Investor Readiness in the Western Balkans: challenges, opportunities and practical experiences.

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1 What is investment readiness?

Innovative companies frequently face challenges when raising external funding because, among other factors, they are not considered to be 'investor-ready'.

Investment readiness can be defined as the set of characteristics that an investee should have to become an appropriate funding opportunity (Gregory et al., 2012). Solid investment propositions should include at least a Minimal Viable Product (MVP) with a strong competitive advantage, commercial traction in a big and growing market, a validated business model, and a credible and experienced team leading the project.

Investors are commonly interested in projects that meet the above requirements, although their notion of investment readiness may differ, depending on their own priorities, interests, investment strategies, risk perception and tolerance. Likewise different types of investors will be drawn by diverse or additional attributes when analysing an investment opportunity.

Angel or seed investors participate in businesses that are early-stage and in pre-revenue with very little or no customers. Such businesses could have a well-developed business plan, prototype, a MVP, or similar level of development. Some of the businesses, however, may have revenue or even cash flow.

Venture capital (VC) firms typically invest in businesses that have an established revenue model, or at least a good and rapidly growing customer base with a clear revenue strategy.

Private equity (PE) firms tend to invest on businesses that have profitable margins and stable cash flow.

VC usually seeks a high return on investment and a clear exit strategy, corporate investors look for opportunities that fit into their existing product portfolio or research strategy, business angels are inclined to invest in sectors which they are familiar with, whereas institutional funders are driven by public policy objectives. In Table 1 is presented a summary of the investors categories that have been discussed.
There are several factors that contribute to the lack of investment readiness which include the resistance of entrepreneurs to transfer ownership and company control to investors, insufficient knowledge on the entrepreneur side on available financial instruments, little understanding of what investors are looking for when considering an investment, different company valuation estimates between the entrepreneur and investors, and finally low appeal of business proposals from an investment perspective and shortcomings in business plans or pitches (Mason and Kwok, 2010).

In order to increase the likelihood of achieving a successful fundraising goal, it is key to build a strong business case which is aligned with the investors' preferences and goals.
2. What does it take to be investment ready?

Being investment ready is in general about assuring that the needs and expectations of target investors are met (Mason and Kwok, 2010). It is the task of the business to demonstrate that it has:

- The key drivers of business success in its specific technical and market segment.
- A solid and as much as possible validated route to generating financial returns in a reasonable timeframe.
- An understanding of interests, values and expectations of the potential investor.

The investor proposal or memorandum is the instrument that outlines the plan that will stand up to investor scrutiny. Investment proposals must clearly demonstrate the key milestones the money will enable, the viability and certainty of debt repayments or a return yielded to an equity investor. Investees need to cover financial modelling (in dependence also of the stage, early seed is different than scale up) and detailed market research in order to be attractive. Finally, they need to be able to communicate the business opportunity adequately.

An investor readiness checklist

This list provides some basic indication on the information that most investors will look for during their due diligence process. It has to be kept in mind that companies at different stage of investment may or may not have all the information in the list, and that the due diligence process can be quite different for an early stage investment with respect to a well-established startup. Finally consider that each investor in general has developed its own due diligence process so the list below should be viewed as a guideline.

a. The Pitch and the Deal

The pitch quality and the proposed deal structure play a key role on a successful investment. There is a vast literature on how to structure an investor pitch, see for an example (Griffit, 2017). In creating the pitch, particular emphasis needs to be put on describing clearly the company milestones, one or more potential exit strategies, the growth plan and use of investment, and there should be a clear acknowledgement of potential risks and their mitigation, especially in operating environment. Details of protection of intellectual property are very important as they constitute nowadays a relevant company asset.

b. Market and Business Planning

A completed business plan is needed in particular for companies in advanced stage of investment. For early stage businesses is less critical even if still very important, and it is often considered more as a good exercise that the business has done in order to explore the potential of the innovation proposed, than the plan that will be implemented in practice. It should include a pricing strategy if possible, a Unique Selling Proposition (USP) and a list of key reliable partners. Other key elements are: distribution channels appropriate to market, solid sales force or sales strategy, and a strategic planning process in place.

