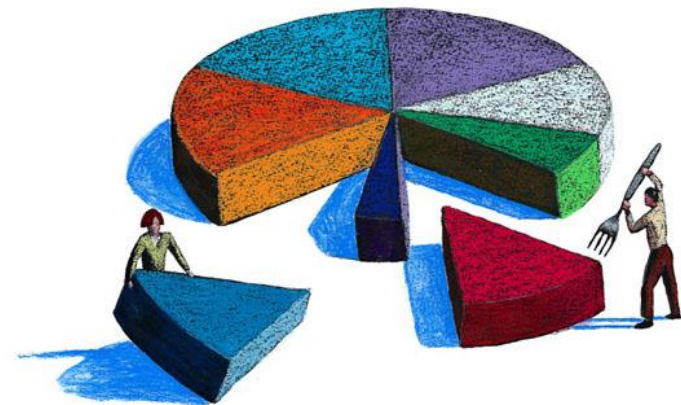


Presented by: Mr. Thian Chew

Venue: HKICPA, 27/F, Wu Chung House, 213 Queen's Road East, Wanchai

Date: 12 October 2018

Start-up and Venture Capital: Challenges for Investors and Companies



Hong Kong Institute of
Certified Public Accountants
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STARTUP AND VC'S: CHALLENGES FOR INVESTORS AND ENTREPRENEURS

Thian Chew

Managing Partner, Polar Ventures

October 2018



Thian Chew

Professional Experience

- Managing Partner at **Polar Ventures** (Hong Kong): Private equity firm focusing on small-medium sized enterprises in Asia
- Executive Director at **Goldman Sachs** (Hong Kong, New York): Proprietary investments in growth capital, distressed and special situations
- Consultant Project Manager at **Morgan Stanley** (New York): Strategic Services Group
- Director at **KPMG Consulting** (Singapore, Sydney): Managing large-scale operational restructuring, post-merger integration and business performance improvement programs
- Senior Manager at **KPMG** (Taipei, Melbourne): Business process re-engineering, performing financial and information technology audit and assurance

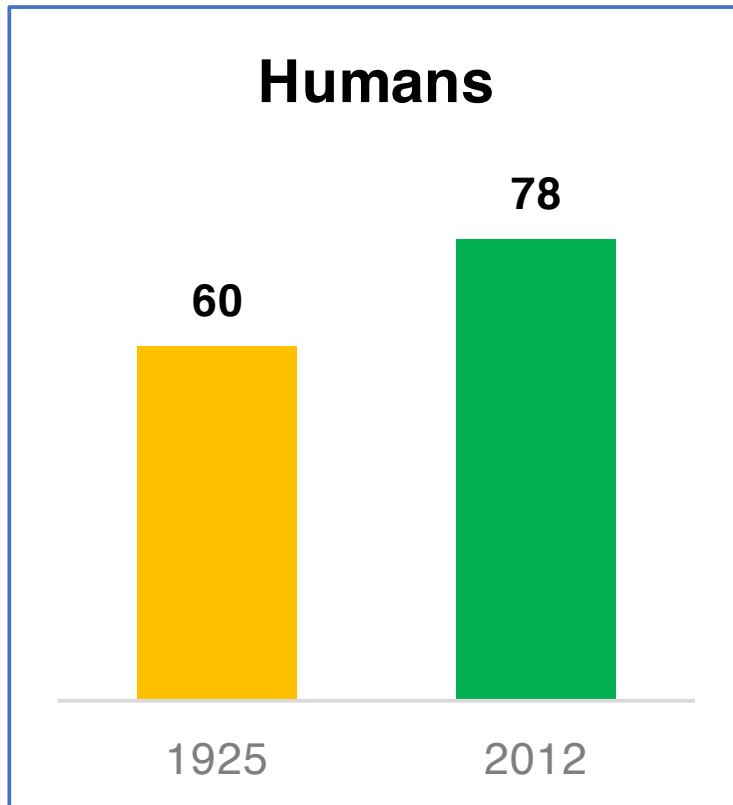
Education

- MBA from the Wharton School (Palmer Scholar)
- MA from the Lauder Institute, University of Pennsylvania
- Bachelor of Information Systems from Monash University
- Chartered Accountant
- Adjunct Associate Professor, Hong Kong University of Science & Technology, School of Business and Management

