FOREWORD

Dear Reader,

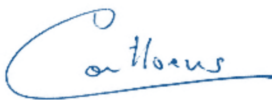
In order to develop their company's activities, company directors must have a good knowledge of their business, particularly the technical and commercial aspects. They need to ensure the growth of the company through a strategic vision and a feasible plan, and by identifying the best employees and the right financing.

A little-known approach is financing by means of venture capital.

This guide has been written by two respected professors who describe the various stages in a venture capital investment in simple and objective terms.

The purpose of this guide is to show company directors and their advisors how the venture capital sector works, from the first informal contact to the successful investment. Through this guide, we hope to both demystify this industry and to introduce you to an industry that actively supports entrepreneurs in their growth projects and also contributes to the growth of our national economy.

On behalf of the non-profit Belgian Venture Capital & Private Equity Association (the "BVA"), we hope you will find it useful!



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For more information on the BVA and its activities, please visit the website **www.bva.be**.

This guide was written by **Dr. Sophie Manigart** and **Dr. Olivier Witmeur** with the support of the non-profit Belgian Venture Capital & Private Equity Association.

If you have any questions, please feel free to contact us at **www.venture-capital.be**

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INTRODUCTION

Venture capital is, without a doubt, the financing method that is most readily associated with the creation and development of small and medium-sized companies looking to grow. The venture capital companies or funds possess significant financial resources that they invest in order to help the entrepreneurs to realise their company's potential. In this way, the companies have access to much greater financial resources and are able to develop more rapidly and efficiently.

Although the venture capital sector has currently reached a certain maturity, it is still little known among the general public and certain myths and negative attitudes continue to persist. As a result, too few companies consider the possibilities offered by this sector or they are too quick to reject this form of financing.

The primary goal of this introductory guide is to demystify venture capital and thus, to provide the simplest, clearest and most objective picture possible of this financing method. This guide will answer the following questions, which are relevant to any entrepreneur:

- What is venture capital?
- Who can use it and under what circumstances?
- What are the pros and cons of this type of financing?
- How can one get into contact with a venture capital fund and how should one prepare?
- How, and on what basis, do venture capital financiers make the decision whether or not to invest?
- What happens after the investment?

This guide describes the process from the first contacts with a venture capital fund to the collaboration and finally, the exit. We shall also present a number of 'best practices', which form the basis for successful collaboration between a company and an investor.

1 WHAT IS VENTURE CAPITAL?

This first chapter outlines general principles. An interesting note is that the abbreviation 'VC' refers both to venture capital as an activity and to its leading proponent, the venture capital manager or venture capitalist. In this first chapter, the fundamental principles will be outlined in simple terms, but they will be discussed in greater detail in the following chapters.

Financing via equity for entrepreneurs who have ambitious plans for their company's growth

Venture capital is equity financing with the aim of facilitating the development of young, non-publicly listed companies with a growth plan for the medium term, generally from 3 to 7 years. One could essentially say that companies call upon VC when the shareholders are not, or are no longer, capable of putting new resources into the company and when the banks refuse to be the sole source of financing because they judge the company's equity to be insufficient. Banks also talk about the necessity of 'strengthening the upper side of the balance sheet.'

Generally, a VC injects capital (he or she in fact takes part in a capital increase) in a company with a large potential for growth in order to allow the company to develop more rapidly. In exchange for the investment, the VC becomes a (usually minority) shareholder of the company. The growth of the company is accompanied by an increase in the value of the company and thus of the shares held by the VC and the entrepreneur. Once the value creation has become large enough, the investor will want to sell his shares, for example by selling the company in its entirety or by launching it on the stock market. The added value realised during the sale is the compensation for the investment the VC has made. Because the sale of the interest also entails the investor's departure, this is generally referred to as an 'exit'. The value of the shares held by the other shareholders, including those held by the entrepreneurs themselves, naturally evolve in the same way and at the same pace. That is why all shareholders work together to prepare for the exit of the investor. When the exit happens in the form of a complete sale of the company, the other shareholders – in this case the entrepreneur – will also have to sell their shares. In the case of an initial public offering, generally speaking they may continue the adventure, joined by the new shareholders who replace the departing VC.

It is extremely important to understand that VCs invest in capital and therefore fully share in the business risk. When things go wrong, they lose their entire investment, but obviously this is not their goal! If everything goes according to plan, they will realise a considerable added value on their investment. VC is therefore clearly distinct from banking financing whereby the risk, as well as the anticipated profits, are much smaller.

The following table summarises a number of essential differences:

	Venture Capital	Bank
Form of financing	Participation in the capital	Loan
Expected profits	As high as possible, in the form of added value on shares upon the investor's exit	The interest rate of the banking market
Term of the Investment	Usually 3 to 7 years	Credit on the short (<1 year) and medium (often 3 to 5 year) term
Guarantee requested	None, except a few protective clauses for the minority shareholder who was not involved in the day-to-day management. If the project fails, the VC will lose his investment	A true guarantee, e.g., a personal guarantee by the entrepreneur or those close to him, a mortgage, deposit of securities, …
Selection criteria	The quality of the project's growth potential	The capacity for repayment of the quality of the guarantees provided

Financing adapted to the company's stage of development

The VC funds and companies do not usually invest the required amount all at once. They prefer to invest the resources that are necessary for the development of the company gradually, as goals are periodically realised. For this purpose, the lifecycle of the company is generally divided into different phases and the financial needs are re-evaluated at the end of each phase. Each new capital injection is called a round. Often, the amount invested and also the number of investors increases with each new round.

The development cycle of the company is often divided into four different phases:

1. A preparatory and launch phase, known as the *seed and start-up stages*, in which chiefly the preparatory work is carried out (often a lot of R&D and prototype development) before the start of the actual commercial activities.
2. The initial growth phase, known as the *early growth stage*, made up of the first years of commercial activity, which is often on a limited scale, but is intended to confirm the viability of the project.
3. The rapid growth phase, known as the *fast growth stage*, the large-scale expansion of the company.

4. *The mature phase*, known as the maturity stage, which is characteristic of companies that have come to set the standard in their industry and must struggle to maintain their position at the top.

Although VCs are active in each of these phases, the focus of this guide is chiefly on the second and third phase in which Belgian VCs largely concentrate their activities. The first phase is usually financed by the entrepreneurs themselves, their family members, *business angels*[1] and a number of support measures from the government. The latter phase, on the other hand, is financed by the company itself (self-financing), banks, stockbrokers or industrial players.

This division allows us to get a clear view of the activity zone of the VC and to compare this with other forms of financing such as in the overview shown below.

