Driving growth:

How to get your early-stage business investment ready

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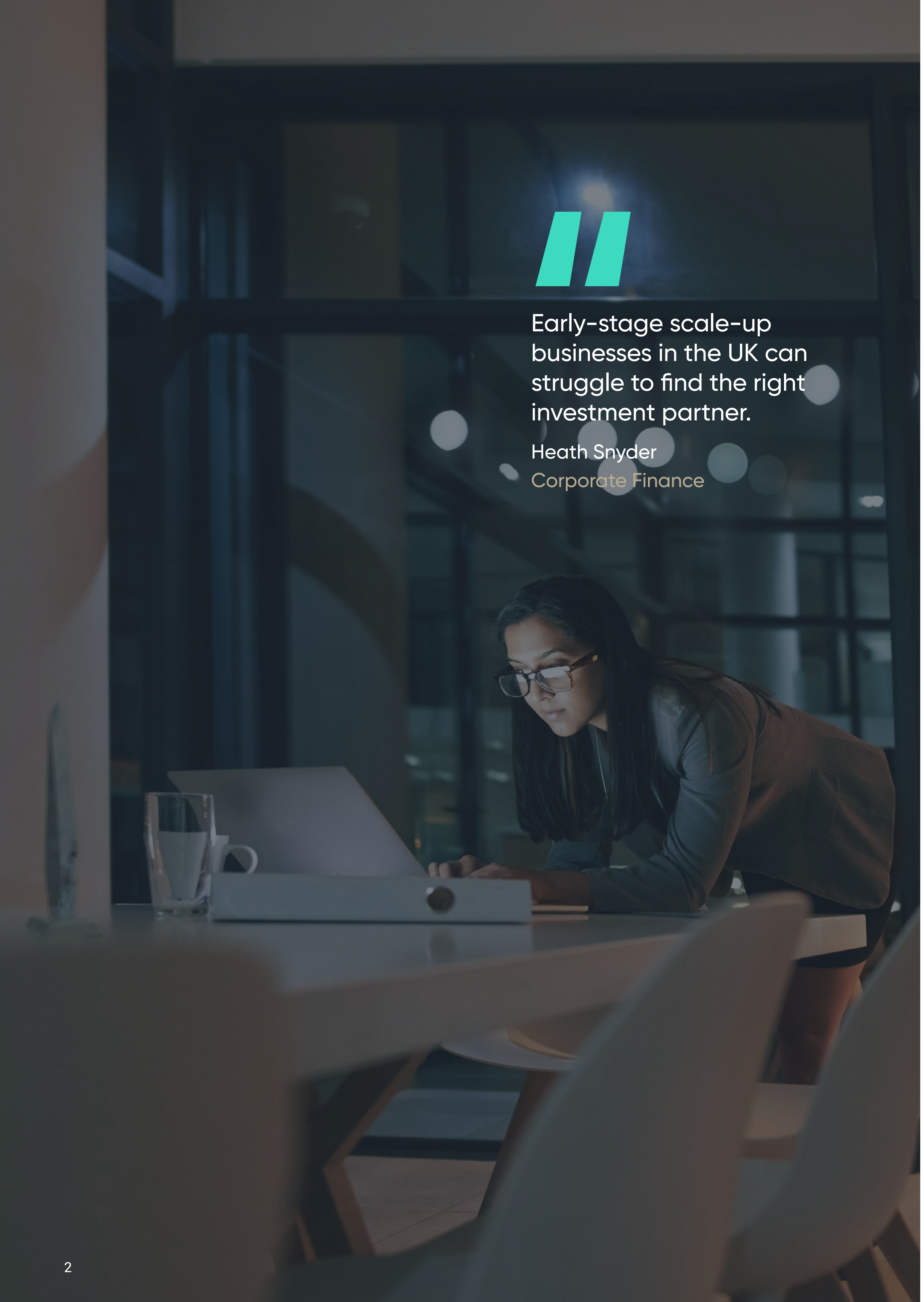

Early-stage scale-up businesses in the UK can struggle to find the right investment partner.

Heath Snyder
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Driving growth: how to get your early-stage business investment ready

Synopsis

From the onset of the pandemic, businesses across the UK have responded quickly to the COVID-19 crisis. They have continued to innovate, investing in research and development to launch new products and services; and many have collaborated with one another, often pivoting their business models to respond to changing consumer demands and to tap into new market opportunities. Businesses in tech-enabled sectors have fared well, with many recognised for their resilience and ability to disrupt entire industries for the better, while start-ups in business services have also driven growth, with sub-sectors such as logistics, warehousing and e-fulfilment benefitting from the boom in online retail.