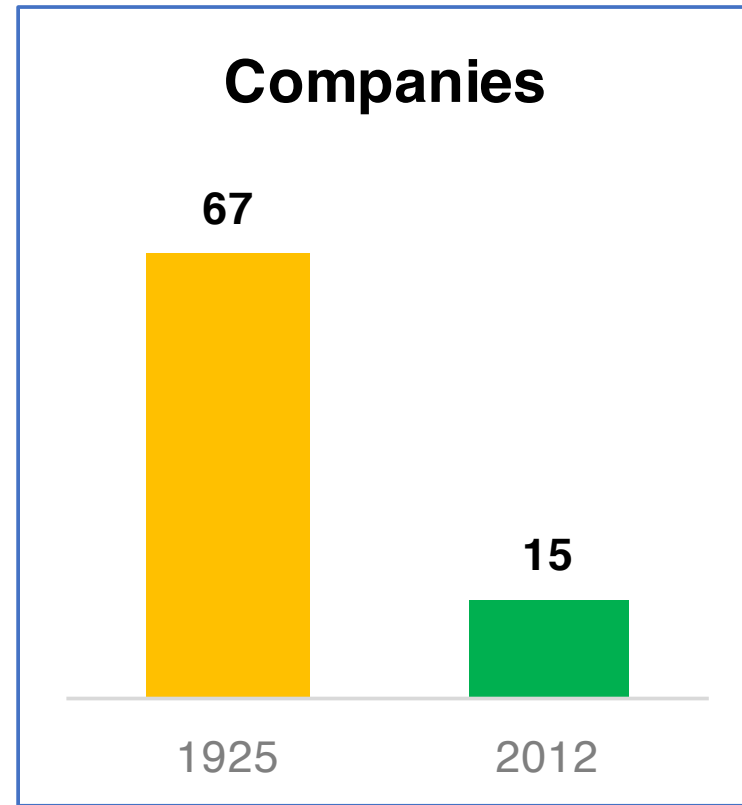


THE EMERGENCE OF STARTUPS AND HOW THE ECOSYSTEM HAS CHANGED

The world has changed... lifespans have flipped



Men and Women US



S&P 500 Companies

Source:

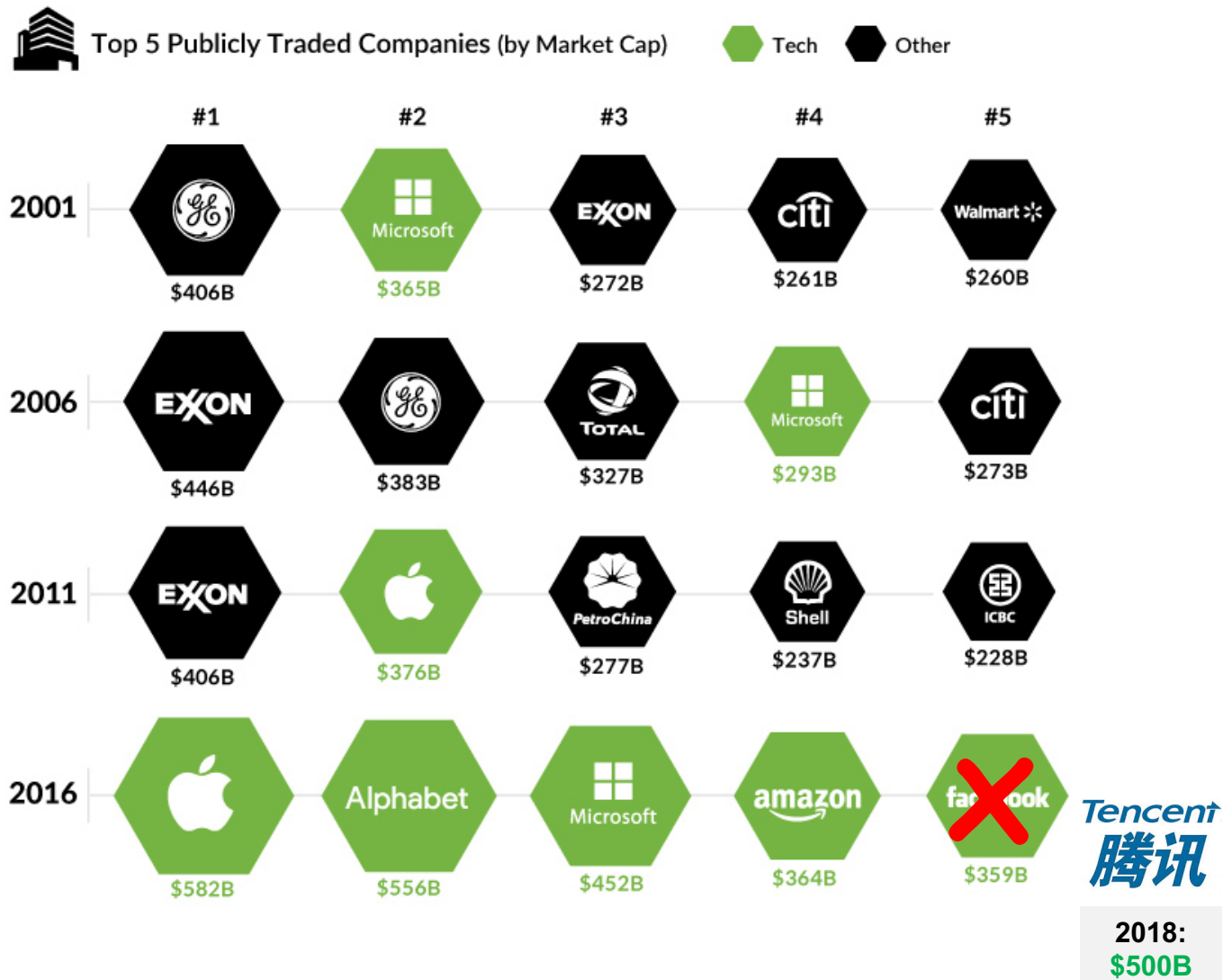
* Lifespan of S&P 500 Companies, Richard N. Foster (Yale)

* Men and Women US Lifespan National Center for Health Statistics, National Vital Statistics Reports. Web:www.cdc.gov/nchs.