EVOLUTION OF THE SOURCES OF FINANCING FOR COMPANIES

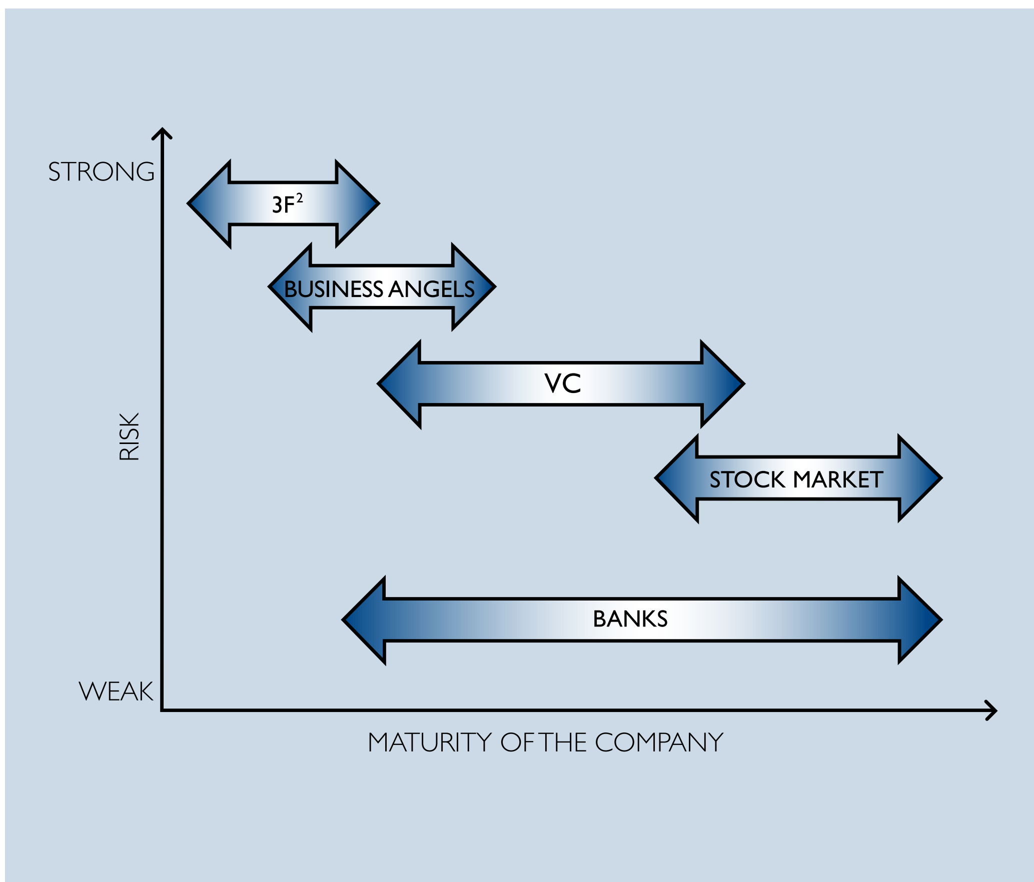
The types of financing available for SMEs can be divided into four categories:

- The self-financing: this is the capacity for a company to generate an operating cash flow that allows it to finance its necessary working capital and investments. This financing method is used by over half of the rapidly growing Belgian companies;
- Capital contribution: this is any contribution of capital that comes from the entrepreneurs themselves, all the way through to financing from the VCs, financial markets or industrial partners;
- Short and long-term debt: these are loans granted by banks, generally with a guarantee, with interest charged and a repayment plan;
- Subsidies and government support: these are all the measures taken by the governments to encourage the development of companies and the creation of jobs.

If we only look at capital contribution, it is conceivable for different sources of funding to be used sequentially, as the company passes through the developmental phases. During the seed and start-up phase, capital comes from the entrepreneurs, people close to them and business angels. Although in some cases, entrepreneurs may also call upon VC in the initial phase, the help of VCs is usually only sought during the growth phases. Even when companies have reached full development, they can still make use of VC, but they usually opt to proceed further via self-financing or an initial public offering.

[1] A business angel is a person with considerable private wealth. This is generally someone who has been a highly successful entrepreneur or a former member of the senior management who wants to invest a (small) part of his/her wealth in the project(s) of companies in which he/she believes, whereby the company has the benefit of his/her experience.

The chart below shows the financing sources in function of the company's maturity:



[2] This is often referred to as '3 F', meaning "Family, Friends and Fools!" as well as community financing or even love money!

THE 'EQUITY GAP'

Particularly during the start-up phase, it is often difficult for an entrepreneur to find investors for his project. This situation, known as the 'equity gap' (literally a hole in the financing by means of the company's own equity), especially occurs when the amount required is too high for a *business angel* and too low for a VC. VCs prefer not to invest in projects that are too small because they need to assess and follow-up each investment that they make and this brings considerable costs, which are not easy to recover from a small investment. The equity gap can also be explained by the fact that many sources of financing (including VC) are only available for companies with ambitions for strong growth; many companies do not per se want to become big. The limited information that companies have about investors and vice versa (this is sometimes called the asymmetry of information) reinforces the difference in perception between the two parties and makes it more difficult to coordinate demand and supply.

In order to bridge this *gap*, a number of VCs, which often have government ties, have specialised in relatively small projects.

More than just money!

Based on the above, one might come to the conclusion that VCs are only the suppliers of money, but that is far too limited a description. In fact, the VC professionals also have a wealth of experience in the development and guidance of growth companies. These competencies, together with their large network of contacts, allow them to assist the entrepreneur in:

- devising a company strategy,
- preparing for the growth of the company,
- obtaining other forms of financing, which becomes much easier once the capital structure of the company is reinforced with VC,
- the optimisation of the company's performance,
- the professionalisation of the management of the company.

The VCs also help the company by allowing it to benefit from their reputation: most VCs have a reputation for picking winners and therefore, financing quality companies. Their presence thus also sends a strong signal of quality to all parties involved with the company, such as employees, suppliers, customers, because it becomes common knowledge that the VC can sustain the financing for the company as necessary.

The VC is thus a true partner for the entrepreneur with whom they share a vision for the growth ambitions and risk-taking.

Venture Capital, Private Equity and hedge fund.

Venture Capital is a part of *Private Equity* (abbreviated PE). This investment category encompasses all equity investments in non-publicly listed companies. Within *private equity* the VC funds and companies closely resemble the funds that are specialised in the purchase of companies, generally with the help of the management, in the form of a *Management Buy-Out*[3] (abbreviated MBO). For institutional investors, private equity – which thus also includes VC – forms a category of financial assets alongside shares in publicly listed companies, bond loans, real estate, or other forms of investing money. The different categories of financial assets are distinguished from one another on the basis of the different levels of risk and the expected returns. *Private equity* belongs to those investments with greater potential returns and a higher risk. The major investors in *private equity* (in other words, those who finance the PE funds) are institutional investors and sometimes governments, banks or large companies, although in Belgium, the latter do not tend to be active in PE.

VCs should however not be confused with *hedge funds* which apply an entirely different investment philosophy. Although both VC and *hedge funds* manage the assets of third parties, their goals are completely different. First and foremost, VCs invest only in non-publicly listed companies in order to help them grow, whilst hedge funds invest in a wide spectrum of financial assets (such as shares, bonds, options, …) on different markets, often for strictly speculative purposes. Secondly, VCs invest on the medium to long-term, whilst hedge funds operate with a shorter investment horizon, ranging from a few days to a maximum of 3 years. Finally, VCs actively take part in managing the company and they verify their activities, whilst *hedge funds* never actively participate in the management of the companies because they prefer to retain the flexibility to be able to sell their investment at any time. In order to outline the context and the prevailing customs within their sector, a number of Belgian VCs have established a code of conduct, a charter that expresses the general principles for the activities of these funds.

[3] A Management Buy-Out (MBO) is a process whereby a management team repurchases a company that they manage (but in which they do not have a controlling majority), with the help of capital and debts that are repaid by means of the future added value of the company.

THE CODE OF CONDUCT OF THE BELGIAN VENTURE CAPITAL & PRIVATE EQUITY ASSOCIATION (BVA)

In order to improve the image of VC and to clarify the ethical guidelines for VC, the BVA has drawn up a 10-point code of conduct. The BVA ensures that its members respect these rules.

1. Sustainable value creation

Parties who are active in providing risk capital (or related areas) have a function in building, in a sustainable way, the strength of portfolio companies in order to create value.

2. Active involvement in the interest of the portfolio company

This sustainable creation of value shall be realised through an active shareholdership with the portfolio company. This involvement shall serve the interest of the portfolio company.

3. Source of investment

The applicable laws regarding money laundering are to be strictly complied with. Investment of an unspecified source or investment that, directly or indirectly, stems from criminal acts or organisations shall not be accepted.

4. Use of investment

No investment shall be allocated to companies active in domains such as illegal narcotics, human trafficking, social exploitation, organized crime or any other domain that the board of directors of the BVA judges incompatible with applicable regulations.

5. Integrity and trust

Relationships among members and between members and other parties concerned shall be based on integrity and trust, whereby the highest ethical standards shall be applied. Members shall behave in an honest and trustful way by making clear promises and agreements, honoring them and not escaping their responsibility. Competitive advantage and business success shall be pursued by excelling in skills. The use of fraud, deception, manipulation or unfair practices as defined under applicable law are unacceptable.

