Key Discussion Points – Funding entrepreneurship – Sev Vettivetpillai

I have invested in startups in Sri Lanka (MIT Millennium, Blue Waters, etc.). We now invest in more mature companies. Entrepreneurship creates growth and is the heart of an economy.

- Typical funding
    - Depends on what state of funding you are looking at
    - The most informal is (easier to raise but challenging) family and friends.
    - Crowd funding is semi-formal and is driven by technology. Also gives you early indication about your business models' fundability.
    - Triple bottom-line companies get funding from governments.
    - Bank debt
    - Equity funding

Is it free money?

- Equity is the most expensive form of money with a number of connotations. Private companies are not governed by the same rules, and ownership is bought.
- Management is more important in driving the company forward in equity companies. In private companies, it is privately help ownership without dilution.
- Equity ownership and entrepreneurs are very emotional about their companies.

Different options at different stages

Seed funding – early stages, high risk (8/10 startups fail globally) by angel investors

- Can be very demanding, involved.
- Entrepreneurship requires advice and handholding, not just money

Series A – venture capital funds to invest to optimize product and user base

- Looking for homeruns, to make up for losses in the companies that didn't excel.
- 10x to 30x return
- Doesn't exist in many parts of the world, the environment needs to be developed

Series B – VC and private equity funds invest to grow the business

- Similar to Series A
- Minimum 20% return
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Series C, D, E….

- At this stage the company has a successful track record of at least 4-5 years
- There are detailed valuations, detailed financials/projections, and exit strategies

Companies that can scale up quickly is what we are looking for when we invest.

Questions to ask potential investors:

- Can you refer me to other entrepreneurs you have worked with?
- How do you like to help your portfolio companies?
- What amount of follow-on investment do you think our company will need to succeed?
- What are your other investments in our space?

It is essential to ask these questions to ensure a good partnership. Comprehensive background checks are also very important.

Deal structuring: common terms

Preferred return, protection of valuation and position on future money

Exit rights (the venture capitals will always want an exit strategy even though entrepreneurs want to keep them around for long times).

Case studies:

Iprice Group, Malaysia received $550,000 in seed funding from Asia Venture Group in 2015 (not from our company).

- They don’t have a market yet but have a rough idea.
- Online business

Have invested $30 million into Ninja Van, Singapore

- Started in Jan 2014.
- Acquired 3000 clients across different industries by April 2016.

Swiggy, India

- No cash made, only burning money
- Investors buy on GMV. This is a bad idea but it happens.

Panel Discussion – Mr. Wijesinghe and Ms. Wijesundera, moderated by Mahendra Jayasekara

1. Providing capital, due diligence, exit strategy: You are looking for capital, what is your experience?

Lakmini: This information is not freely available here, so we also learned a lot: esp. about return expectations. We have to ask around, network to get to the sources. Opportunities come one-on-one. There are companies, but finding them is hard.

2. Making investments and exiting: is it easy?

Ranil: exit is difficult for venture capitalists. In Blue Waters, you made the investment and I did the exit strategy for you. The company was successful. But when you can't exit (because the war was on and it was not making money), you need to be careful. We spoke to many banks, exited at 21 and sold back to promoter, but it was tough. Is the institute going to lobby to return exits on capital gains?

3. How do you find the right partner, how do you maintain, how painful is the process?

Sev: finding – we have clear areas we want to invest in. if they don't fit in, there will not be any investment. We engage with the entrepreneur from the beginning, and maintain constant engagement up to 9 months. We will push on certain things to see what s/he is sensitive about. They should be testing us too but they are always careful. They don't realize that we are trying to build a strong relationship. Sometimes, at the end, the agreement is thrown away.

Lakmini – when the capital company comes and tries to put rules, it is difficult for the entrepreneur. After talking to many, we have changed the way we look at things, looking closely at the growth. Understanding is also difficult because we don't know who to ask from. But we are getting better. Some have not gone beyond the valuation because of the returns they expect. I understand their issues too, such as getting more money and justifying it to their people.