As has the pace of change

The Largest Companies by Market Cap



Source: visualcapitalist.com

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What changed in the past 10 years?

- Everyone has a computer in their pocket
 - No need for capex / devices
 - App's needed => low barriers to entry, highly scalable
- Everything can be tailored / customized
 - Market vs democracy
 - Supply chain / sourcing is tailored (even 3D printing makes design accessible)
 - Ecosystem of expertise (eg, crowdsourcing)
- What does this mean?
 - Easier to become a unicorn
 - A lot more competition (lower barriers to entry)
 - Far fewer survivors but beware of survivorship bias!

VC Ecosystem: Easier and faster...

Entrepreneur

- Rome can be built in a day...
- Easier than ever to start up a company
- Easier than ever to grow a business

Investor

- More choice
- Easier to find
- Easier to check... sometimes...



Source: Wikipedia

But some things don't change...

- Startups still need money
- Investors still worry about losing it
- Successful startups still need to worry about what happens next (after initial success) or risk getting stuck in the “black hole”



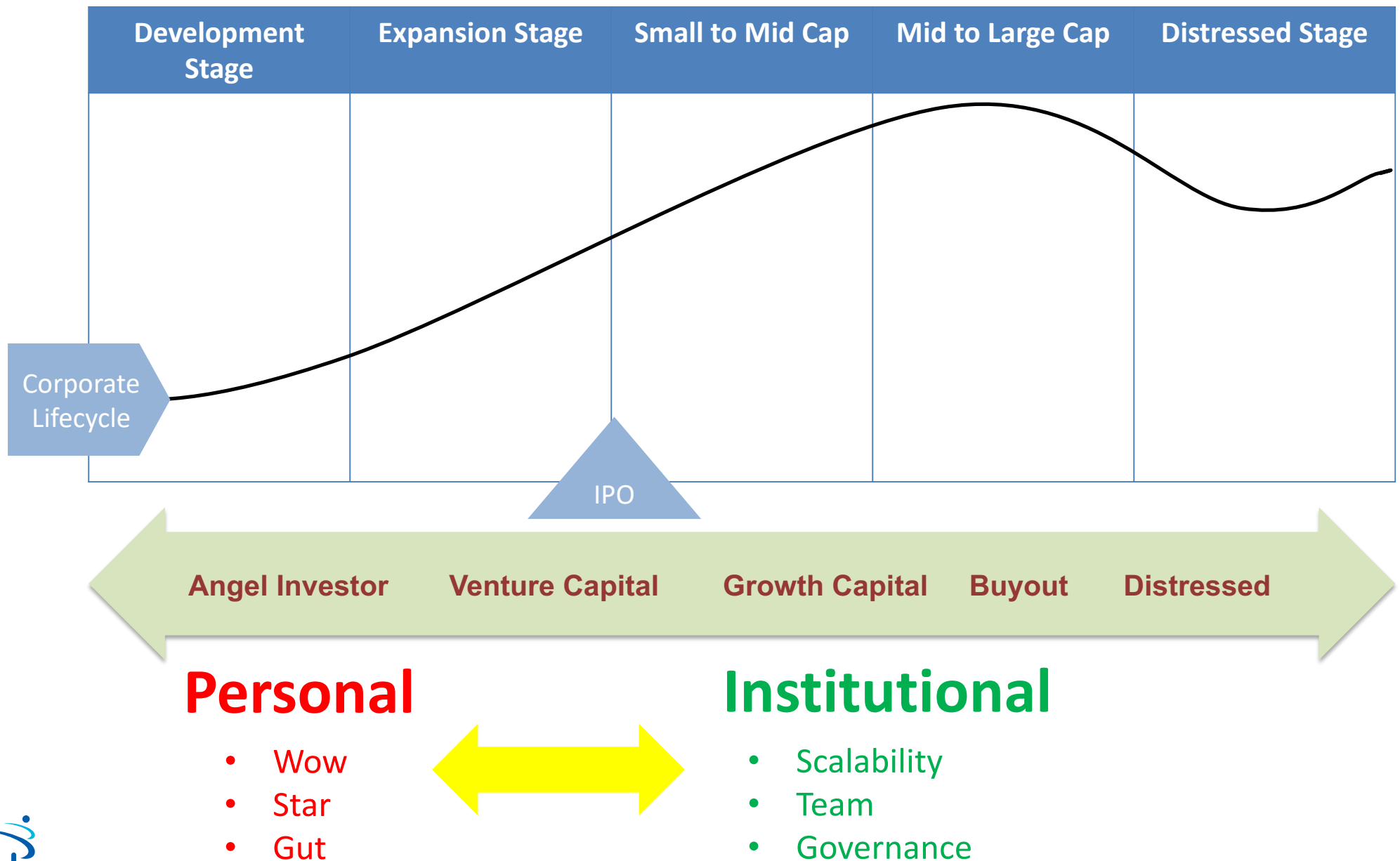
WHAT DO INVESTORS LOOK FOR

Truths: VCs making investments

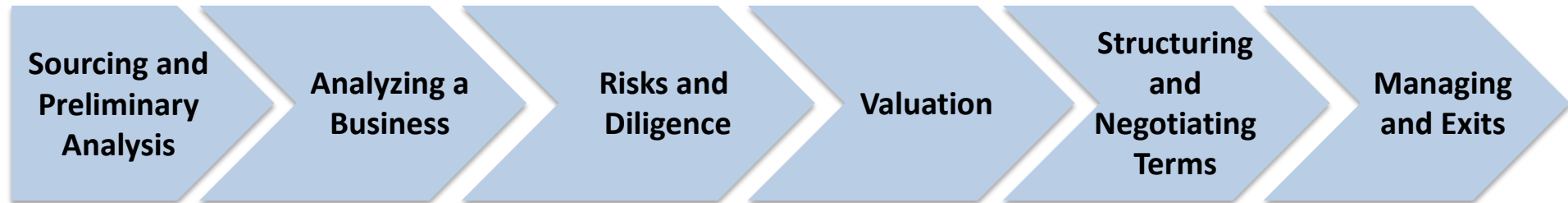
- Alignment of interests
- Asymmetric information (The seller is always right, the buyer is not always right)
- WIIFM (people act in their own interests, so understand what these are)



