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TAKING IDEAS TO MARKET

*How can start-ups attract investment? Business advisor and multinational entrepreneur **Reinhold Karner** explains.*

Start-ups disrupt business models by thinking differently. When it comes to financing, do start-ups also think differently?
We have to differentiate between three categories. The first category consists of start-ups in the common and old-fashioned sense. These are totally new companies trying to establish a business on their own from scratch and are mainly driven by young, inexperienced entrepreneurs.

The second category is a new type of start-ups which are more often set up like a spin-off from established enterprises or family businesses, also in Malta, as they've learned that this is the most promising way to ramp up new, fast and flexible innovations outside of their structures.

The third category is a young concept started in 2012 by General Electric with their GE Garages business incubator structure, followed in 2013 by Allianz and many more. Large, mainly global companies in various sectors have realised that establishing symbiotic relationships with vibrant start-ups can be a very interesting way of getting involved with disruptive services, technology or trade. Companies do so by, for instance, embedding accelerators and innovation labs in their existing structures, which provide supportive structures, experience, mentoring, equipment and funding to promising entrepreneurs and their start-ups.

Let's focus on the first category, as the second category is mostly getting good backing from their parent business and executives and the third category will be embedded in a bigger structure, even though that doesn't guarantee success.

Start-ups are thinking different in nearly every aspect. This is, of course, positive – however, it can also have adverse affects. On the one hand, these start-ups have a very innovative idea, talent and the passion to turn it into a successful business as well as the willingness to fail, learn and try fast again until they succeed. On the other hand, they are normally short of money, time, experience and the proof of concept.

This means that they are aware that they have very limited resources, time, trials and opportunities and so they have to be fast and run their venture in as lean and flexible a manner as possible. They are a tight team, manage a portfolio of suppliers with just short-term contracts, and use crowdsource innovation. They don't think like established leaders or in a linear manner – rather, they think exponentially. Start-ups want to move 10 or more times faster. They don't think about the amount of resources they can throw at a problem, but how they can run their organisation as leanly as possible.

When it comes to funding, unfortunately we often see an inexperienced approach. Many start-up entrepreneurs are so convinced about their innovation, business concept and value that they expect that banks or investors are overwhelmingly willing to finance their start-up. Yet most financiers are first of all looking for proof of concept to keep the risk of losing their money low and for a good and safe return. Furthermore, they know that the bleak truth is that just about 10 per cent of start-ups, if they aren't supported by an experienced and professional mentor and 30 per cent if they are, manage to survive and be successful in the long term. Moreover, the EU average age of companies is about 12 years. That translates into an almost 10 per cent wind-up annually.

What start-ups usually also underestimate is that they will need a second, third or even fourth round of financing as their business plans are usually too optimistic or developments turn up quite different than expected.

This can be an issue because, as an entrepreneur and leader of the start-up, you have to invest most of your time chasing the next funding to survive – this means that you inevitably neglect your business, developments and team. And with a further round of funding you could probably lose credibility and more control of your business and shares.

This is why it's so important to get an experienced and professional mentor, early funding, and prepare an honest, conservative business plan with a worst-, medium- and best-case scenario.

