bangkit

Class 8
Startup Valuation and Investment Pitch

Learning Objectives

01. Recognizing the reasons of raising capital for new business

02. Developing an understanding of terminologies related to business valuation

03. Communicating effective presentation pitch

Introduction to Startup Valuation

TECHINASIA

Indonesian investment app Stockbit raises series A funding

TechCrunch

Indonesian robo-advisor app Bibit raises $30 million led by Sequoia Capital India

Indonesian start-ups enjoy wave of funding, investment despite sluggish economy

The Jakarta Post

You have defined your big vision and you're ready to take the world.
But there's one problem, you need resource.

With headlines like the above plastered all over the news, they make it seem easy to become a successful entrepreneur and bring your idea to life. After all, all you need is a good idea, right?

Sadly, it is a startup misconception and the reality paints a different picture.

Did You Know?

In the third quarter of 2020, the world saw a total of US$76.4 billion in venture funding, but **only towards 360 companies**.

(Source: Crunchbase, based on disclosed rounds in Q3 2020).

It won't be a smooth-sailing journey to receive funding, but either you're building your product as an entrepreneur or under a company, you'll need capital (funds) to fully develop your idea.

As such, there are two important elements that you need to pay attention to when planning for your project:

1. **Why you need to raise capital.**
2. **Why people would be on board and invest in your idea.**

Why the Need to Raise Capital

Here are several general reasons why someone looks for fundings:

1. **Prototype development.**

   When starting your business, you might find yourself in need of new equipments and technologies to build your product, team members to do the work, or storage to store them.

   Example: Manufacturing or robotics sector, such as 3D printers, which require warehousing and technology support.

   The same also applies if you are an intrapreneur. Although the money doesn't go into your account, they are allocated to cover other costs, such as coaching needs, product support, or intrapreneurial incubators, all of which require the companies to spend money for a period of time.

   Example: IBM Garage rewards innovative minds by giving its employees resources and time to tinker and around under the expectation that their ideas will bear fruits for the company.

Why the Need to Raise Capital

Here are several general reasons why someone looks for fundings:

2. **Urgency to grow the product as fast as possible.**

   You might not need to finance all of them at the same time, but there are times when you **need to start as soon as possible** before the momentum disappears and competitors come in first. Especially so in a competitive market, you may want to ensure that your product can be a **first mover** and gain people's attention before everyone else.

   Example: An online marketplace needs to build presence by partnering with vendors/sellers which require staffs to do do outreach marketing.

3. **Overcome barrier to entry.**

   Government regulations and certifications compliance require extensive research and multiple testings before you're able to release the product to the mass market. This alone will require some amount of funds to ensure that your product are safe and secure to use.

   Example: Building products for financial or pharmaceutical industries, where you need licenses from OJK or BPOM.

Why the Need to Raise Capital

Here are several general reasons why someone looks for fundings:

4. **Gain external feedback.**

   It may not be as obvious at first, but when you're looking for funds, you not only get the opportunity to secure the fundings, but you also get an **additional benefit** in a form of **investors' feedback**, criticism, and thoughts on your product.

   These investors are people who have seen and listened to numerous proposals. Thus, these feedback are valuable even if they don't invest in you, because you have the **next starting point to improve** your solution.

Why do People Invest?

It is entirely up to you if you'd like to proceed to look for fundings, use your own resource, or wait out until you have enough. You have learned about the benefits and risk surrounding each option.

If you choose the former, you need to start thinking of your startup/product value. To do so, you need to pay attention to these two key factors that people look for in common:

1. **A robust business model with growth potential**

   Investments are not donations. People put in their own money because they believe that it will be good for them, and that is why they expect a return on investment (ROI). If you can demonstrate that your idea will be able to make money a lot more than what they can provide now, you will have a chance to secure their help in form of fundings or even knowledge.

   To do that, refer to your learning in building an MVP, that is to know your market, who your customers are, how you can reach out to them, whether your feature will work, when you can expect the MVP to be released, and your competition. Essentially, you need data to make sure that you can make money or deliver results. From there, demonstrate that you have a clear plan, i.e. your product roadmap.

Why do People Invest?