6. Observation of laws and regulation

Members shall comply with the laws and regulations applicable to their activities (irrespective of the jurisdiction) and ensure that this is also done by portfolio companies. Within portfolio companies, members will not tolerate practices of fraud, corruption, false competition and other crimes (e.g. of a social or fiscal nature).

7. Confidentiality

Members shall treat the information they obtain from portfolio companies or companies searching for private equity or venture capital with caution, shall respect its confidential nature and shall use that information only for purposes of making or managing a (potential) investment or divestment.

8. Monitoring and control

Members shall put in place mechanisms for internal and external monitoring and control, in their own organization and their portfolio companies, adapted to their size and activities and they shall fully cooperate in the exercise thereof.

9. Communication

Members shall communicate in an open way with parties they act with (to the extent not restricted by obligations of confidentiality). Providers of private equity and/or venture capital shall regularly account for their activities towards their investors and shall inform them in a timely, relevant and adequate way about the exercise of their activities including the related risks and conflicts of interest.

10. Respecting the image of the private equity and venture capital sector

Members shall abstain from acts that may damage the image of the private equity and venture capital sector as promoted by this Code of Conduct and the BVA. They shall engage themselves to cooperate to a constant professionalization of the sector.

2 HOW DOES A VENTURE CAPITAL COMPANY WORK?

This second chapter explains how a VC fund or company works and how it organises the selection of projects in which to acquire an interest, supports them and finally sells them again.

The logic of the portfolio

In the Anglo-Saxon model, a VC is generally an autonomous company that invests funds in different companies. All of these companies[4] together make up a portfolio, each element of which has been carefully chosen and is closely followed. The logic of a VC is naturally essentially a financial one. By investing in multiple companies, the VC managers hope to earn returns on their portfolio that are on average higher than the returns that they would have earned through other financial investments. After all, VC investments are riskier than other investment opportunities, and that is why on average, a higher risk premium is expected.

This is more difficult than it may appear because of the inherent risk present in any participation. In a portfolio, only 10 to 20 % of the projects are true success stories that generate considerable added value upon the investor's exit. The others are sometimes complete failures (closure or bankruptcy) or, as frequently occurs, companies that never truly grow, and the value of which increases little, making a successful sale of the shares difficult.

THE 'RETURN ON INVESTMENT' (ROI) EXPECTED BY A VC

A VC hopes to achieve a net profitability across its entire portfolio of 15% to 20% per year, in order to be able to offer its (institutional) investors decent returns. In order to reach this average rate of return, and given the significant number of projects that fail, a VC will automatically expect greater returns from any investment, generally between 30 and 60% depending on the maturity of the company being financed. A VC thus ideally aims to see the value of each individual investment multiplied by a factor (usually referred to as a 'multiple') of 3 to 5 within a timeframe of 3 to 5 years. Although this return is expressed as an annual rate of return, it is not paid out annually, for example as a dividend. The majority of the return on investment is realised upon the investor's exit.

We should point out that VCs often charge a yearly 'management fee' to the company that is expressed as several percent of the amount invested. The 'management fee' is used to cover the cost of the transaction and the follow-up by the investor.

[4] Because of the spreading of risk, it is rare for a single participation to represent more than 10% of the portfolio of a VC.

A great diversity of VC companies

VC companies exist in a variety of legal and organisational forms. Some are completely independent, others are dependent on the government or large institutions such as banks.

The independent, highly specialised VC companies are often founded at the initiative of a VC management team that establishes one or more funds, financed by different shareholders. Often, an individual VC Fund is established as a specialised investment vehicle with an investment focus that forms an extension of the management team's experience. Each fund is presented to potential shareholders as a clearly delineated investment project that is limited in time, generally 10 years. The profit from the exits is not reinvested in new projects, but is distributed among the shareholders of the VC fund.

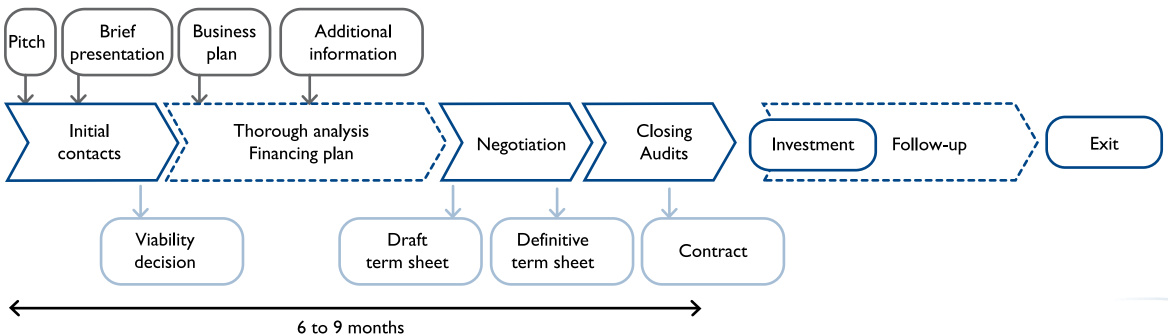
Other private funds are structurally embedded within an organisation such as a bank or a large industrial company. These so-called *captive* funds have no limit to their lifespan, so that their portfolio 'rotates': the added value from their exits is reinvested in other projects. This type of fund is frequently seen in Belgium, primarily at the initiative of banks.

The Belgian regional governments have also established a number of funds, as a complement to the private initiatives. Government funds often have somewhat lower expectations for returns, but naturally, they do make demands in terms of the location and the development of the activities of the company within their sphere of activity. This type of fund is also frequently found in Belgium, where each region has its own range of initiatives including regional investment companies (*"locale invests"*).

An organised and highly systematic selection process

Whatever the form the VC may have, it is always managed by a board of directors or an investment committee that makes the investment decisions. Investment committees are thoroughly prepared by an analyst (the *investment manager*), who is the main go-between for the company and the VC.

Although each investor has its own rules, the VCs generally follow a widespread process that is summarised below and explained in greater detail later in this guide. As a whole, the cycle of decision-making for an investment generally takes 6 to 9 months and can be broken down as follows:



1. During the first step, contact is made with the investor. Too many entrepreneurs forget to take the initiative themselves. Some of them limit themselves to submitting a business plan and waiting for the investor to contact them. This is certainly not the most efficient approach! The best way to get in contact with an investor is by mobilising your network of relations (after all, it's advisable to have an introduction by a respected party) or to take part in conferences, workshops or investment forums where the VCs are present. At this stage, it is important that the entrepreneur focuses his or her efforts primarily on those investors whose investment policy is compatible with the company project. That is why the entrepreneur needs to gain information in advance as to the VC's investment strategy, in order to avoid having to discover the rules of the game along the way!
2. The second step starts with an initial, brief presentation of the project. If this goes well, it will be followed by multiple meetings between the *investment manager* and the entrepreneur in order to become better acquainted. Based on these meetings, the VC will generally indicate whether or not the case is theoretically of interest, which is referred to as the viability decision. When this decision is positive, it results in a *'letter of intent'* that leads to thorough research in a third phase.

THE VC'S FIRST SELECTION FILTER

The VC very quickly judges whether a project is potentially valuable for the fund, by checking the fund's strategic investment criteria against the proposed project.

Criteria concerning the fund's general investment policy:

- Does the amount sought correspond to the investment capacity of the VC fund and the minimum amount that it wishes to invest?
- Is the sector of activity compatible with the fund's expertise?
- Is the geographical location compatible with the fund's sphere of activity?

Criteria concerning the project:

- Is the first impression of the managerial qualities of the management team positive?
- Is the first assessment of the originality and the growth potential of the project positive?

3. In the third phase, the entrepreneur's project is thoroughly investigated based on the business plan and the additional information that the analyst will request during his analysis. This phase is often called the *due diligence*. If the conclusion is positive, the first discussions of the primary terms for the investment will be set down in a *term sheet*.