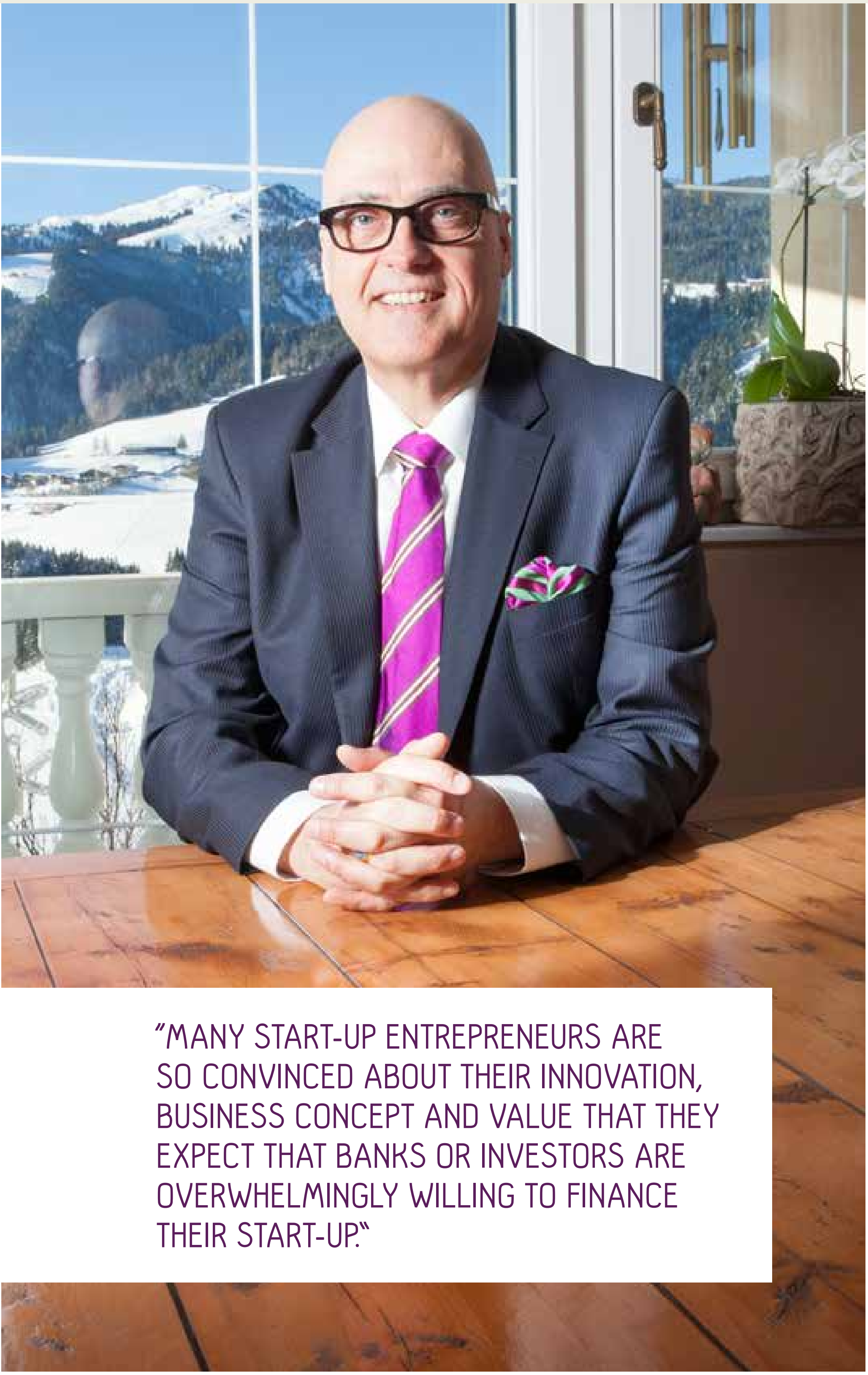
What financing models are the most effective for start-ups?
I strongly recommend a hybrid model, which means raising funds from banks, venture capitalists, investors, angel investors, and possibly crowdfunding. If you depend on just one funding partner, then the situation can become critical when things don't go according to plan or the single investor or banker gets greedy.

From your experience, how does the financing of start-ups in Malta compare with that in the rest of Europe and the world?
Following the 2008 economic crisis, the world of financing has changed. Many banks are not really open and willing to finance even established businesses and their risk management has changed immensely due to new ECB and EU regulations.

On the other hand there are vast amounts of money around waiting to be invested. Yet to attract an acceptable interest, financiers have to take more risk. Viewed in this light it's a very good time for start-ups to get funding – that's probably one reason why they are increasing in number, maybe causing another kind of bubble.

Raising successful money for start-ups and getting a fair deal is hard and the market is very competitive. Having said that, you really have to convince your financiers on all counts: product, business model and plan, market and marketing, management and entrepreneurship.

The situation in Malta is similar to the rest of Europe. Of course, Malta is a very small market and its start-up scene is very young – however, it's moving in the right direction.



"MANY START-UP ENTREPRENEURS ARE SO CONVINCED ABOUT THEIR INNOVATION, BUSINESS CONCEPT AND VALUE THAT THEY EXPECT THAT BANKS OR INVESTORS ARE OVERWHELMINGLY WILLING TO FINANCE THEIR START-UP."

Photo by Roland Muehlanger

Apart from finance, what other support do start-ups require?
From my experience, the key is to involve a professional and experienced entrepreneurial mentor from the start. Studies in the US show that start-ups that have this kind of support are three times more likely to succeed. Other forms of support vary, depending on the kind of business, product, business model and market.

What should encourage angel investors and venture capitalists to support start-ups?
Return is key. Sometimes it's also about spreading their risk or a strategic partnership regarding their other investments in businesses.

From my experience, it's not uncommon for investors to impose harsh terms, especially from the second round of funding onwards. However, with some luck you might get a real angel investor or fair investor who totally believes and trusts in you and your business idea and who supports you in whatever it takes, including professional mentoring.

What financial returns should investors expect?
There is no golden rule. Investing in start-ups is always quite a risk and it's only fair that an investor expects a much better return than you'd have to pay for a bank loan. So it depends on so many different factors: at what stage the start-up is, whether there is proof of concept, which barriers you expect the start-up has to face and to master and what yield could be achieved.

Do investors in start-ups also gain in status and social standing?
Yes and no. Yes, if it's a private investor, angel or a local venture capitalist and they want to publish their involvement, support and commitment and want to build an honourable track record. No, if the investment is preferred to be kept anonymous (as it could fail) or low profile or if the track record of the investor isn't that good because of valid reasons.

Is investing in start-ups considered high risk?
If it's still in the seed or another start-up phase definitely yes. But risk implicates also a big chance, so you either could lose a lot or gain a lot.

How can start-ups earn the trust of potential investors?
This list is long: you need a professional and reliable appearance, a serious business plan, full transparency, self-confidence, positive marketing and good knowledge of your market, numbers and competitors. You also need to talk frankly about challenges and worries and ask for advice, feedback and support. Last but not least, start looking for an investor at the early stages of your venture – if you are late, you'll make mistakes and desperately try to get any deal, which could be dangerous.