2. **Product vision, which is your narrative.**

Remember, ideas are a dime a dozen, but executions make the difference. People hear a lot of pitches packed with hard data, but how do they compare similar business models and choose one over the other? **Your vision** and how you can convey it. What makes your idea unique and special? Strongly show that you want to **bring impact** to the world.

"People don't only buy products, they buy stories."

Understanding Investment Stages

Understanding Investment Stages

Businesses receive their investments in several rounds depending on the current valuation and growth trajectory of the respective business. Here's a glossary to help you go through each of them.

Pre-Seed Funding

This is the money that most likely comes from your own pocket, gifts or loans from family and friends, and can also be the prize for winning on competitions, which will be used to get you started. The funding is usually just enough to get you start tinkering on your idea.

Seed Funding

This is the stage where **angel and venture investors start to be viable financing options**. The aim of a seed round is to give your idea enough money to take root, which usually means to help you develop the initial product, find initial customers, and conduct validation/retargeting as needed. To be noted, usually in this stage entrepreneurs are the price takers while investors become the price makers.

Valuation Terms Glossary

Series A

Businesses that go through Series A Funding are companies that can demonstrate market demand and have a potential to grow. The number of investment varies and changes over the years, but it could reach up to tens of million US$ depending on the number of interested VCs. According to Alpha JWC Ventures, the average Series A funding in 2020 is $15.6 million.

- In Series A funding, investors are not just looking for great ideas. In addition, they are looking for entrepreneurs with a **strong business model and real market traction** that can turn the product into a successful, money-making business.

Series B

"B" is for "build". As the business continues to receive growing market demand, so does the need to increase manpower to support the growth.

- Series B fundings are all about taking businesses to the **next level** beyond the development stage. You can predict a market expansion while the business is fine-tuning a winning product through a strong and high quality internal team.

Series C

As businesses show signs of self-sustainability, they usually look for additional funding in order to help them develop new products, expand rapidly into new markets, or even acquire other companies.

- Companies engaging in Series C funding, often called later-stage rounds, should have **established** strong customer bases, healthy revenue streams, proven histories of growth, and resilience in challenging times.

Beyond Series C, businesses may still continue with Series D funding and beyond. They tend to do so because they are in search of a final push before an IPO or to scale up even more. In fact, in 2020, Gojek has raised over US$3 billion in its ongoing Series F round.

The rule of thumb is, the further you get in the funding rounds, the more you have to prove.

Valuation Terms Glossary

Unicorn

A Unicorn company is a business that is valued for more than USD$ 1 billion or equals to IDR 14 trillions.

Example: tokopedia traveloka

Decacorn

10 times higher than a Unicorn, a Decacorn company is valuated to USD$ 10 billions.

Example: gojek

Hectocorn

Hectocorn can be attained if the company valuation is US$ 100 billions and is still a startup.

Startup Valuation

When you start looking for funds to boost your business, you also need to **start talking about your business valuation**.

Valuation is essentially determining how much your business is worth. This worth will then be utilized by VCs or angel investors to help determine whether they should invest in you and by how much.

The problem is there is no exact way on how to value your business, particularly for businesses that haven't generated revenue or even the solution itself **(pre-revenue or pre-product) or going through seed funding**. What most businesses at this stage have is simply the idea.

Startup Valuation

However, this doesn't mean that you can come to investor meeting empty-handed. In seed rounds, startup valuation boils down to **negotiation between you and the investors** to find a deal that will benefit both sides.

A negotiation then requires you **back up your argument** with data and analytics, planning, as well as an educated guess on the aspects surrounding your business.

Here are the guideposts you need to prepare before you start raising your seed round:

Startup budgeting
How much do you need to run your operation?

Market size
What is the potential scale of the business?

Milestone
How are you going to develop the business?

Supporting data points
What else do investors may look at?

Estimating Your Startup Expenses

When your business is still in its early stage, it would be difficult to project how much income you're going to make. However, one data point that you can plan since the beginning is the **cost you need to maintain operation and acquire customers.**

Understanding your business finance and how you utilize those expenses to support business growth is what the investors will look for, as they will want to know how much capital you need to operate and why you need it.