Even at the initial selection stage of the investment opportunity or during the analysis phase, it often happens that the VC wishes to invest jointly with other investors: then an investment syndicate is formed.

ANALYSIS OR FIRST 'DUE DILIGENCE'

The *due diligence* is a thorough analysis and verification of the information that has been provided by the entrepreneur and covers all aspects of the company's project, in other words:

- Evaluation of the team: verification of the motivation, reputation and soundness of the key figures within the company;
- Technical analysis: control of the technical feasibility and intellectual property;
- Analysis of the market: verification of the feasibility and the commercial potential of the project;
- Strategic analysis: discussion on the applicability of the business model and the company's strategic planning. This analysis often leads to a thorough review of the business model;
- Financial analysis: control of the present financial situation of the company, confirmation of the hypotheses for the forecasts, establishing the financing plan.

SYNDICATES OF MULTIPLE INVESTORS

Many funds opt not to invest in a company alone. Often, VCs invest jointly in a company. This is known as a 'syndicate' of investors. In this case, one investor, the 'lead investor', assumes leadership of the syndicate (whose members are called the syndicate members). The lead investor provides the coordination between the various investors and between investors and the entrepreneur. It is extremely important to identify a lead investor as soon as possible. If an entrepreneur is not able to do this, the project is liable to stagnate, costing the entrepreneur valuable time as the project will have to be explained in detail all over again to the new potential investors.

4. The fourth phase is the negotiation of the contract between the entrepreneur and the VC(s) on the basis of the *term sheet*. This comprises the main terms of the investment that will later be expressed in a detailed investment contract.

5. Once the agreement is reached on the general terms, comes the final phase before the investment, the 'closing'. During this phase, the investor performs the final formal controls – also known as an 'audit' – and the various parties take the necessary legal steps such as the modification of the company's Articles of Association and drawing up an investment contract (which incorporates a shareholder agreement) according to the prevailing standards.

NB: Considering the large amount of work that is involved, these first five phases usually take between 6 and 9 months. In other words, it is important to get started on time!

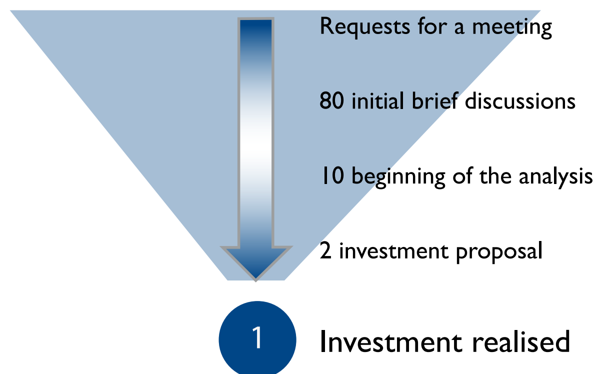
6. Once the investment is made, of course the investment manager continues to monitor the company. Often he or she is a member of the board of directors of the company and provides advice on the financial and strategic planning. The investment manager ensures that the investment committee and the syndicate members are kept informed of the company's evolution.

7. The company and the VC part ways at the time of the exit. Naturally, this is a decision made jointly between all the shareholders of the company and its board of directors, in which the management team and the investor are represented. For the investor, ultimately, it is also a decision that is discussed with the investment committee.

A highly selective filter

The complete analysis of the project takes a great deal of time, often more than 2 months' work for the analyst who has been assigned to the case. VCs try to avoid wasting their time on projects likely to lead nowhere or which do not correspond to their investment policy. They are highly selective and do not hesitate to quickly reject cases that do not match their investment strategy or which they do not find convincing.

The following diagram illustrates the situation, which ensures that investors end up thoroughly analysing only 1 or 2% of the proposed projects.



3 HOW TO PREPARE?

The aim of this third chapter is to indicate what an entrepreneur who wishes to engage the support of VC, should do. First of all, the entrepreneur must write a complete and solid *business plan*. This document in fact plays a central role in the analysis phase. Of course, the way in which the project is presented to the potential investor(s) is also of importance. Before being able to meet an investor, in addition to the business plan itself, other documents and presentations will need to be prepared.

Good preparation is crucial: you never get a second chance to make a good first impression!

The elevator pitch, one minute to persuade someone!

An *elevator pitch* is an extremely short introduction to the project by the entrepreneur. The name refers to an imaginary meeting between an entrepreneur and a potential investor in an elevator, whereby the entrepreneur makes use of the short time together as a unique opportunity to tell the investor about the project. This type of brief introduction is often obligatory for all entrepreneurs who wish to present their project. Unfortunately, we noticed that too few entrepreneurs understand the art of presenting their project convincingly in a minimum amount of time.

Concretely, the purpose of the *elevator pitch* is to describe the rough outlines of the project, usually in under one minute. Naturally, the first topic to address, is the company's activity and the market demand that the product or service fulfils. This is certainly the most important point of the pitch. It is then important to express the project concretely, as credibly as possible, for example by giving real examples of well-known references. Finally, the objective of the meeting is explained and the amount of funding and the type of financing that is being sought is described.

The first presentation: it's impossible to say everything!

The first formal meeting between the entrepreneur and the VC will generally be fairly short and limited to approximately one hour. It is impossible to cover all areas in such a short amount of time… It is therefore essential to select the right messages and to remember that this initial contact is only the beginning of a dialogue between both parties. In order to succeed at this, we advise preparing a brief presentation, for which two simple rules apply:

- Maximum 10 slides:

  The purpose is not to present the entire project in all its details, but to show enough about it to get the investor interested in starting the next step in the process. It can be useful to prepare a few extra *back-up* slides that present the major points in the presentation in somewhat more depth, just in case the investor asks a specific question, for example. Each slide needs to contain a core message. The following topics should certainly be covered: the *mission statement*, the team, the client's needs, the market or the market potential, the vision, the *business model*, the funding required.
- Maximum 20 minutes: even when an hour has been scheduled for the meeting, it's best to limit the presentation to 20 minutes, because it is very important to save enough time for the discussion.

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[5] The business plan is increasingly being limited to one large PowerPoint document (not to be confused with the presentation used during the initial contact!), supplemented with annexes such as the results of the market study, the commercial documentation and the complete financial plan as an Excel file, with parameters that can easily be adapted, …

A complete and professional business plan

The business plan is the central document that serves as the basis for the dialogue between the entrepreneur and the *investment manager*. It allows the latter to comprehend all facets of the project. It even regularly happens that this dialogue leads to considerable changes in the initial project.

The business plan is much more extensive than the financial plan with which it is often confused. It's a professional document about 30 pages in length[5] which describes an opportunity for value creation and the way in which the management team will structure the project in order to realise it and carry it out within a period of 3 to 5 years (sometimes longer in the pharmaceutical sector). The financial plan forms the conclusion of the business plan.

Beyond a mere document, the business plan is above all:

- An analytical tool that enumerates the different variables that will help determine the success of the company: its team, its range, the market, the competition, the market environment in the broadest sense of the word, etc.;
- A strategic and operational aid that concretely demonstrates how everything will be organised by dividing the project into a number of clearly identified steps known as *milestones*;
- A financial instrument, because it contains a forecast of the financial performance and the need for liquidity;
- A communication tool for persuading the partners to provide the funds that the company lacks.

