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# Financing and support for start-up companies

Riga 15.9.2010



Part-financed by the European Union  
(European Regional Development Fund)



## TTM Topics

- What is business incubation in general?
  - Differences concerning incubation and acceleration services?
- Short view about global examples of business incubation processes
  - Role of public and private actors in different phases
  - Service models and good practices within BDO's
- Private incubation (acceleration) model
  - Examples and obstacles to create sustainable business development
- Good growth company in the eyes of seed capital fund
  - What elements should be ready for company to succeed?
- How current BDO services match with the need of companies who look investment money?
  - Discussion based on two case company needs
- Risk management tool as a one solution to ease up the work

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## TODAY FOCUS IS

~~Lectures!~~

~~Need to push and learn some one way of doing supporting and financing activities~~

## Active discussion Sharing experiences and knowledge

Looking roles and aspects that can be take in to  
account in our own region

Possibilities for joint activities within Baltic region

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## Focusing on most potential startup cases or supporting all SMEs?

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Heinz Fiedler  
President of SPICE group



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# HEINZ FIEDLERIN KALVOSETTI

## Global experience?

- Is there still a need for business incubation?
- How does Business incubators differs in different countries or metropolitan vs. rural areas?
  - Level of targeted companies (Gazelle vs. local micro company)
  - Business segment of targeted companies
  - Period of incubation time (When to let go?)
  - Service models to select and develop companies
- Role of public and/or private actors in different areas
  - What is the level of Critical mass for private actors to participate
- Obstacles concerning starting new business incubation activities or modifying existing based on the needs
  - Typical ways of starting new activities
  - Need of cooperation between different actors?

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# Focus in terms of activities

## Deal Flow activation

How to encourage innovation? How to find good business cases? Which are target groups?

## Pre-Incubation activities

What is the requested level for company to participate? Where to focus? Who carry the risks? What should be the time frame of these activities?

## Incubation (acceleration) activities

How to select companies? Key elements in incubation process? How keen the BDO should guide the process? Using independent experts with high knowledge in narrow segment or general business experts (organizations) who can manage and see the whole entity?

## Role of public and private actors

Where should different type of organizations focus? What should be the level of cooperation? How BDO's can encourage the private actors to participate incubation activities? What are the obstacles that comes when cooperating with commercial business incubators

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# Generating income – how to run an incubator like a business?

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Pekka Jussila

CEO Hermia Business Development Ltd

## What is happening?

- New businesses are more and more complex and it is more hard to create new growth businesses
  - Market is hard and competition is also very tough
  - New companies need more work and more services
- At the same time there is bad economic situation, cities and areas have not so much funds to invest and EU-funds are also limited
- Private market can not take risk too much
- To make results, it should be combination of public funds and private funds that is needed
  - All the available money should be gathered together to serve new businesses and new jobs

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## Obstacles for sustainable service

- There are many concepts in service business, that are only funded with public projects
  - Sometimes there is no projects, when one is ended and an other one is not started yet, but companies need services all the time
- There are private businesses with good performance
  - start up companies do not have money to buy services
  - private actors can not afford to take too much risks to do activities without decent payments
- It seems to be difficult to work together for public business development and public business development systems.
  - Why? It should be good cooperation?

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## Joint funding should be possible

- In seed capital phase there are often good cooperation between public funding and private funds.
  - Private funding and know how is needed to get public money
  - BDO's see this securing the next round funding and access to market
- This system and cooperation should be working also on earlier actions and services
  - Deal flow activation – pre-incubation – incubation – acceleration
- Very good results has achieved when public actors has used in right way private cooperation partners. And when public actors has been good and clever buyers!
  - continues process secures smooth development
  - commitment is bigger which help achieve goals
  - better understanding of company state helps avoid risks

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## Market is missing

- There is need of private money in business development system. Problem is, that there is no real market in many places which prevents the activities
  - For example in Finland there is closed (no) market, where are mainly public funded public organizations doing free of charge services to companies.
- If we need more actions, results and jobs, we need to open real market in this phase of innovation system.
- There should be a market place, where best available skills would work, where private money is flowing and where it is possible to make also profits if one makes results.
  - In order to take risk, private actors and investors should need also opportunity to make money (or other profit)

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## HBD combined activities

- Fully public operations are run based on contracts and ethic rules
  - E.g. pre-incubation project activities
  - Clear and openly discussed line between public and commercial services
- As a private company HBD has possibilities to take risk concerning its consultative operations (Key element in acceleration activities)
  - E.g. shares if company don't have resources to buy services
- Selling services to successful clients afterwards opens markets to normal business consulting and gives possibility to make profits
  - Focus on selling RTD planning, business strategy and financing consultancy to SME's
  - Companies and/or entrepreneurs may found public funding to these activities
- EU projects helps to keep up information and networks, develop tools to BDO activities and serve client companies purposes
  - Give some basic funding to operate with fixed means