In general, there are 2 types of expenses that a company needs to project:

1. **One-time expenses:** initial costs needed to start the business and only payable once throughout the course of the business.

   Example: permits/licenses, equipments like chairs or other technologies, logo design fees, etc.

2. **Recurring expenses:** various costs that you need to pay every month, usually to cover for day-to-day business operations.

   Example: salary, office rent, tax, utilities, marketing costs, etc.

Estimating Your Startup Expenses

You should have identified the total money that you need to support your operations for 1 year or even more. When you ask for investment, it is in your best interest to having the entire expenses covered so that you can focus to achieve whatever milestone you've set, for example from pre-product phase to having your MVP ready.

In seed round, the capital that you want to ask usually covers **12 to 18 months cost plus 20-30% buffer** from the projected cost.

Always add buffer.
Remember, what you have right now is a projection. Your monthly expenses could be different each month depending on your needs. There will be unexpected and emergency needs that emerge and affect your financials. Buffer acts as a guard so you have more room to adjust and continue your operations.

Example:
Startup A projected that its monthly expenses stand at $15,000 a month. However, it also plans to hire two more engineers at the start of the second semester to help build its product. Each employee will have US$1,000 monthly salary. It is currently unknown if Startup A will need more employees down the road. To cover for 12 months expenses, this is how Startup A may calculate its expenditure:

Projection	:	(first 6 months x $15,000) + (second 6 months x $17,000) = $192,000
Buffer	:	25% x $192,000 = $48,000
Total Budget	:	$192,000 + $48,000 = $240,000

Estimating Your Startup Expenses

Calculating a realistic startup cost is an essential factor of your plan due to these reasons:

1. **Signalling to the investors that you've done your homework.**

   Many entrepreneurs opt to raise more money than they need should any changes happen during the operations. While that would be advantageous if you can secure it in the short term, investors will question your business model. VCs don't want to give you more money than you need, for obvious reasons: it's their money at stake.

   As such, the cost budgeting is important because it shows that **you've thought about what it takes to actually build the business**. It shows a plan for how you will spend the money you raise from investors. You are thinking about who you need to hire, what you need to focus on, and how you plan to balance your priorities over a specific time frame in order to achieve key milestones for your business.

   Key milestones could include: "X" number of customers or key product launches. These are the commitments you give to signal that the business is worth injecting capital into.

Estimating Your Startup Expenses

Calculating a realistic startup cost is one of the essential factors of your financial plan due to these reasons:

2. **Determining how much capital you need to raise.**

   Having a careful planning on your expenses allow you to **know how much money you really need from an equity investment**. In seed rounds, valuation is most often based on how much money the business founders think they need to support the business. As such, your expenses will be translated to how much you're asking the investors.

   This will also assist the investors to **estimate the ownership stake that justifies their time and money**. Remember, investors and VCs are businesses. It is in their interest to have an ownership shares that is large enough so that they can take measures in your company to ensure that it will be able to generate returns. Naturally, you'll want to keep the majority of ownership so you still have sway over the direction of your company.

At the end, you need to engage in negotiations, and the results needs to be a win-win. So, aside of determining the fundraising needs, you need to have other bargaining power to improve your valuation, which comes from the **market opportunity** you have.