EXAMPLE OF THE STRUCTURE OF A BUSINESS PLAN

EXECUTIVE SUMMARY

1. THE TEAM AND THE COMPANY
- Background
- Composition of the team and the shareholders

2. THE OPPORTUNITY
- The need(s)
- The products or services
- The market: size, growth, segmentation, …
- The sector: general trends, chief players, direct and indirect competition, …

3. THE STRATEGY
- SWOT analysis
- The business model
- The positioning
- The *core* activity
- The long-term vision

4. THE ACTION PLAN
- Sales and marketing plan
- Production plan / production method and logistical plan
- Research and development plan (R&D)
- Personnel policy (HR)
- Control of the management and governance of the company
- The developmental phases (or *milestones*)
- Analysis of the risks and the possible ways to respond to them

5. THE FINANCIAL PLAN
- Projected financial reports: Profit and loss account, balance sheet and cash planning
- Sensitivity analysis
- Financing strategy

ANNEXES:
- CV of the major team members
- Commercial documentation
- Annual accounts from previous years (if not a beginning company)

Although there is no such thing as a dream project or business plan, an ideal project meets the following criteria:

- A first-class team: honest, motivated, fully engaged in the project (not a part-time commitment, for example), professional, flexible... In short, worthy of trust!
- A unique range, supported by a sustainable competitive advantage and meeting a genuine need in the market;
- A concrete demonstration of the feasibility of the project: *proof of concept*;
- A market study that indicates a sufficiently large, growing market that is accessible to a new player;
- A business model that can be developed rapidly on a large scale;
- A strong focus on a clearly identified market niche;
- The sales and the customers must be central elements of the action plan;
- Focus on a perfectly managed *core business*;
- An ambitious but realistic vision;
- Development stages determined in advance;
- A realistic risk-analysis with a “plan B”;
- Special attention for the financial management;
- A financial plan that is based on a limited number of well supported hypotheses;
- An exit strategy determined in advance;
- Emphasis on the implementation capacity (more important than the capacity to continue with the strategic analysis!);
- Plenty of common sense and simplicity in the execution of the plans.

The most complete possible data room

In addition to the elements from the business plan, during the process, the analyst will request extra documents. In order to save time, we advise centralising a number of documents about the company at a single location, the data room.

This should include the following:

- The company’s articles of Association;
- The register of shares and the shareholder agreements;
- The minutes of the Board of Directors;
- The full accounts and fiscal declarations;
- Exact information on the evolution of the turnover and progress in prospection;
- The most important articles, analyses, regulations... that make it possible to evaluate the market environment;
- Documentation on the competition;
- Press releases on the company and its managers;
- Patents and registered trademarks;
- Methods developed and described by the company;
- Contracts with the major operational partners and clients;
- Dossiers on government support;
- Credit and financing contracts;
- CVs and employment contracts of the key employees;
- The job descriptions of the existing key employees and those needing to be hired.

CONFIDENTIALITY

Some entrepreneurs worry that by presenting their business plan to a VC they run the risk of their idea being 'stolen'. This fear is unfounded for two reasons. First of all, the business plan rarely contains strictly confidential information. In fact, this should not be included in the documents that are used with the initial contacts and should be released only later, after the signature of a confidentiality agreement. It is not realistic to expect the VC to sign a confidentiality agreement from the very first contact, before the VC can form a rough idea of the project. Secondly, and as also indicated in the code of conduct of the BVA, the ethical standards applied stimulate the VCs not to share the information received from one company with another. VCs who do this will quickly damage their reputation. And probably, the reputation of a VC is its most important asset on the market. The VCs therefore do not want to lose this by passing on confidential information to other parties.

The role of external advisors

During the preparation of the case and during the entire analysis phase, entrepreneurs may call upon the support of specialists, who can be grouped into a number of categories:

- Specialised consultants: they help the entrepreneur to draw up the business plan and come into contact with investors. They advise about the negotiation of the *term sheet*. At the beginning of the assignment, they generally work with a fixed fee (a *retainer fee*) and a success bonus (*success fee*) equivalent to several percent of the amount that is collected from the investors.
- Accountants and company auditors help the company to draw up clear annual reports and sometimes play an important role in the preparation of the financial plan. As first-line advisors for the company, they are often well placed to assess whether it is worth their client's while to pursue a VC or not. Although this type of advisor is certainly valuable, the entrepreneur must also be well informed about the contents of the financial plan and the hypotheses on which the plan is based. The external advisors in fact generally do not take part in the first contacts between entrepreneur and investor.
- Lawyers are almost always consulted in the final phase of the negotiations certainly for the *closing* of the investment and drawing up the definitive contracts.

- Government initiatives for support to companies. Throughout the country, there are various organisations, financed by the government (such as business centres, innovation centres, entrepreneur centres, local development companies,…) who will often provide initial advice about the financing possibilities free of charge, including VC.

It is extremely important that an entrepreneur chooses his/her partners, including the external advisers, with care. A good advisor is a specialist who understands the way the VCs work and who has a good reputation. Checking the references of an auditor is therefore necessary before working together. In Belgium, the number of true VC specialists remains small and the many sorcerer's apprentices unfortunately cost the entrepreneurs and the investors valuable time and money.

SHOULD VCs BE ALLOWED TO COMPETE?

In order to obtain good terms and keep the balance of power in proportion, there is nothing better than competition! It is therefore good for entrepreneurs to begin negotiations with multiple investors, but this also has its limitations. The venture capital world is a very small one. The VC managers meet and speak with one another often, so it is rare to receive more than one completely different investment proposal. On the other hand, the analysis process, prior to starting the concrete negotiations, is very long and intensive. Having to undergo this process more than once is time-consuming for an entrepreneur and for the management team. Take into account that all the time that goes into negotiating with investors is time that is lost for the development of the company. That is why it is rare for a company to negotiate with more than three investors or investment syndicates.

More than allowing VCs to compete with one another, it is essential to find an investor that best fits with the company. The ideal investor has an investment strategy that corresponds to that of the company, and possesses relevant experience or expertise. Identifying the right VC is certainly more important than finding the one whose financial proposal is most attractive.

4 HOW TO NEGOTIATE A TERM SHEET?

This fourth chapter discusses the major outlines of the agreement that binds the company and the VC. The definitive agreement later needs to be converted into new Articles of Association and a shareholder agreement. Before starting with this, the various parties summarise the major outlines in a *term sheet*.

The investment that a VC makes in a company is accompanied by many changes that naturally stem from its position as a new shareholder. As always, it is better to clarify all of the arrangements in advance, before the investment is realised. Each VC fund or company has its own term sheet model. In fact, there are no standard contracts: after all, each company and each investment situation is different.

Nevertheless, every term sheet poses the same fundamental questions:

- What are the conditions for the financing of the investment?
- How will the company be directed?
- What agreements need to be made with the key figures within the company?
- How is the investor's exit organised?

Aside from the purely financial elements, which we shall discuss further in Chapter 5, the *term sheet* sometimes addresses highly sensitive and emotional issues. The negotiation of these is even more delicate because it is often a matter of anticipating problems, or even crises, which all of the parties hope will never occur...

■ The characteristics of a good agreement

Based on the above, one might get the impression that negotiating with a VC is difficult, but that is an exaggeration. It is true that the discussion is sometimes technical, but most of the points are a reflection of common sense and good faith. In any case, it is important to keep in mind the characteristics of a good agreement, in other words:

- Simple (everything must be understandable) and concise (a term sheet is rarely longer than 6 pages);
- Fair (no party may be put at a disadvantage, otherwise the collaboration will be starting on a poor footing);
- Should be more based on trust than on legal procedures (although these are necessary);
- Applicable if the company undergoes a difficult period (without encouraging absurd or evasive behaviour).

These highly general rules, which are applicable in many other situations beyond the negotiation between a company and a VC, allow all of the parties to verify whether the negotiations are proceeding properly.