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## Need to change

- We need models, where money put into company or innovation system could come back to the innovation system
  - Success based loans, other type of investments?
- Services for entrepreneurs should be offered mainly by entrepreneurs but financed from different sources, also from public sources.
  - More effectiveness and work is needed, less theatral actions
  - At the early stage it is better when someone is helping hand-in-hand the company as whole, rather than using several experts with small and limited services
- Public actors should control the market and there should be ethical rules for private companies activities
- Ownership and seed capital is one important tools and assets to make things happen

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## Need to change

- In order to use maximum resources business development organization should be able to use many kinds of cash flow sources
  - Secure BDO own development and investment
  - Helps diminish the effect of being “bank”, because project funding is coming mostly afterwards
- Some good practices has been private driven actors in incubation business, when one have combined cash flows
  - public (national or EU) project activities
  - selling market based services and consultancy
  - investing into new companies
  - managed seed fund and offering space for companies.
- It means that one should be flexible to find every time all available resources of money to survive and be effective all the time

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## Perfect startup in the eyes of seed phase fund

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Pekka Jussila  
Hermia Ventures Ltd

# Start-Up Funding

- Companies are looking growth that requires decent resources
- Activities are funded mostly by entrepreneur own investments, loans, public RTD funding instruments ,private investments and some cases with early stages incomes
  - Typically the package contain all of these types of funding elements,
  - requires good communication and reasonable time to organize this
- Funding helps company to succeed it development quickly, with better quality and it gives possibility for company management to focus its real development activities
  - "Time to market – time to money" is essential
- Beside funding Start-Up's need constant business knowledge and guidance

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# Seed capitals vs VC actor

- Seed capitalist is normally ready to do some development work, is active owner and takes often minority of shares
  - VC's looks many times majority of the shares, own management and synergy with other portfolio companies (looking for fusions)
- SC advices and guides with processes and often open networks and channels
  - Help company to succeed in short term goals and find next round funds
- Seed capital goal is to target more companies with reasonable risks
  - Sharing risks with investing together with others investors or business angels in part of larger monetary package
  - Seed capital try to start "snowball" effect by making first positive decision
- Management of SC suits well for business incubators or Development companies
  - They have understanding, networks and resources to develop companies
  - Based on earlier activities they may have good understanding about the company potential and risks → Evaluation process already done

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## Investor objectives

- All funding organizations are looking growth for their investments
  - Basic idea is that value of the shares and investment should be after 5 years 6 times more. And success rate up to 40 %
    - There should be also somebody, who would like to buy those shares – EXIT plan
  - If price of the company in the first place is too high, company is not interesting - Valuation and dilution levels are essential
- Investors are handling hundreds of cases yearly and competition about funding is big. It is very important, that:
  - cases are well documented with clear ideas and messages, so that it is easy to analyze and handle
  - cases are presented to right investors, who has:
    - understanding about the business to develop it further
    - interest based on its portfolio to strengthen these type of companies
    - capabilities to invest in this company development phase

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## Companies are evaluated by

- Novelty
  - Is this solution new? IPR novelty, market novelty?
- Competitive edges
  - What issues make this to be better for customers
  - Is there real demand? What customers say?
- Markets
  - Is there market big enough?
  - Who are competitors? How new co will beat them?
- Team and resources
  - Can this team make things happen?
  - What kind of resources are needed to reach targets? Is it possible in practice to gather those resources?
  - Does the team understand how making business?
- Risks
  - What are main risks? What are weaknesses and strong points?
  - How realistic plans and calculations are?

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## Perfect case

- **Team that has previous common activities and both business and technology based experience**
- **Team is taking risk by themselves**
- **Products and services are solving real and important client problems**
- **Focused business segment - First clients are already known**
- **Technology or service model is suitable also to other business**
- **Product life cycle is long**
- **Time to market is short – No long RTD phase**
- **Development is possible to divide smaller pieces and share the risks**
- **Exit can be done within few years by many ways**
- **Valuation is reasonable**
- **Facts are secured by external and neutral experts or surveys**

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## Perfect case

- In the end the main focus is that there is understandable business idea, clear road map to develop the company and plans are well communicated

*“When talking with entrepreneurs, do I FEEL, that those people are trustful and capable to solve tasks and can they communicate with investor and do they accept reporting and steering wanted by investors?”*

- Some times confidence and feelings overrule the facts – investor is still humane

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## How to discuss your business

- Understand the value of the business for the funder
  - Looking how investor can succeed by investing our company
  - Have a clear estimation of the company value before investment and arguments to defend it
- Determine the roles that they are expecting from SC/VC/BA actor
  - Participation of board or operative management
  - Contacts to clients/cooperation companies/other
- Remember to focus your competitive advantages and your activities how you can ensure that competitiveness
- Show that you know also the risks and you have means to control them
- Be open! Show how you are willing to take the risk make this business success story.