It is these success stories that have piqued the interest of investors as businesses have become more visible, appreciated and investable. According to a report by Dealroom, northern Europe has been one of the fastest growing regions for venture capital investment in the first half of 2021, with UK businesses securing $17.1 billion of investment in the first half of the year – up 2.7x year-on-year[*1]. This clearly indicates the appetite of investors to back disruptive and innovative businesses. Yet we also know that historically early-stage, scale-up businesses in the UK have struggled to find the right investment partner and in August 2020 it was estimated that we faced a £15 billion funding gap[*2]. Within this guide, we take a closer look at the funding landscape for early-stage, scale-up businesses in the UK and share advice for those companies looking to raise external capital in order to drive growth.

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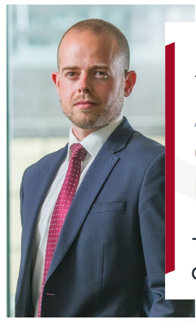

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The beginnings of an investment journey

Over the last 12 months we have witnessed a digital revolution and this has raised the profile of tech-enabled businesses well above the parapet. For many businesses, lockdowns, social distancing and the overnight switch to remote working all contributed to a rapid transition to a new digital way of life.

While this undoubtedly took time for people to adapt and get used to, it created a huge opportunity. The pandemic instigated a level of change that may have otherwise taken five to 10 years to reach, and it shone a spotlight on those businesses that were able to support and accelerate this journey.

In some sectors, innovation and collaboration were fast-tracked. Businesses are now innovating at speed, creating new products and services on a scale that's never been seen before. For example, PropTech which has utilised the introduction of the internet of things (IoT), artificial intelligence (AI) and virtual reality (VR), impacting the way in which real estate is managed.

There's also the transformation of the WorkTech sector with the increase in use of technologies such as Zoom and Microsoft Teams to support those working from home, whereas industries such as FinTech have responded to entire populations going cashless and supported an accelerated move to digital payments that could be delivered securely. The common factors within all of these industries is the advent of technology and the unprecedented pace of change.

The pandemic has truly put tech-enabled businesses in the spotlight and while it has not always been smooth sailing for all businesses, it has presented an opportunity for early-stage businesses to capitalise on investor appetite and drive growth. However, that is often easier said than done.

Many entrepreneurs are specialists by background and operate within small teams, if not alone. They have the passion and technical understanding of their operations and products, but often need a partner with the business and financial acumen to help increase bandwidth, propel their business to the next stage, and connect with a broader customer base.

This is particularly true of early-stage companies, but the funding gap in the UK means these partners can often be difficult to find. There is no central directory of investors, and with a range of options available for early-stage companies, it can often be easier to raise £10 million than it is to raise that first £1 million. This means it's vital that support is given to businesses to ensure they can find the equity to help them move from concept to commercialisation and beyond.

What does the funding journey look like?

Every business needs capital to begin operating, through the lifecycle of any organisation, its funding needs will change. Alongside this, it's likely that its investors will too.

To begin with, most start-ups are funded through personal savings and contributions from friends and family. This is often referred to as 'pre-seed' funding. It refers to the investment that is needed to get the business off the ground.

As the opportunity for the business to commercialise and scale increases, its funding requirements change. And it's here where equity funding, or seed funding, first comes into play.

A typical funding journey will demonstrate the complexity of the market – from angel investors and crowd funding through to the Enterprise Investment Scheme (EIS) and private equity investors. The pools of capital available for businesses varies depending upon the stage they are at, and while it can appear complex this can be demystified with the right advice.