A FEW IMPORTANT POINTS IN A *TERM SHEET*

- Structure of the investment (capital, convertible debt, …) and the nature of the privileges or guarantees granted to the investor (preferred shares is the term used to refer to the shares of the VC)
- The composition and working of the Board of Directors (BoD)
  - Number of directors
  - Presence of external directors
  - Possible veto rights (the VCs often demand a number of logical veto rights)
  - The subjects reserved for the BoD
  - Mandatory reporting and control of the accounts
- The employment contract for the active shareholders
  - Remuneration: fixed and variable, evolution over time, …
  - Terms of the period of notice, with the distinction between an amicable departure and in the case of a dispute (referred to as: *good leaver* / *bad leaver*)
- The shares option plans as a motivation for key employees who are not shareholders
- The terms by which the initial valuation can be adjusted
- The confidentiality and non-competition terms
  - Extent
  - Period
- Rules for the purchase and sale of shares
  - Pre-emption rights: existing shareholders get priority over new ones
  - Multiple possibilities for restricting the sale of shares or, on the contrary, for making this mandatory
  - Priority among the shareholders related to the selling on of shares upon their exit
- How potential disputes will be settled, generally an arbitration clause

5 HOW IS THE VALUE OF A COMPANY DETERMINED?

Much has been written about the topic of this fifth chapter, the valuation of companies! Determining the value of a young company wishing to grow rapidly is no simple matter. On the one hand, the existing financial situation of the company (as indicated by the balance sheet) reflects its history but not its future potential. On the other, the realisation of its potential remains something highly hypothetical, certainly in light of the considerable risk of the project. Nevertheless, the VC and the shareholders must come to an agreement about the value in order to determine what percentage of shares will be awarded to the VC In exchange for the investment. Simply put: even if the accounting value of the company is 10, the economic value might be assessed at, for example, 70. In this case, an investor who invests 30 receives only 30% (=30/ (70+30)) of the company capital, and not 75% (=30/(10+30)) as one might erroneously conclude if one worked from accounting data alone.

The purpose of this guide is not to go into detail about the way in which the valuation is determined. Moreover, the definitive result is never arrived at through just a single method, but rather by applying a combination of different methods. Moreover, the value of a company is not the same as the price that an investor is willing to pay. Ultimately the price is determined by the negotiation capacities of both parties!

Technically speaking, and simply put, it is sufficient to understand the logic of four frequently used valuation models:

1. The Net Present Value (NPV);
2. The method of comparison with similar companies;
3. The accounting value of the existing net assets, potentially corrected;
4. The valuation based on the expected exit value.

■ Method 1: The Net Present Value (NPV) or Discounted Cash Flow (DCF) method

The Net Present Value is the most commonly used formula for the valuation of any investment project whatsoever and is therefore almost always used by VCs for the valuation of the company. According to this method, the existing value of a company depends on the future cash flow (*free cash flow*, abbreviated *FCF*) which it will generate through its activities and which will ultimately benefit the shareholders. It is however not sufficient to simply count up to cash flow. On account of the temporal value of time (money depreciates in value over time) cash flows which are expected in the distant future are worth less than cash flows expected in the near future. Taking into account the investor's target returns, the future cash flows are actualised[6]. The Value of the company is the net actualised value of the sum of the actualised free cash flows (*discounted cash flows* or *DCF*).

The calculation is based on two elements:

- The future free cash flows or FCFs: they stem from the company's financial plan. The net cash flow of one year is the net result after taxes, increased by amortisation and depreciation, and decreased by the investment in fixed assets and the required working capital.
- The actualisation rate (discount rate, abbreviated R) corresponds to the returns expected by the investor depending on the risk of the project. The expected returns vary between 30% per year

[6] According to this principle, the current value of a euro is greater than that of a euro in one year's time, because the current euro can be invested at a higher or lower interest rate, depending on the investment risk.

for mature projects to nearly 100% per year for projects that are still in a very early preparatory stage.

$$NPV = \sum_{T=1}^{\infty} \frac{FCT_T}{(1+R)^T} = \frac{FCF_1}{(1+R)^1} + \frac{FCF_2}{(1+R)^2} + \frac{FCF_3}{(1+R)^3} + \ \dots$$

If the business plan is well written and optimised, this calculation will generally lead to a positive result and this is all the more the case, the lower the discount rate that is used. The result corresponds to the total value of the company.

It should be emphasised that the greatest difficulty of this method is that it is based on many hypotheses, which are often difficult to prove. The use of spreadsheets often encourages entrepreneurs to put forward growth hypotheses that are not very realistic, by putting their trust in mathematical formulas that have little to do with reality.

WHICH DISCOUNT RATE TO USE?

It is extremely difficult to correctly estimate the expected returns. After all, the risk premium for growth projects is difficult to determine. As an indication however, we can show the evolution of returns depending on the company's developmental phase:

- Seed phase (R&D, prototype development, preparatory phase prior to the start of the commercial activities): from 60% to 100 %;
- Start-up phase (the initial commercialisation, often exploratory and on a local scale): from 50% to 60%;
- Start of the growth phase (more systematic organisation and commercialisation, often with the first steps towards internationalisation): from 40% to 50 %;
- Rapid growth phase: from 30% to 40%.

The expected return is much higher than what investors in publicly listed companies can expect. This not only has to do with a higher risk involved in the VC investment. In addition to the risk that needs to be compensated, the VC also expects compensation for the time that he or she will spend on the project. On top of that, there is an extra return expected for the fact that the VC acquires shares that are non-liquid, which makes the exit more difficult. Non-liquid shares are therefore always worth less than publicly listed, liquid shares. A final factor is the fact that the VC generally only acquires a minority interest, which is always more difficult to sell than a majority interest and therefore puts pressure on the value.

Method 2: Comparison with similar companies

The value of a company can also be defined as the price for which the company could be sold immediately. In order to determine this, one first looks at the value of similar companies (for example, as used in the context of an acquisition or IPO). Based on these companies, one can calculate relevant ratios (or '*multiples*'), such as the transaction value in relation to the sale, profit or cash flow. The value of the target company is then equivalent to the sale, profit or the cash flow of the target company, multiplied by the multiple of the reference companies.

The greatest difficulty with this method is finding comparable companies (referred to as the 'peer group'), meaning from the same sector, with a similar business model, and comparable size, …

The *multiples* used are very different and sometimes strongly linked to the sector. The most current are:

- A multiplier of the sales (the *Price to Sales Ratio, abbreviated P/S*);
- A multiplier of the operating results (*Earnings Before Interests and Taxes, Earnings Before Interests, Taxes, Amortizations and Depreciations*).

Also used are:

- A multiplier of the net profits (*Price Earnings Ratio, abbreviated P/E or PER*);
- A multiplier of the accounting value (*Price to Book*).

This method is highly useful because it is based on real market transactions, but it is not always applicable to young companies that by virtue of their young age and their innovative nature are not always in the same situation as a company that has reached a certain maturity. Sometimes the calculation is even impossible because the company has not realised sufficient sales or is still booking losses. This method can also be used to calculate the exit value because business plans always provide indications of the performance that is hoped for, such as sales, profit or EBIT, and is used as the basis for the following method.

Method 3: The valuation based on the expected exit value

The valuation based on the exit value is a very simple form of NPV that works from the principle that the only flow of funds that the investor will receive is his percentage of the value of the company on the date of exit. It is therefore sufficient to concentrate on this figure. In order to estimate the exit value, the multiples method is used, taking into account the sales or profits to be realised in the future, assuming that the project is successful. In this way, the company (which will then no doubt have become an important player in its market) is easy to compare with other, established companies. In this method, one starts calculating the value of the company on the day of the sale or initial public offering. This value is then calculated back to the date of the investment, taking into account the returns expected by the investor (just like for the NPV).

According to this method, the value of a company is calculated exclusively on the basis of the realisation of the exit value (it is assumed that the investor receives no other income):

$$NPV = 0 + 0 + \ldots + \frac{FCF_E}{(1+R)^E}$$

Whereby:

- E is the exit year;
- In practice, the denominator $(1+R)^E$ corresponds to the global multiple that the investor will realise on his investment.

Ultimately, one must also take into account the possible future needs for extra capital, which would then bring about a dilution of the shareholders. The value of the company, taking to account the future dilution, can then be calculated as follows: $V = (V_E / M) \times (1 – D\%)$

whereby:

- V_E is the sale value;
- M is the multiple expected by the investors in the successful scenario;
- D% is the dilution of the capital that will be necessary to make room for new investors before the sale takes place.

Method 4: The net assets

In contrast to the NPV, which is based on the future, the net assets method reflects the past. In this method, the value of a company is approximated through the accounting value of the invested capital, increased or decreased by the previous results and the reserves. This value can be corrected by including the fair value of assets which have not (yet) been included in the accounting results, such as non-realised added or reduced value on assets, but also the non-payment or underpayment of the active shareholders or expenditures that are borne privately for the start up of the company. If these expenditures are significant, the symbolic term 'sweat value' is used.