Different investors for different stages



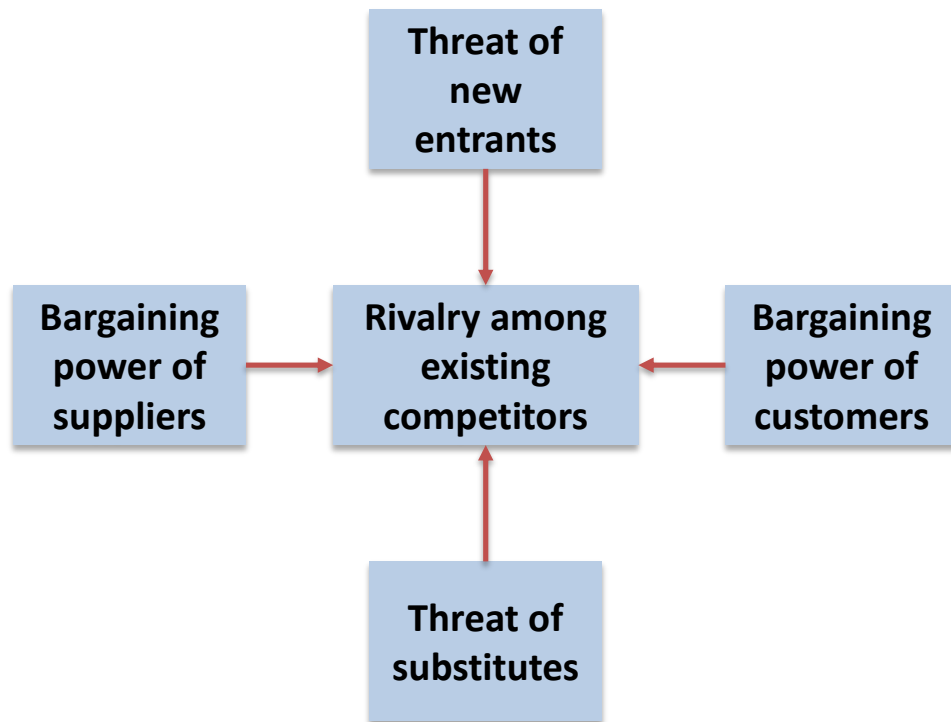
The investors' perspective: What they look for



- **Sourcing and Preliminary Analysis:** Many deals, few close
- **Analyzing a Business:** Deep dive
- **Risks and Diligence:** Front-ended, know what you're getting into
- **Valuation:** Today and tomorrow, multiple outcomes
- **Structuring and Negotiating Terms:** Different ways to come to an agreement and protect both sides
- **Managing and Exits:** One-way street, and potentially a long road...

Is it a “Good” Company?

Porter’s Five Forces can be a useful framework to think about a company



Questions

- Does the strategy make sense?
- Is the company well positioned?
- Growth prospects / defensive characteristics of business?
- Competitive advantage / barriers to entry?
- Form and intensity of present and future competition?
- What are major risks to the business?
- Are margins sustainable?
- Is it a good management team (can I trust them in tough times, can they adapt, will they stay cohesive as a team)?

Can I get a good price or good terms?

- How flexible is the company on pricing and/or terms?
- What does management really want, what do we really want... can both of us get what we want?
- What alternatives do the company have and at what price?
 - Auction vs. proprietary deal?
 - Other financing options
- Can I get better downside protections?

Can I make the firm more valuable?