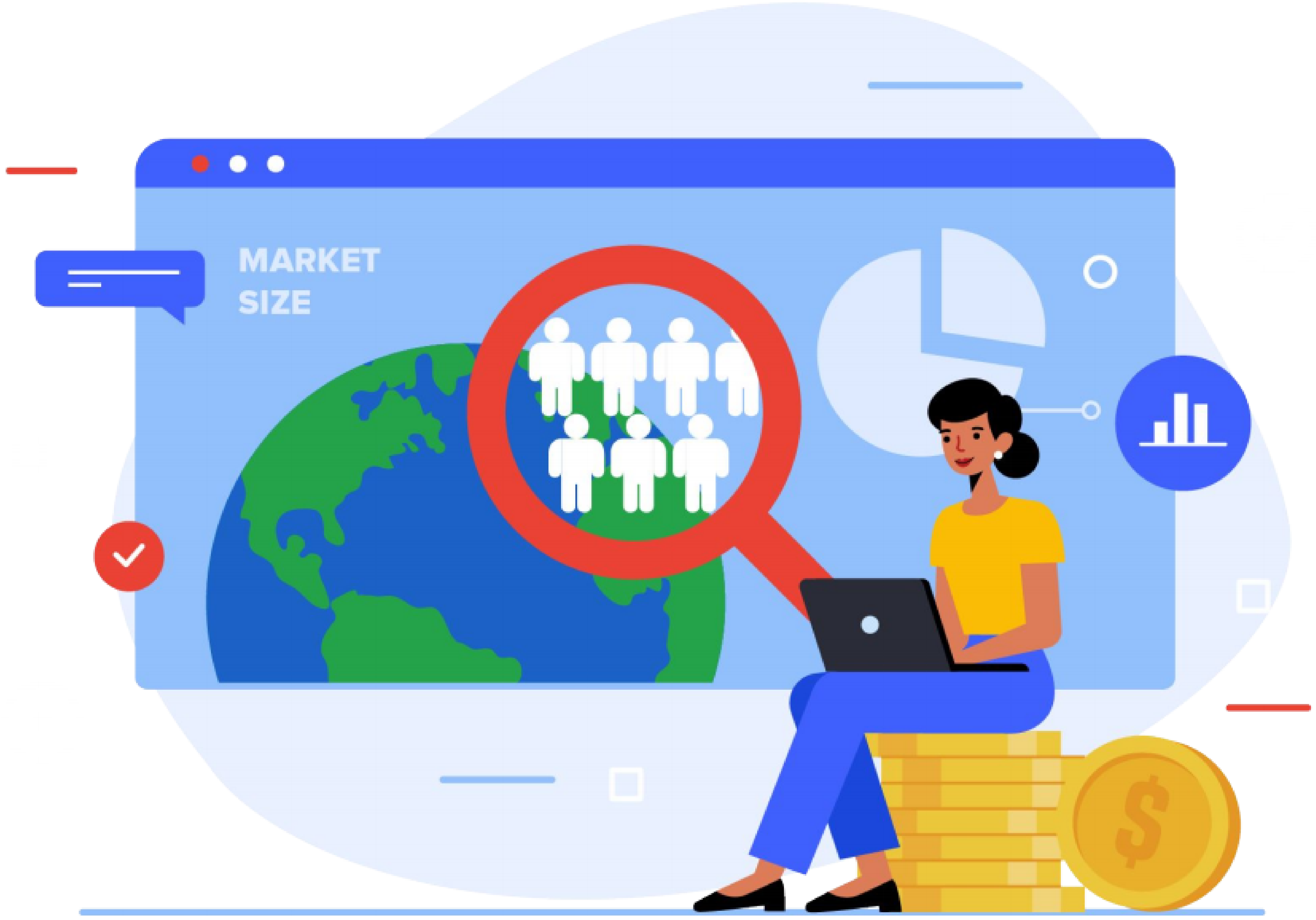
Forecasting Your Market Size

Determining how much you need to run the business is only half the battle. The other half is to make a projection of the potential scale of the business in regard to the market.

Investors need this data for two reasons:

01. **Help them figure out if your startup has a market** (i.e. risk assessment)

02. **Identify whether your business has a substantial upside potential** (i.e. huge market size)



Forecasting Your Market Size

As a starting point, you can predict your business market size through the following concepts:

1. **Total Available Market (TAM)**

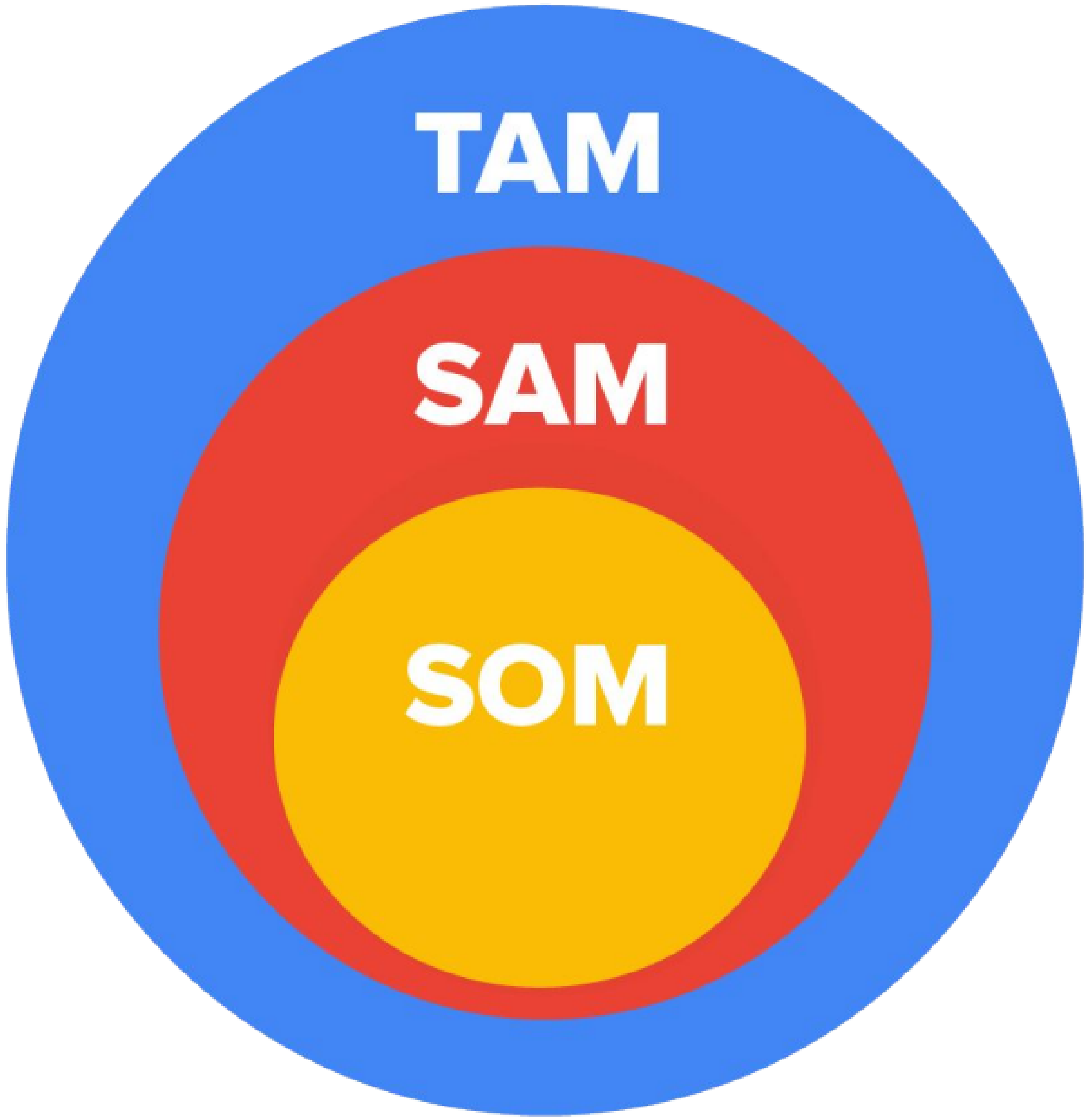
   The total market demand for a product or service. It refers to the industry's entire revenue opportunity.

2. **Serviceable Available Market (SAM)**

   A segment of the TAM which is within your reach.