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## Case examples

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## Case 1

- The technology uniqueness is still open question. More detailed facts has to be gathered. What may be the situation e.g. in 2015?
  - Money to buy expert services and surveys
- Focus is too big. Needs new strategic approach to first activities.
  - Strategic consultancy with expert
- Time to positive cash flow is unclear. Time to market is long (>2 years). Risks are really high. Can the company with the help of seed fund get results that secure the real investments?
  - Public RTD funding to cover development risks
  - Company valuation and exit strategy consultancy
- The jump from Latvian market to EU level seems very big and funding resources may become obstacle. Is there a strategy for back wall of investments? What is combination of other funding elements?
  - Risk management and strategic consultancy
- Juridical risks are high.
  - Operations takes money. Is there connections to high knowledge global expert?

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## Case 2

- En tiiä mitä sanoa. Yritys aika hyvin valmistautuneen näköinen. Isoimmat ongelmat
  - Markkinointi ja brändin rakentaminen
    - Erottuminen isosta massasta
    - Suhteellisen kapea tuoteperhe tällä hetkellä
  - Kosmetiikka-alan edellyttämät hyväksynnät?
  - Tuotannon ja jakelun selvittäminen
  - Go-To-Market suunnitelmat
- Voisi kysyä yritykseltä itseltään, mitkä ovat olleet keskeisiä ongelmia ja oliko niihin palveluita saatavilla

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## Case 2

- Companies business model and structure looks ok. Based on this the problems are lying
  - Marketing and building the brand
    - How to differ competitor
    - Current product portfolio is limited
  - Regulations in cosmetic industries?
  - Production capabilities
  - Distribution channels and how they will effect business model and activities
    - E.g. own sales is competing with retail market activities
  - Go-To-Market plans
- What company think are/were the key obstacles?

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## Current BDO services

- Does our current services match to the need?
  - What services in general all well organized?
  - What services are existing but the level of deepness is too low?
  - Where are the biggest problems and black spots?
- Whose responsibility is to develop these missing services or the deeper level of activity?
  - public or private
- What are the public and BDO means to establish these activities?
  - Resources to private BDO's for development these activities
  - Supporting more focused and prioritized service providers
  - Bonus based success fees
  - project based actions...?
- How Seed Fund see these opinions?
  - How much risk they are willing to take
  - What should be the role of public funding

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# Risk management tool to help evaluation and management

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## Key problems in start-up funding

Too few companies get investment

- Lack of private seed funding and number of funding organizations
  - VC actors don't have resources or business model to evaluate and manage seed phase companies
  - Business Angels based their activities with own experience and don't have effective tools to evaluate companies
- Evaluation takes lots of time and resources
  - start-up companies has to show their cases with numerous investors who has their own interest and evaluation criteria's
- Goals for public and private money may differ and communication between different shareholders is essential

Success rates are low

- Re-use of information that is collected during evaluation is low
  - Due diligence is not used after investment
  - Information collected for RTD or other business funding serves the public need but not the company needs
- Communication to shareholders of business risks is not formulated
- The knowledge of business risks (business understanding) doesn't flow quick enough to entrepreneurs
  - Focusing only viable risks and problems that are already existing

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## Success elements of the tool

- Quick evaluation & decision making process
  - Concentrating right issues to see the real value and challenges
  - Based on the real problems that companies in this phase has had
- Tools for monitoring and self-reporting
  - Concentrating right issues
  - Constant development of risk issues
- Similar decision methods and better learning curve
  - Smoother process for SC actors to make decisions
  - Tool not just help SC/BA actors but also entrepreneurs
- Better communication
  - No miss-information, on null-information
  - Commitment of different parties