- Scale
- Synergies
- Operational improvements
- Optimize capital structure
- Strategic value-add
- Corporate governance and transparency
- Go public / sell to a strategic buyer

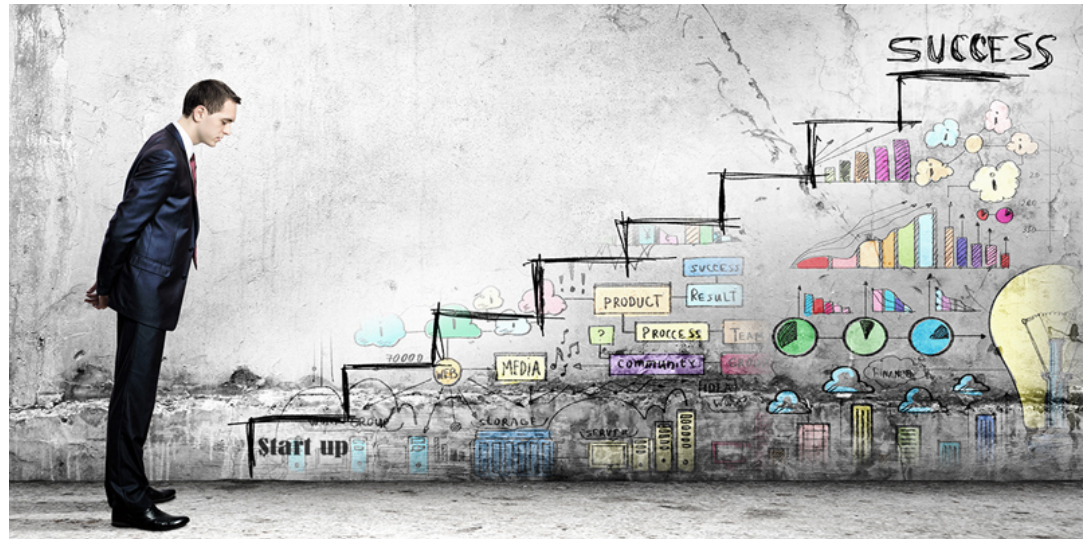
Helpful hints...

- Understand the unit economics, operating leverage and cost structure of the business
- Has the company proven that its business model works?
- Understand what the company has to do exceptionally well in order to succeed (eg, benchmark vs competitors)
- Be skeptical, especially on projections
- Understand why this deal is in your hands and not in someone else's if it's that good
- WIIFM: who is telling you what