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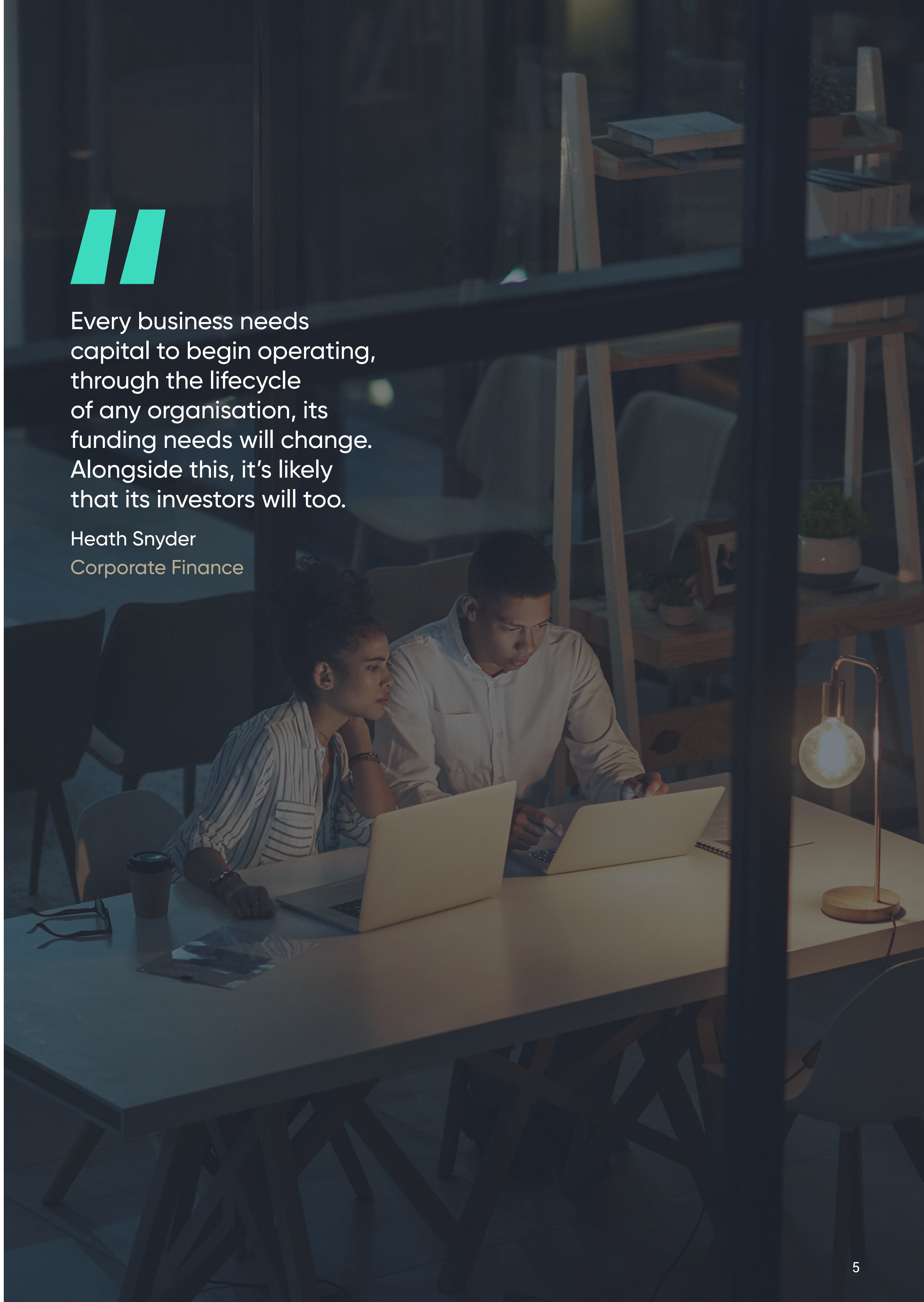

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What do investors look for?

Once it has been decided that external capital is needed to help drive the business forward, it's important to present the business as a strong investment opportunity that will ultimately deliver returns for an investment partner. To do this, it's good to know what potential investors are looking for, which includes:

1. Business proposition

Every early-stage business that is seeking external capital must have a clearly defined proposition. This is important across sectors, as being able to articulate the need for your product or service can help bring a business to life for potential investors. It's important to remember that the majority of investors will not be a specialist in your sector, so being able to communicate the problems that your product or service helps to solve is key.

2. Management team

Many investors will say the strength of the management team is the most important factor when making an investment decision, and while it is crucial, the proposition needs to be in place first. However, if the business idea is strong enough, then investors will certainly look to the management team next. They will be looking for a team of individuals that are passionate, driven and resilient. Investors will support individuals as much as they support the businesses they run, so they will want confidence that the team driving the business forward are all working towards the same goal, and remain aligned through the varying challenges they may come across.

3. Protected intellectual property

The third most important factor is to ensure that the company's intellectual property (IP) is protected. Any innovative product or service is open to imitators unless it is protected, and many larger players within the market have bigger resources and buying power to develop products at a faster pace. This puts start-ups without adequate IP protection at risk, any potential investor will want reassurance that if they back a business, the risk of a competitor encroaching on its patch is limited.

What to consider before seeking external investment

While many businesses will take an outward-looking approach to securing investment, asking important questions about what a potential investment partner will want to see from them is also important to determine personal boundaries too.

A typical investment horizon could last anywhere from one to seven years. This means it's vital that a strong working relationship, trust and chemistry is established from the outset. To lay the foundations for that, there are several questions to ask – this includes:

- Will you need to give up control of your business?
- What benefits you will gain from an investment partnership – for example, is it just an injection of capital, or is there an investor that will also provide hands-on support, operational inputs and guidance to support the growth of the company?
- What will it cost you in terms of equity dilution?
- What happens if it does not go according to plan?

It's also important to do your own due diligence. Take references, speak to the entrepreneurs and founders of other businesses your potential investment partner has backed, and ask them to share their track record in supporting companies when a business doesn't hit budget. The growth trajectory of any early-stage business is often up and down, and you may want confidence that an investor will provide follow-on funding when things don't quite go to plan.