3. **Serviceable Obtainable Market (SOM)**

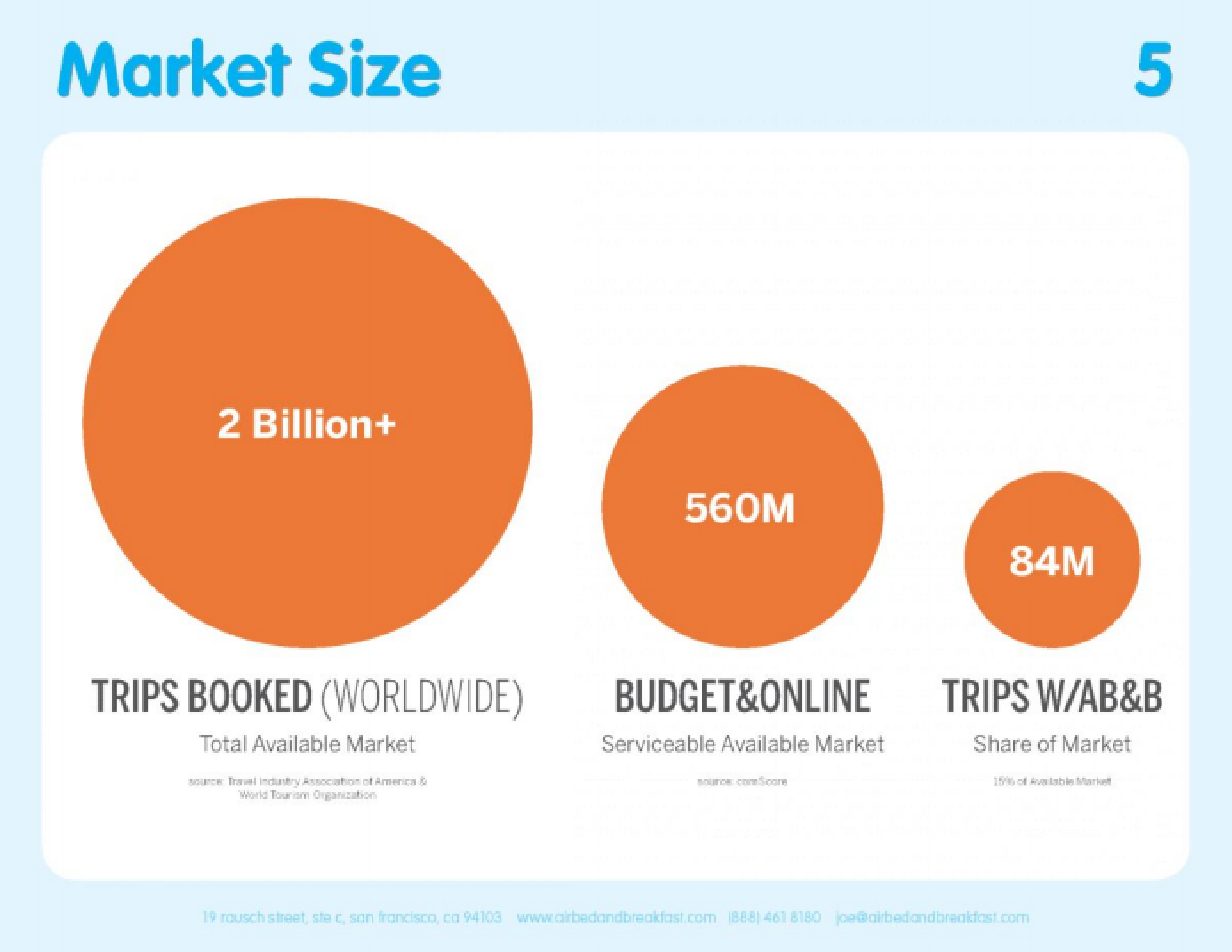
   A fraction of SAM that your product can capture considering competition and market exposure.



Forecasting Your Market Size

To illustrate, let's take a look at **Airbnb's pitch deck** at seed stage investment, when its name was still **AirBed&Breakfast**.

- As it operates in the travel industry, its TAM was more than **2 billion people**. This represented not only American travelers, but also **worldwide**. Potentially, if it was present in every country and had no competition, it would generate revenue in proportion to its TAM.
- However, **customers' journey and needs were different**. Some preferred to book through travel agent and pick established hotels, while Airbnb targeted travelers who ordered online and prefer budget accommodations. In turn, this decreased its market size to 560 million people, which represents its SAM, i.e. the demand within its reach.
- Further complication arose, as Airbnb was not the only player offering affordable packages online. This **shrinked its market size** even further to **a more realistic 84 million people** who show potential to use Airbnb's services, hence its SOM.