4. When you follow the process do you feel they are messy to work with?

Lakmini – It is not personal. It is numbers. We have to understand their KPIs. Maturity and knowledge missing in Sri Lanka.

5. She has low valuations. From your point of view as a CA and someone who headed a venture capital company, can valuations be driven too low?

Wholesome approach if you have professionalism. They realize the sincerity. I believe CAs should facilitate either entry or exit. If you are thorough in your research, there won't be a problem.

Something I miss out in valuations, we depend on accountants, and we have found that a valuation given in the early stage is incorrect because it is based on a theory. This was based on income-based valuation and I was given a value. Now I understand the other theories and when questioned, they said that it is not in Sri Lanka, so we did not use it, but our market is not Sri Lankan!

6. What reforms would be required in local banking (state banking) to cater to startups?

Ranel: None. I think state banks don't need to help startups.

Sev: Startups should never take debt. They are not in a position to understand their cash flow. Don't put them under time constraints. Most countries are setting up sovereign funds. Non-banking, and they provide long term capital, like in Malaysia.

7. If you look at startups in Sri Lanka, they need only a small amount, so how can they approach big companies.

Lot of banks use collateral and help companies. It is the job of SME banks, not of the state banks. They were ruined! There should be dedicated SME banks, maybe with some special benefits. There have been many people who worked with SME banks.

8. When you talk to people, he will exit in 3-5 years, and ask for big ticket size. How would you manage your funding?

Lakmini: exits are fast in our sector. Durations is thus fine. My ticket size is smaller and have successive rounds of talking to people but need to go faster. We are global, so we can achieve this, so not a problem for me. Need guidance but not a problem.

9. Talking about venture capital firms, is taxing favorable?

Sev: taxes are not a major issue, but the currency is a major issue. The depreciation against the dollar adds pressure. If SL is to get its SMEs going, it will have to raise currency. We don't put anything less than $30 million. The environment of supporting SMEs has gone.

10. Why has this environment gone?

Ranel: equity investment – there is a lot of talk about SME banking. The government made large allocations, but bad decisions were made. What is the source of funds: we raise through debentures, and need returns for it. ADB or World Bank funding to enhance SMEs offer low rates. That is a separate matter, the problem remains that there is not an adequate vessel to get this money.

11. How do you identify genuine investors? How would you select?

Lakmini: We have only approached certain types of organizations, definitely not individuals. It is hindsight anyway. We have used our own funds, bank debts, and now only am I looking for venture capital.

It is not only money you are looking at, an investor brings a lot to the table. What values do you bring to the table as a venture capital company?

Ranel: E.g.: A South African company offered first stage funding, but I was a bit apprehensive, got it checked out and declined it. We told John Keells' David Krishnan that it might affect them and thankfully we did not part with a cent. They were scams. They left the country. Be careful.

12. One aspect of startup financing is market taxing. Can you give market taxes to startups?

Sev: We have done it. When we talk to the company, we ask "why do you want us?" If you can't get a clear answer, we don't invest. What defines the relationship is what you provide to make the company grow.

13. There seems to be multiple ways to calculate a startup's value. What's your preferred method?

Ranel: business model, what are you bringing to the table. Identify the market need. It is a guessing game to value the startup.

14. When investors come, they want to see a few things: 1. corporate governance, what are your internal controls. 2. Planning your exit. 3. How do you ensure revenues don't go through the back door?

Lakmini: We are at a stage where market is proven. Vendors more mature than us but we have clear edges so we can show our value. We can show this to the investor. The problem is finding people who understand the potential growth.

Ranel: thousands of governments look into the future. I urge Abraaj to monitor, and I will help freely.

Sev: these areas are critical. Leakages are a sign of control and governance structures too. If targets are not achieved, exit. We put in controls in place, have a financial control, right to remove the CEO if he does not achieve targets. If the CEO is a major shareholder, he gets a separate agreement from the others. Be upfront, don’t sell too hard to sell quickly, the consequences will come later. Be soft. Go neutral, be balanced.