Of course, this valuation method, based on the past, often generates lower results and does not take into account any of the future prospects of the company. This method should however not be ignored, as the result of this calculation represents the value of the amounts invested by the founders.

Combining the methods and adapting the result

The four methods described above, of which many variations exist, generally result in a different valuation for the company. If the results are highly divergent from one another, one should carefully consider the causes of these differences. In this way, inconsistencies can be avoided. In order to arrive at a final estimation of 'the' enterprise value, VCs often combine the results of multiple methods, by averaging the results, for example.

Adjustment of the value and 'random' valuation

Whatever valuation method one chooses, the valuation of a non-publicly listed company remains arbitrary to a certain extent. Questions arise such as the value of an entrepreneur's work, which companies are comparable, what is the correct discount rate, what is the expected exit date and exit method.... It is therefore rare for VCs and entrepreneurs

to agree about a single exact enterprise value. That is why correction mechanisms are used in order to bring the different points of view closer together. Without going into detail, we can divide these methods into two categories:

- Agreements before the purchase and sale of shares made between entrepreneurs and VCs at predetermined prices, but with conditions that are related to the profitability goals of the VC.
- Value correction mechanisms along the way as certain preset goals are realised (‘*milestones*’). The value can be increased or decreased in function of the attainment of these targets.

There are many possible combinations for these mechanisms and they make it possible to establish a valuation margin, depending on the fact of whether or not the company realises its business plan.

6 WHAT IS INCLUDED IN A SHAREHOLDER AGREEMENT?

A few final formal controls

After the negotiation of the term sheet, VCs often request a formal confirmation of elements that were accepted as assumptions during the research on the company, such as:

- An audit of the accounts and the articles of association by a company auditor;
- An audit of the situation by a taxation specialist;
- A social and legal audit (verification of the major contracts with employees, partners, clients and suppliers) by a law firm;
- A control of the intellectual property (patents, brands, domain names, …) by specialised companies.

Naturally, companies that raise VC can save a lot of time by having the quality of their management confirmed by professionals. In that case, the formal verification by the investor can go very quickly or may even be superfluous.

The shareholder agreement

The last step before the VC releases their funds is the signing of the shareholder agreement. The goal of this is twofold. On the one hand, it concretely expresses all of the points from the *term sheet* in the form of a true contract. On the other hand, it outlines the legal process that will need to be undertaken to be able to release the funds, such as, for example, modification of the company's Articles of Association.

The shareholder agreement is an essential document because it officially confirms the terms of the collaboration between the new partners and specifically stipulates their rights and obligations. It often also leads the entrepreneur to draft better administrative and financial procedures. We should emphasise the following elements, which frequently form part of the shareholder agreement, because many entrepreneurs underestimate the importance:

- The establishment and organisation of the Board of Directors with (a) representative(s) of the investor(s), often supplemented with one or more external directors who are elected by all shareholders jointly;
- The determination of the maximum amount of investments and expenditures for which the management committee and the CEO may decide autonomously, or vice versa, the amount of expenditures above which the approval of the Board of Directors is required;
- Drawing up a complete contract between the company and its management, which includes an exact stipulation of the function, remuneration and termination terms for the collaboration;
- The periodicity and transparency in the financial reporting, based on accounting rules established in advance (in other words, the end of the creative accounting practices applied in some SMEs);
- Ceasing any potentially creative or even illegal habits related to the remuneration of the management and employees of the company;
- Introducing stimuli (usually *Stock Option Plans*) for all key figures in the company.

The agreement, which is linked to the investment by a VC, often marks the end of the period in which the founders of the company were omnipresent and were able to take all decisions autonomously. Although the advent of an investor is sometimes seen as the cause of administrative red tape and heightened control, one should not lose sight of the fact that reporting and control are only designed to promote the proper working relationship between the company and the VC and above all to ensure that the company functions according to the best practices which are necessary if all parties involved are to realise a successful exit at the end of the process. Strict administrative monitoring and proper financial reporting help to create value in a company!

7 HOW TO COLLABORATE WITH A VC?

The relationship between the entrepreneur and the VC does not stop at the point of investment. On the contrary, most VCs spend a great deal of time following up the management of the companies they finance. They provide support to them in order to ensure their optimal development. The term '*hands on*' is often used to indicate that they act as genuine partners. It is important to understand that the assistance provided by the VCs is chiefly situated in the strategic and financial areas, rather than in the day-to-day running of the company, which remains the domain of the management.

The VCs almost always have a seat on the board of directors and in addition keep in regular contact with the CEO or other key managers of the company. Because VCs often have a lot of experience supporting growing companies and generally possess a lot of experience in the sector, they can often help the company:

- With the choice of establishing professional management methods, specifically regarding
  - the *corporate governance* of the company,
  - Drawing up and ensuring compliance with healthy budgets,
  - Developing and reporting spreadsheets,
  - …
- By establishing a relationship with the parties who can provide specialised services;
- By developing synergies with the other companies in their portfolio;
- By allowing them to benefit from their network of relations, for example with large companies;
- In the negotiation of other forms of financing (banks, government support, …);
- With the preparation of the exit strategy;
- With difficult decisions, by offering a second opinion;
- By stepping back and taking distance to gain a view from above of the strategic decisions;
- …

This demonstrates that VCs invest more than just money in the companies that they finance. That is why the term *smart money* is often heard.

THE FOUNDATIONS OF THE COLLABORATION

- Ethics
- Engagement
- A shared vision

8 THE EXIT: HOW DOES THE INVESTOR WITHDRAW FROM THE COMPANY?

This final chapter is about the end of the partnership between the company and the VC. The exit strategy is of essential importance for the VC because it is only then that the added value can be realised on the capital invested.

In general, four major exit methods can be defined:

- The sale of the entire company to a different company, which is known as a *Trade sale*;
- The free purchase of shares by the management: known as a *Buy out*;
- The sale to a different financial investor: known as a *Secondary sale*;
- A stock exchange launch: known as an *Initial Public Offering*, or *IPO*.

The complete sale is the simplest and most common scenario. Moreover, it offers the advantage that it can be realised at relatively low cost and can be performed quickly since it is only a matter of convincing a single buyer, although it is customary to place various buyers in competition with one another. Usually, a competitor, a supplier or a client buys the company. The greatest disadvantage of this type of sale is that it generally spells the end of the initial entrepreneurial adventure and leads to a certain anxiety among the employees of the company. Whilst the VCs want to sell their stake, some entrepreneurs want to continue to develop their company.

Another option is for the entrepreneur himself to buy back the shares from the VC. This can be done by means of a Management Buy Out (MBO) or the buyback of shares with the help of a (partial) credit that can be repaid with liquidity generated by the company. An alternative is that the entrepreneur or investor tries to sell a part of the shares of the company to a different financial partner who replaces the VC. In this case, it is referred to as a *secondary sale*.

An initial public offering or IPO offers the advantage of creating a market for the resale of the company shares. If the market conditions are favourable, the VCs can sell their shares, while the entrepreneurs may keep them if they wish (the value of the shares continues to evolve in function of the company's performance). In this case, the entrepreneurs usually remain in charge of the company, which means that they regain control over the company. In Belgium, thanks to the Free Market and Alternext, SMEs can be listed on the stock exchange without having to meet the many conditions for the regulated market such as Euronext.

An IPO has other positive effects. Carrying out a capital increase on the capital markets becomes easier, which means that new capital can be raised at better conditions than with the VC. With this money, the company can further finance its development. Another consequence of an IPO is that the visibility and the name recognition of the company grows or is reinforced.

All exit strategies are essentially possible, but the company must meet highly diverse requirements depending on the chosen exit route. It is therefore important to identify an exit strategy as soon as possible, but of course flexibility remains necessary. After all, it is impossible to perfectly predict the future!