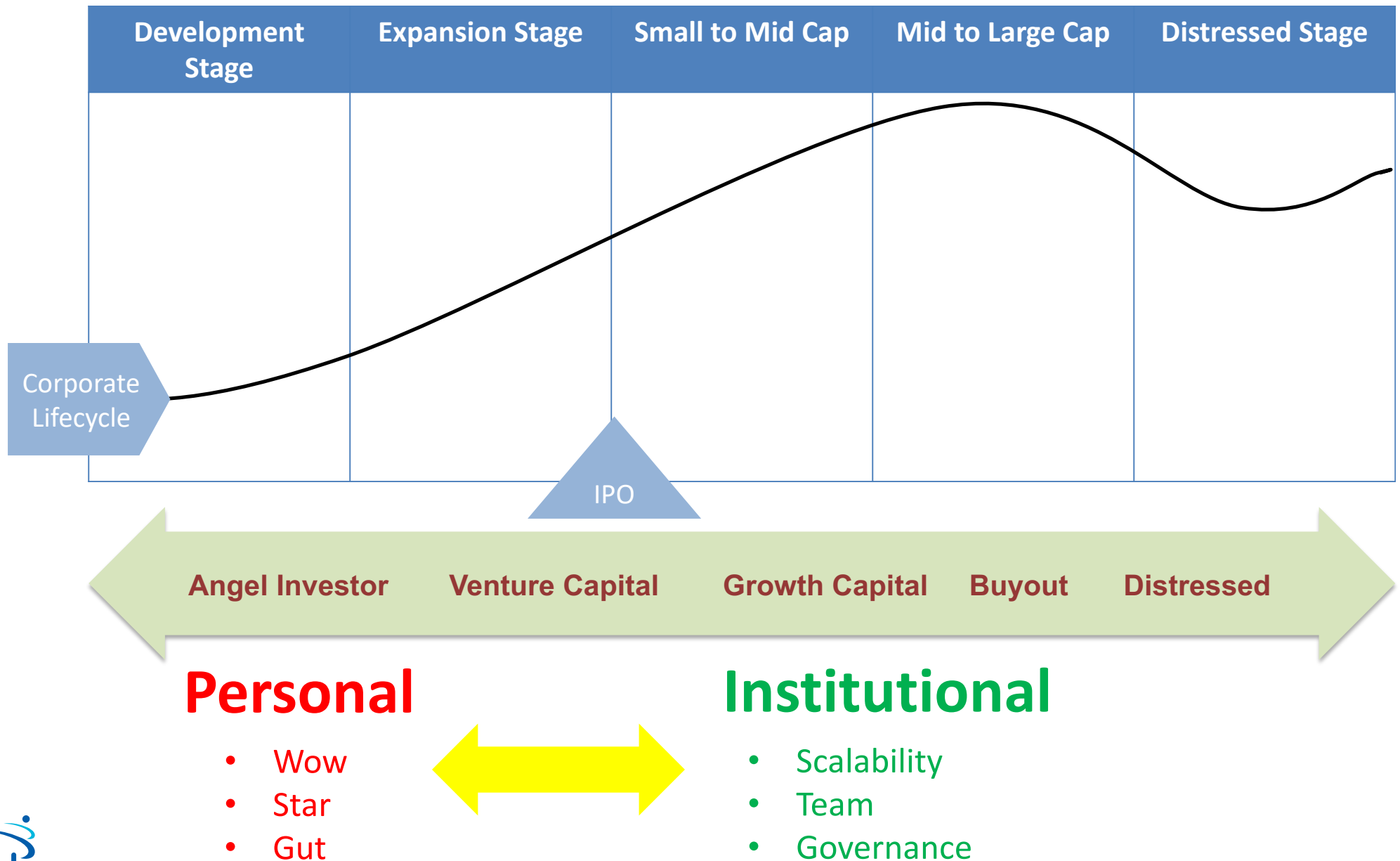
WHAT STARTUPS NEED TO ATTRACT CAPITAL

Truths: Startups

- People want to give you money when you don't need it (no one wants to be first, lots of people want to be second)
- Everything takes longer than you think (operationally and funding wise), so don't cut it too fine
- Be prepared to self-fund
- Find ways to avoid spending money
- Better to have % of something than 100% of zero
- Hustle and pound the pavement
- Pivot... business and people



Different investors for different stages



Business Plan: Foundation of the Pitch

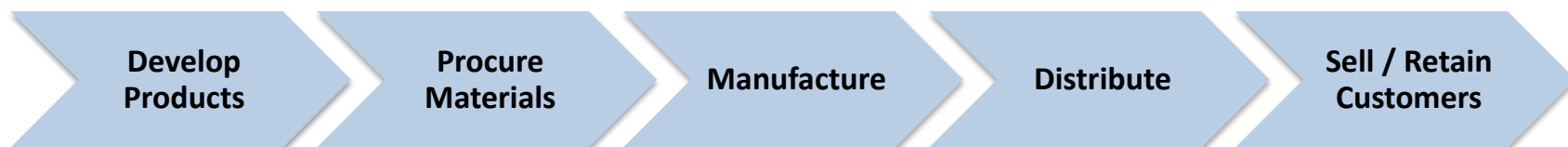
Elements in an effective business plan (not necessarily in this order, nor necessarily in the initial pitch):

- Executive Summary
- Industry and Market
- Company / Product Description
- Financials: Historic and Forecasts
- Risks and Mitigants
- Valuation
- Organization and Team
- Post-Investment Plans and Exit Strategies

- Where do you play?
- What problem / unmet need are you addressing?

- **Customer:** Who you sell to
- **Product:** What you sell
- How are you **differentiated** from the competition
- **Unit Economics:** How you make money and how much
- **Value Chain:** How to execute

- Structure
- Team
- Shareholding



SO WHAT HAPPENS NEXT

So what happens next?

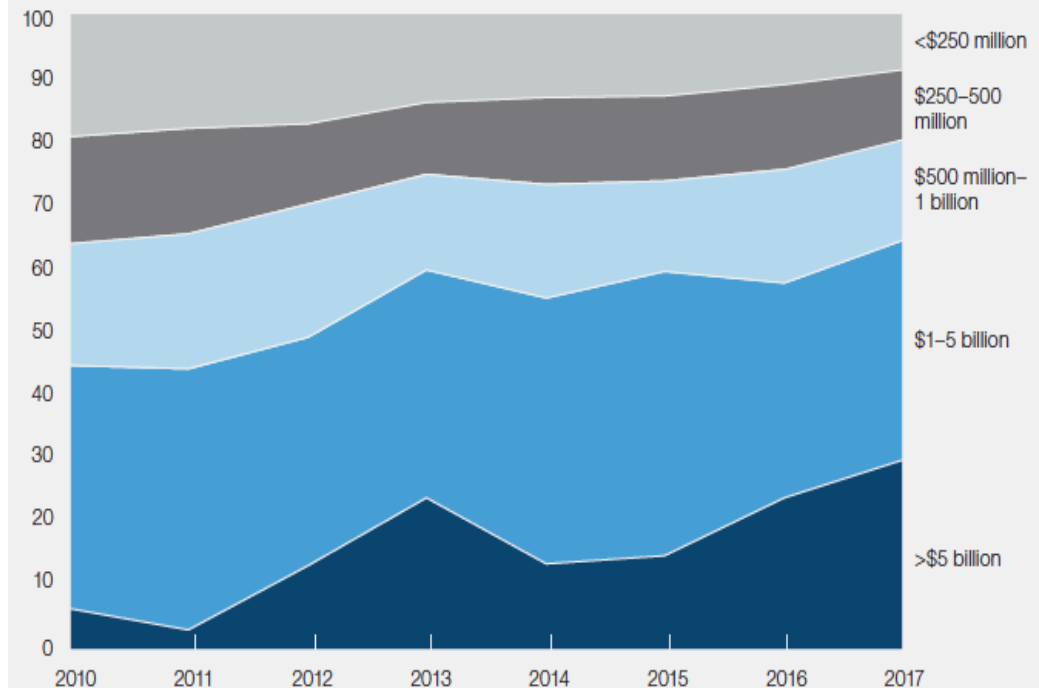
- **Startup success means it's no longer your company**
 - Not your own company anymore, have to look after the little guy
 - Fiduciary responsibility
 - First step to becoming a public company
 - Team vs star lone ranger
- **Corporate governance*:**
 - Lay solid foundations for management and oversight
 - Structure board to add value
 - Promote ethical and responsible decision making
 - Safeguard integrity in financial reporting
 - Make timely and balanced disclosure
 - Respect the rights of shareholders
 - Recognize and manage risk
 - Remunerate fairly and responsibly
- **Addressing the black hole for investors => Path to scale and sustainability**