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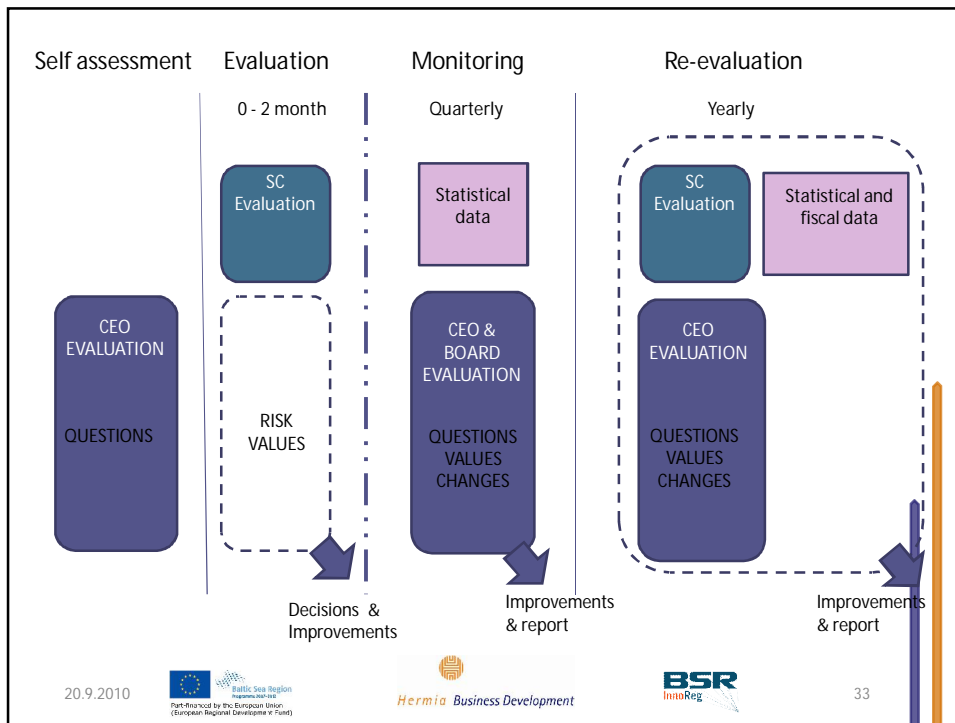
## Risk Tool

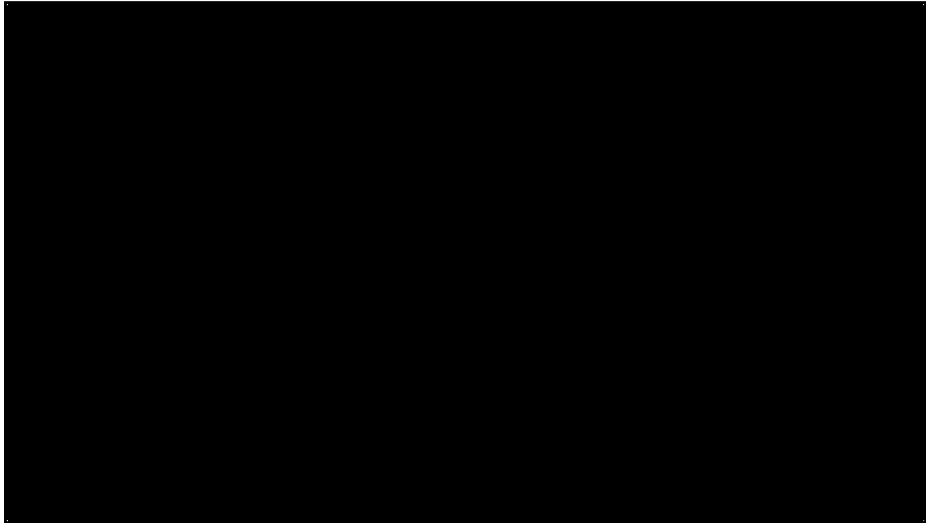
- Combination of
  - known start-up phase risks
  - methodology to use it in evaluation and development phases
  - FMEA basic structure
- Risks are collected with failure cases and those determine the basics for which companies has to answer
  - Company specialized risks can be added to the table
- Risks are given values that helps to prioritize activities with most crucial ones
  - Severity, Probability, Detection
- Every risk will be written corrective actions and also B-plans
- State of the risks are followed and those create one basic element that can be reported to other stakeholders.
  - Changes are most important

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## Future activities

- The development of the tool is still ongoing
- Next phase will be pilot actions in real cases
  - Should risks divide in smaller level
  - Determine the best and typical indicators
  - Concretize the corrective actions to create good collection for companies to take some of those in use
    - Possibilities to link some of those already existing services or portals
- Focus the usability of the tool to ensure companies and investors are able and willing to use it
  - Focus right issues, not create more bureaucracy
  - Create simple means to report changes and risk state better
- Look BDO's and investor to use the tool

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## Conclusions and Feedback