BASIC CONDITIONS FOR AN EXIT	
Trade sale	The company must be attractive and easy for the buyer to integrate. The management must for example be easy to replace by a team from the buyer and the company may not have too many contracts for alliances with the buyer's direct competition.
Buy-out	The company must generate as much liquidity as possible in order to repay a debt, the amount of which must come as close as possible to the sale value of the company. We also advise including a number of fiscal limitations.
Secondary sale	There are two highly different scenarios possible here. In the first, the new investor is also a VC and the conditions remain similar. In the second, the investment is made by a passive financial partner, sometimes a holding, who assesses the potential financial returns (including dividends) on the long-term.
IPO	The company must be attractive for stock market investors and ideally, must already be known and have a good management team in place, respect the rules of good governance and have a good view of the future results and a growth margin.

9 CASE I – ABLYNX

Ablynx is a young pharmaceutical company, founded in Ghent in 2001, which further develops and commercialises the research results of the VIB (*Vlaams Instituut voor Biotechnologie or Flemish Institute for biotechnology*) and the VUB (*Vrije Universiteit Brussel*). Ablynx is specialised in the development of '*nanobodies*'. These are new proteins based on antibodies from ungulates, which make it possible to develop new medicines for treating diseases such as Alzheimer's, cancer, thrombosis and infections.

Already from its founding, Ablynx called upon VC: at the time it was founded, Gimv invested €2 million in the capital. With this sum, Ablynx was able to start up the exploitation of the nanobody technique. The funding from Gimv also created a leverage effect for R&D subsidies from the Flemish Region.

Gimv is a venture capital fund that was originally owned by the Flemish Region, but is currently publicly listed on Euronext Brussels and has built up some 30 years of experience in Private Equity and Venture Capital. Gimv has specialised biotechnology team.

Between 2002 and 2006 Ablynx raised nearly €78 million from various VCs in three additional investment rounds. During the first of these three rounds, in January 2002, Sofinnova Partners SAS (France) and Gilde (the Netherlands) invested €3 million. During the second round, in April 2004, Ablynx was able to convince investment funds Alta (USA) and Albingworth (United Kingdom) – two new investors - along with the existing shareholders to invest €25 million. During the third round in August 2006 (then one of the largest deals of the year) they were able to receive nearly €40 million from the existing shareholders and two new investors, KBC and SR One (USA).

Since 2003, Ablynx has been able to consistently increase its revenues, from €0.1 million in 2003 to €16.8 million in 2008. The number of employees has also grown exponentially, from a staff of 10 in 2002 to 205 in 2008.

In 2007, Ablynx was launched on the Brussels Stock exchange and the company raised €85.2 million new capital. At the time, this was the biggest ever initial public offering of a biotech company in Belgium! During the IPO, Gimv did not sell any shares, but on the contrary, took advantage of an attractive issue price (€7 per share) to further increase its investment.

The Ablynx case perfectly illustrates the way that it is possible for a company to call upon VC already from the seed phase in order on the one hand to raise the necessary funds for preparatory activities (R&D and prototype development) and on the other hand to benefit from the expertise and network of the VC.

Source: IPO Prospectus and company website

10 CASE 2 – 4 ENERGY INVEST

4 Energy Invest was founded in 2005 and is located in Wallonia. The company is active in the renewable energy sector. It develops projects for converting uncontaminated surplus products from wood processing into energy (electricity and heat) or fuel (biomass). Currently 4 Energy Invest has two cogeneration projects, "Amel I" and "Amel II", near Amel in Wallonia. Based on wood scrap from three other local companies, 4 Energy Invest generates electricity and heat and receives, for example, green energy certificates in return. The electricity obtained in this way is sold to the grid and the heat is sold to wood processing companies in the region.

In order to finance its first cogeneration project "Amel I", 4 Energy Invest decided to call upon VC. In late January 2006, KBC Private Equity was convinced by the project. KBC Private Equity's investment of €3.478 million enabled 4 Energy Invest to complete the financing for its first cogeneration factory "from-wood-to-energy". This installation has been operational since November 2007.

In late 2008, 4 Energy Invest wanted to pursue a growth strategy and to diversify its activities. Three projects were already in an advanced stage of development, specifically the cogeneration projects in Ham (Flanders) and Pontrilas (United Kingdom), which were scheduled for start-up in the course of 2010 and a "green coal" project in Amel that was scheduled to become operational in 2009. In addition to these three projects, the company is planning another cogeneration project in Germany, comparable to the one in Ham, and another project for the construction of three biogas sites in Flanders.

4 Energy Invest was able to realise these projects thanks to the initial public offering in June 2008, whereby €22 million in new capital was raised. It should be pointed out that since the IPO, KBC Private Equity currently still holds 26% of the shares in the company.

The success story of 4 Energy Invest is a good illustration of how a company in its initial growth phase can call upon a VC to start up its commercial activities. In the case of4Energy Invest, it is clear that only a VC was capable of investing the €3.5 million needed to start the project.

Source: IPO Prospectus and company website

CASE 3 – VIVIO

The ViVio Group is specialised in medical publications. In 1998 the brothers Philippe and Laurent Violon, a neurologist and a business administrator respectively, founded Violon & Violon bvba. At the time, their goal was to launch Belgium's first humorous medical magazine "Acta Humoristica".

In order to simultaneously enable the European development of "Acta Humoristica" as well as the launch of "Ma santé" (My Health), the first 100% French-language Belgian magazine on health and well-being, both founders decided to call upon the *Gewestelijke Investeringsmaatschappij voor Brussel* (GIMB) in 1999. The investment of €237,000 in capital allowed the holding V&V Communication Company n.v. to be established, which owns all of the shares of the company

Thanks to the intervention of the GIMB, the company increased its turnover, solely from the sales of the magazine "Acta Humoristica" to €250,000, whilst the company employed only a single half-time employee in addition to the two founders.

The magazine "Ma Santé" was launched at the end of 1999 through a new subsidiary, V&V Publishing n.v., of which the Rossel group took over 50% of the capital one year later.

The magazine "Acta Humoristica" folded in 2002, a victim of the crisis in the sector of professional medical publications. Nevertheless, the company continued with the development of publications about health for the general public. Specifically, Vivio developed its activities in two main directions: custom publishing (the made-to-order production of magazines for third parties) in the Belgian health sector and the creation of pedagogical aids for patients such as manuals, inserts, comic strips and websites.

In 2009 Vivio had a turnover of €2.5 million and 20 full-time employees.

The GIMB withdrew from ViVio in 2007 by selling its shares to an active partner who became the commercial director of the ViVio group. This example illustrates that financing by a VC is not only reserved for the so-called high tech companies and can offer advantages for any company, in any sector.

Source: Interview with Laurent Violon

BIBLIOGRAPHY

A number of titles recommended for further study:

- Attracting Investors: A Marketing Approach to Finding Funds for Your Business
  Philip Kotler, Hermawan Kartajaya & S. David Young
  John Wiley & Sons (2004)

- Financing Entrepreneurial Companies: How to Raise Equity as a High-Growth Company.
  Sophie Manigart and Miguel Meuleman
  De Boeck & Larcier (2004)

- Smarter Ventures: A Survivor's Guide to Venture Capital Through the New Cycle
  Katharine Campbell
  Financial Times / Prentice Hall (2003)

- The New Business Road Test: What Entrepreneurs and Executives Should Do Before Writing a Business Plan
  John Mullins
  Financial Times / Prentice Hall (2nd Edition, 2006)

- The Venture Capital Cycle
  Paul Gompers & Josh Lerner
  MIT Press (2002)

- The Venture Capital Handbook: Strategies for Successful Private Equity Investment
  William D. Bygrave, Michael Hay & Jos B. Peeters
  Financial Times / Prentice Hall (1999)

- Venture Capital Handbook: An Entrepreneur's Guide to Raising Venture Capital,
  Gladstone David and Gladstone Laura
  Financial Times/Prentice Hall (2002)