Challenges of attracting larger investors

- Search costs are still high... or rather need to focus time (Paradox of choice)
- Less time to decide (Competition)
- More unpredictability because companies succeed / fail much faster
- Valuation?
- Still a people business (like online dating)
- Money...
 - Lots of large investments + Early stage money
 - Less funding in between
 - Don't spend it all at once

Large funds continue to absorb a greater share of funds raised.

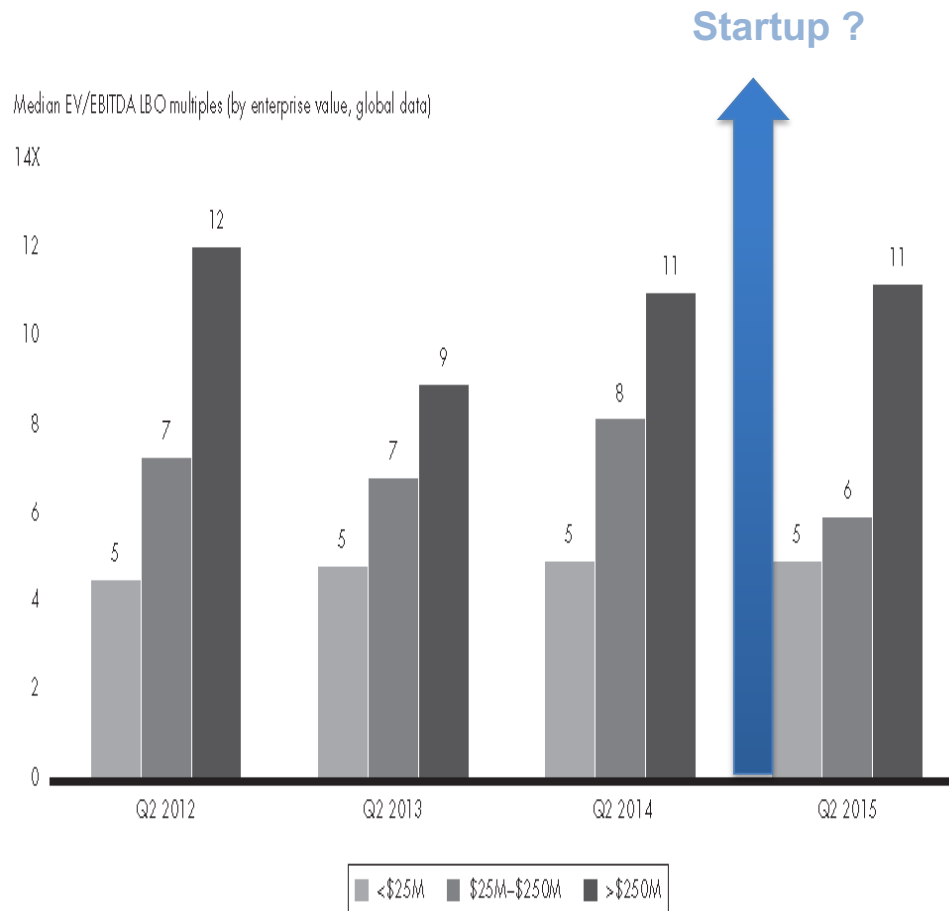
Global private markets¹ fundraising by fund size and year, % of total in-year fundraising amount



¹ Private equity, real-estate private equity (ie, closed-end funds), private debt closed-end, natural resources closed-end funds, and infrastructure closed-end funds. Secondaries and fund of funds are excluded to avoid double counting of capital fundraised.