c. Financial Reporting

A financial model with at least three years of projections is in order. If the business has been active for a given amount of time it is important to present audited financial statements for the past years. In case of seeking equity, a realistic company valuation is
very relevant for the negotiations. Similarly information on burn rate calculation, limited debts or debt/equity ratio, accounting policies, last two year budgets, and detailed information on the cash flow is important.

d. Operational Reporting
Information on turnover rate, segregation of responsibilities related to accounting and finance, protections against fraud and misconduct, inventory turnover, human resources plan and policies, and a good track record are all relevant for the characterisation of the business and to boost investor confidence.

e. Good Governance
Information about the company constitution, its Board of Directors, showing that it has the right mix of people, skills and abilities to develop the organisation and that is operating well (i.e. read the reports, contribute in the proper role to the health of the company, etc.) is very relevant.

3. Boosting investment readiness

To overcome potential mismatches between investees and investors' expectations and maximise the chances of a successful investment round, several recommendations are detailed below:

- Capacity building is needed to upskill entrepreneurs on investment readiness, providing practical training programmes to enhance the quality of investment propositions and make them fit for purpose regarding different types of investors' requirements and geographical nuances.
- Mentoring and coaching activities are also recommendable as they provide bespoke support to investees further to the training programmes. Qualified mentors can add valuable input to investment proposals besides sharing their networks within the investor communities with the entrepreneurs.
- Institutional commitment is key and government bodies, public organisations, universities and research centres should be actively involved and assist the fundraising process, providing support with business planning, financial tools, preparation of investment proposals, investor coordination, and deal access.
- It is also desirable to advise investors on the peculiarities of technology-based projects to support better informed decision making, as very frequently they are unfamiliar with this landscape (these business opportunities are normally characterised by intangible assets, long development phases, high risk, lack of revenues in the first years of operations, and consequently absence of returns in the short and even medium term).

Along with the implementation of these recommendations it is equally important to put into effect a set of performance measurements and evaluation systems that will allow the assessment of the outcomes, as well as their economic and social impact in the innovation ecosystem.
4. Practical experiences in the Western Balkans

4.1 Context in the Western Balkans

The innovation performance of the Western Balkans has been steadily growing over the past years, although the region still presents some challenges as a low patent intensity and a lack of R&D activity in the private sector. Hence the development of institutional capacity and frameworks, the strengthening of innovation communities and systems, and the support of innovative projects would significantly assist the economic transformation of the region (Matusiak & Kleibrink, 2018).

The European Commission’s Joint Research Centre (JRC) is currently providing assistance to an Innovation Agenda for the Western Balkans in cooperation with the Directorate-General for Neighbourhood and Enlargement Negotiations (DG NEAR), specifically with its Smart Specialisation Platform (S3P) and the project "Technology Transfer Capacity Building in the Western Balkans" (EU4TECH).

These recent capacity building activities are having a significant impact on the innovation ecosystem, as they are allowing numerous creative projects to benefit from bespoke support processes while enabling the region to keep up at the competitive pace of the EU.

In 2015 an extensive 5-country Randomized Controlled Trial (v.v.a.a., 2015) was run by the World Bank and used to test the effectiveness of investor readiness programmes. 346 firms were divided into two groups: a treatment group that received a high-cost and intensive programme that involved help developing their financial plans, product pitch, market strategy, and willingness to take on equity, and a control group which received access to an online-only basic investment readiness course. At the end of the programme, both groups of firms competed in a pitch event where they were scored by independent judges on their investment readiness. The study that was completed in 2017 showed the effectiveness of investor readiness programmes.

4.2 Investor readiness programme of EU4TECH

The Instrument for Pre-accession Assistance (IPA) funded EU4TECH Project is focusing on capacity building on several dimensions that span from technology transfer to investor readiness (more detail can be found on www.eu4tech.eu). In this paper for sake of brevity we will focus just on the last component.

