during the first months or years of company life can make it difficult to ensure adequate liquidity and thus endanger the company. Some cash reserves should always be at hand.

Which aspects does an entrepreneur have to take into consideration? Again a thorough financial counselling is necessary. Just to highlight some important points, that are the most relevant impact factors on the required size of funds, are the branch of industry and the product (or service) that shall be offered. Production processes (duration), delivery span, terms of payment, both for receivables and payables, required stock and machinery, required personnel and overall cost of production have to be calculated or estimated in order to derive the budget.

### **Creditworthiness and Rating**

Most important for receiving the funds are several requirements. One of them has been described in the previous paragraph, i.e. a proper, plausible and consistent description of the technical and financial plan in the business plan. Of course the legal requirements, i.e. the question, which legal form the entity should have and who is the legal representative, has to be checked and clear for the start up itself as well as for the investors. The decision on this topic is from strategic importance, as it binds the company for the future life.

Much more important than the legal entity and representation is the question of creditworthiness, which has two prominent aspects: the personal and the material. The personal aspect refers to the trustworthiness of the founder or the founders of the start up. The person(s) should be trustworthy, honest, open-minded, communicative and experts in their field. If one of the founders is in charge of the technical aspects, he or she should have a technical professional background and/or some experience in this field. The partner(s) responsible for the economical

aspects of the company and start up should have some financial, marketing, HR and general management education and professional background.

The second aspect of creditworthiness, at which investors look, is the ability to pay debt and interest. This is mirrored in the so called “rating” which is a prominent feature since the Basel-II-accord came into existence in 2007. The rating is a classification of the probability of default, i.e. the non-ability to pay debt and interest, during the next financial periods. The rating is made up by various hard and soft facts. The soft facts are partly based on the personal aspects (see above), partly due to other qualitative figures and values, e.g. the risk-matrix of the start up, the ability to install and maintain early warning systems, the risk management, the position in the market etc.

The hard facts are based on the company figures, i.e. balance sheet and profit-and-loss-statement for the past (which is obviously difficult for a start up) and the budgets and plans for the next 5 years. Thus the ability to present plausible comprehensible and credible budget plans and forecasts is crucial for receiving funding from investors. Helpful in presenting a material creditworthiness is the ability to point out collaterals.

The banks or investors will use various sources of information to double-check the disclosures of the applicants. They will make use of information from the start up, internal information of the bank, especially if the entrepreneur has a record or business or private account history with that bank and finally the bank or investors will use third-party information, provided by information brokers or other banking institutions. Thus prior to applying for funds the entrepreneur should try to investigate, which information is available about himself and if it is correct and positive or if it might pose a threat in the application for funding.

In order to receive a positive rating, the entrepreneur should not only think about his project and the markets, as discussed above in relation to the presentation of his business idea within the business plan. He or she should broaden his view to the overall organizational and procedural set up of his company. A good credit record, a well defined system of controlling, reporting and information, a thorough risk-management and internal audit system should be seen as necessity, even in young and (very) small companies.

### **Advice for the appointment with bank**

As the entrepreneur wants to receive money from the bank or investor, he or she should think about the view that an investor has on the project. Thus a credit commitment is depending on

a promising and comprehensible business concept, the person of the entrepreneur, how he conducts and impresses with clarity and honesty and openness in the meeting as well as on the perspective for the investor to receive his loan back or to be able to sell equity at a later point of time and receive his investment back. In the meantime, of course, the investor expects ROI, i.e. interest in the case of loans or dividends in the case of stocks.

Usually, persons who have a thriving business idea (e.g. Bill Gates in the early 1980s, Marc Zuckerberg around the year 2000 etc.) are so called “hidden champions” before their setting up of a company. It is their own task, to make their character and competence known to the investors and convince these of the positive concept. The concept includes the focus on narrow market segments, technical excellence and a more innovative solution or technology than the competition has. Flexibility and continuity and close links to the person who set up the company and owns it are further positive aspects, that have to be communicated to the bank.

As there are often public funds and subsidies available to foster young enterprises, start ups and innovative ideas, the entrepreneur should inquire about these programmes. He should ask the bank and investor about their knowledge of those programmes, inquire himself and get counselling on this topic, as it can help ensure a good start, adequate funding and sufficient liquidity during the first few years of harsh business life.

## **Conclusions**

Entrepreneurs have to take a broad variety of business aspects into consideration in order to convince investors of their idea. The business plan is a means of communication, but not the sole one. Personal appearance, competence and a strategic way of thinking and preparation of the meeting with the investors are necessary as well.

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