Like any good partnership, there needs to be chemistry, so don't feel pressured to partner with the first investor that makes you an offer.

Notes

[1] Dealroom and Sifted, 2021. Startup cities in the Entrepreneurial Age. European Startups. [online] Available at: <https://dealroom.co/uploaded/2021/07/Dealroom-Sifted-Startup-cities-in-the-entrepreneurial-age.pdf?x23070> [Accessed 26 August 2021].

[2] ScaleUp Institute, Innovate Finance and Deloitte, 2020. The Future of Growth Capital. August 2020. [online] Available at: <https://secureservercdn.net/160.153.138.71/g8r.bcb.myftpupload.com/wp-content/uploads/2020/08/The-Future-of-Growth-Capital-August-2020-1-1.pdf> [Accessed 22 June 2021].

What to share when pitching

Many entrepreneurs have visions of Dragon's Den when the conversation turns to pitching for investment, but there are a number of ground rules you should follow to ensure you put your best foot forward:

1. Convert your vision into an execution plan

Translate your vision and strategy into a tangible business plan. Ensure this is forward-looking and spans the next two to three years, support it with forecasts that demonstrate what funding is needed and where. This will also help you to articulate the amount of funding you're asking for.

2. Quantify where the investment will be spent

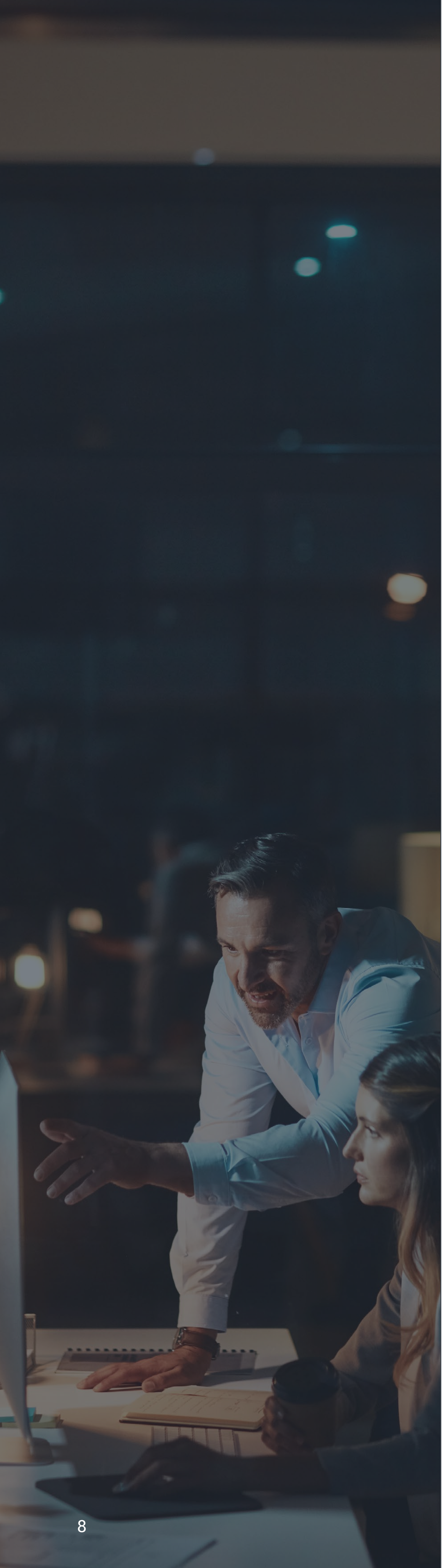
Investors will want to know where their money is going. For example, is it to support expansion into new markets, to invest in research and development, will it fund losses, is it a requirement for working capital? There are many things investment can be used for but, without a business model that helps you to articulate where that capital will go, it may be hard to get an investment partner on board.

3. Route to market

For many businesses there isn't always a straightforward route to market. If you will need the support of a distribution partner to ensure your product or service can reach the consumer, ensure they're on board first. And if not, ensure you have a clear roadmap in your plan.

4. Multi-disciplinary team

While it's vital to put your best team forward, we would recommend limiting the pitch team to no more than three people to keep the pitch as focused as possible. Alongside the founders of the business, you'll want to make sure you have someone on hand who knows the numbers inside out. This is even more crucial for early-stage companies as investors are more trusting of individuals who they are confident will manage their money carefully.



Conclusion

There is no doubt that certain sectors of the UK economy are thriving, but there still remains significant untapped potential among the UK's early-stage businesses. With the right investment and support, these businesses will be prepared to drive growth and create jobs, helping the UK to build back better post-COVID.

For those entrepreneurs and business leaders in need of capital to drive growth, it's important to remember that investment is available and with the right support it can be unlocked – and ultimately help you to take that next step on your growth journey.

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