As part of EU4TECH a six weeks investor readiness programme was designed and articulated according to the following phases:

- Scouting for innovative projects, startups and SMEs that needed support on investor readiness.
- Selecting a subset of the applicants on the basis of specific criteria.
- Structuring an intense programme defined on the characteristics of the selected applicants, focused to bring concrete results and tools and to bring them to an acceptable investor readiness level in a relatively short period of time.
- Organising an Investor forum event in the region with the participation of local and international investors and experts, so that they could put in action what they learned during the intense training and make practical use of the developed tools, and finally confront themselves with the investor community.
A total of 125 projects were submitted via an online application form developed by the EU4TECH project. Some statistics are shown in Figure 1.

Figure 1. Top: geographical distribution of the applicants. Bottom right: Male vs Female Leader distribution. Bottom Left: Legally incorporated vs non-incorporated applicants.

As it can be noted Serbia had a large contribution of submitted projects followed by Former Yugoslavia Republic of Macedonia (FYROM), Bosnia and Herzegovina, Kosovo, Albania and Montenegro. It also can be seen from Figure 1 that there was a significative female presence of project leaders.

1 This designation is without prejudice to positions on status and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.
Great part of the applicants, as shown in Figure 2, were in the startup phase, prior revenue generation. The application form that was developed for the programme addressed the assessment of investor readiness and the state of the applicants, to better target the coaching format and content.

In particular the analytics of Figure 3 underlined the very early level of the investor readiness of the applicants. Note the almost uniform distribution of the different stages of sourcing funding that was expected, given the clear dominance of early stage startups among the applicants.

On that basis it was decided to structure a programme differentiated for early stage projects/startups, projects that were already running operations, and finally for SMEs and startups that were in the scale-up phase. A total of 35 projects were selected.

The programme was designed with a holistic and lean approach and focus was put on three specific tools: business model canvas review (mainly for early stage and running operations teams), the development or refinement of an investor pitch, and an investor proposal. For the investor proposal three different templates were used: one focused on early stage, the second on initial revenue generation startups, and a more articulated one for startups/SMEs in the scaling up phase. International experts where involved with specific competences in the three stages of the businesses and on investor readiness. Four events were organised during the coaching period:

- Event on **Investor Memorandum in Belgrade**: the event consisted of presentations in the morning and workgroup activity on the draft investor proposal of each project in the afternoon.
- Event on **Crowdfunding in Pristina**: the event included presentations in the morning and workgroup activity in the afternoon specific to crowdfunding.
• **Pitch Training event in Belgrade**: five international experts were involved. The event consisted of an interactive workshop in the morning on pitching and work group activity practising their pitch with mentors in the afternoon.

• **Investor Forum in Belgrade**: the selected applicants pitched in front of an audience of international business angels, early stage and VC investors and experts.

Investors were involved as early as possible in the programme so that they could become familiar with the different projects and teams and maximise the impact and the success of the programme. The investor forum event was structured in two parts. The first one focused on a 6-minute investor pitch based on the work conducted during the programme, and a second section where the individual startups/SMEs could meet by means of pre-scheduled meetings face to face with interested investors. A specific match-making platform was setup for this purpose.

![Meetings](image)

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</tbody>
</table>

*Figure 4: Face to face meetings with investors during the Investor Forum day.*

A total of 82 meetings were requested for 26 investors, and 34 were successfully completed in a single day as can be seen in Figure 4.

The feedback received by both investors and startups/SMEs was very positive and underlined the efficacy of the 'lean' essential approach of the programme, which focused on refining the essential tools needed to improve the investor readiness of the programme's participants, using a very streamlined process to reach the goal.
5. Conclusions

One of the key issues in access to finance for startups and SMEs is not necessarily the lack of financial instruments or private capital, but more often is the poor knowledge of the financial instruments available and how they can be effectively used, the gap in terms of appeal of the business proposals, and the mismatch on the expectations of the investors. Investment readiness coaching thus plays a paramount role to fill this gap. In particular in this paper, we have presented the very experience of the EU4TECH project and its lean and holistic approach on investor readiness providing tools, coaching and the opportunity to use them in practice. While the project is still ongoing and thus it is too early to draw conclusions, initial feedback has been very positive and given clear indications on how to maximise the impact of future activities of the project in the region.
References


List of abbreviations and definitions

EU European Union

R&D Research and development
JRC Mission

As the science and knowledge service of the European Commission, the Joint Research Centre’s mission is to support EU policies with independent evidence throughout the whole policy cycle.

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