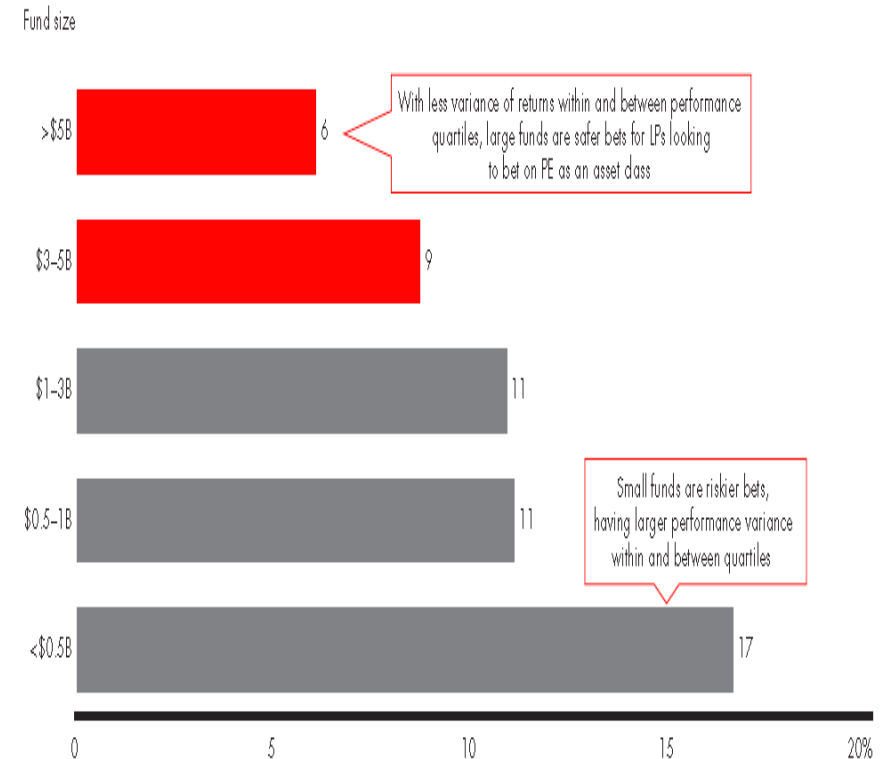
Source: Preqin; McKinsey analysis

Growth stage: Lower valuations, higher returns yet less money is available



Source: Pitchbook

Standard deviation of net internal rate of return by fund size (vintage years 2007-12)



Note: Data effective December 21, 2015
Source: Preqin



Resulting in a gap

Early Stage (Fearless)

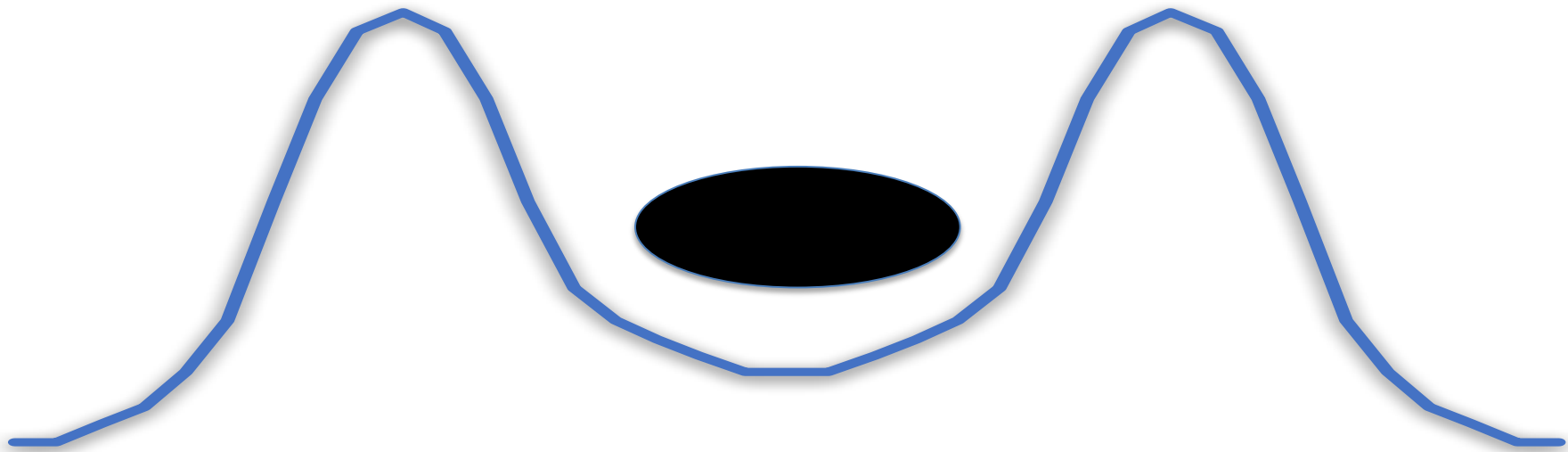
- Valuations - ++
- Money – Gold mines
- Vision / Growth

Growth Stage (Black Hole)

- Valuations - Low
- Money – Low
- Institutionalization

Late Stage (Fearful)

- Valuations – High
- Money – High
- Execution / Predictability



What can be done (to fill the gap)?

Company / Entrepreneur

- Vision + Execution
- “Institutionalize”
- Understand what investor wants
- Terms: Align interest



Investor

- Shoes of Entrepreneur: Tail does not wag the dog (ie, numbers don't create results)
- How to “institutionalize”
 - No longer founders' decision alone
 - Other people's money
 - Star vs Team
- Helping with the knowing what you don't know
- Understand what the entrepreneur wants
- Terms: Align interests

Polar Ventures: Our Focus

- Polar Ventures provides capital, strategic and operating solutions, focusing on small-medium sized enterprises in Asia
- Targeting transformational situations where a combination of capital and expertise is applied
- Active and collaborative investment approach