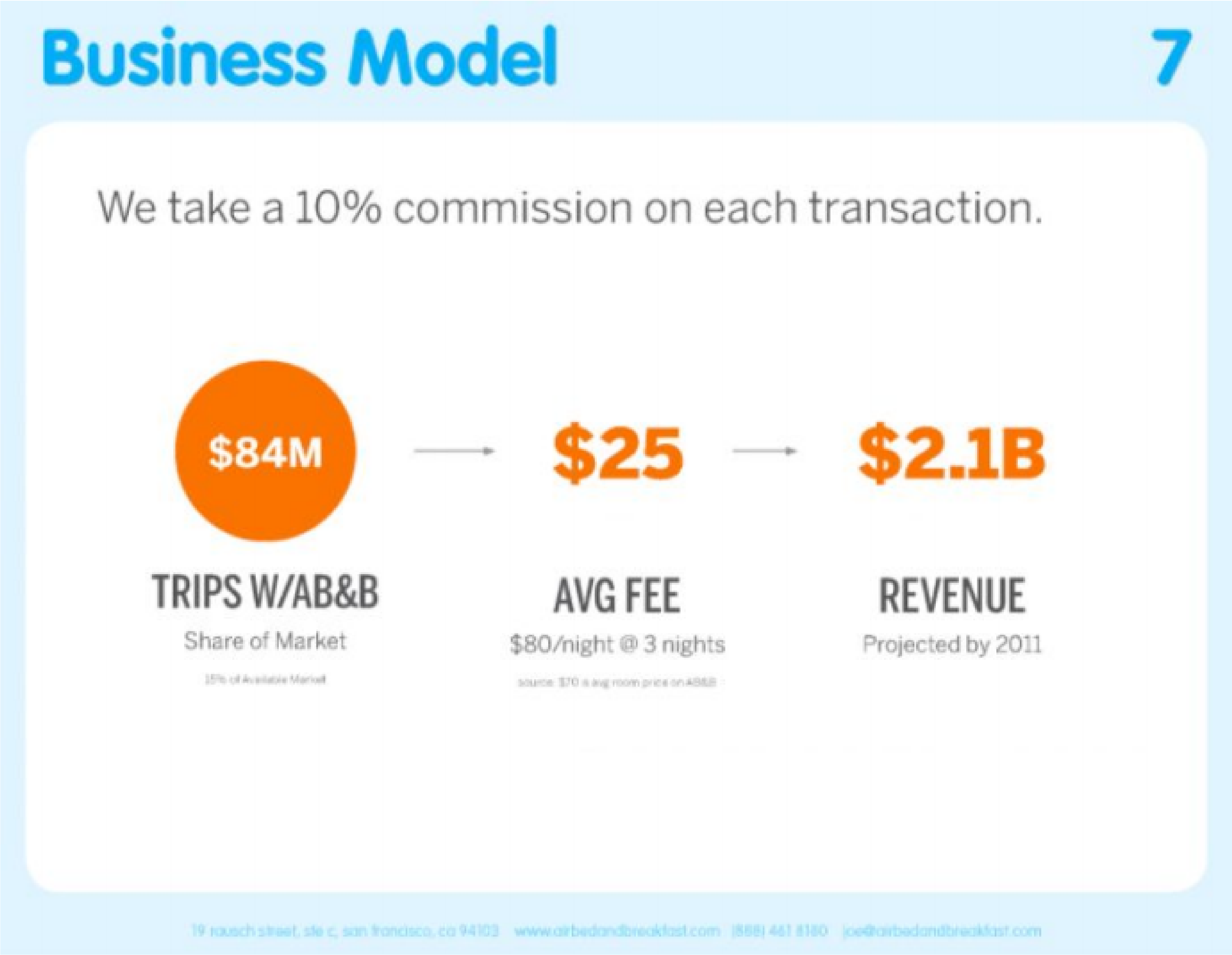


(Source: Airbnb, cited from [AlexanderJarvis.com])

Forecasting Your Market Size

Its **84 million SOM** was then translated into its business model. AirBed&Breakfast **gained income** by taking 10% commission on each booking, which averaged at $25.

When multiplied by its SOM, AirBed&Breakfast showed that it had a large market size and revenue potential, which was an **attractive but reasonable projection**.



(Source: Airbnb, cited from AlexanderJarvis.com)

Forecasting Your Market Size

Based on the example, the **SOM is your short term target** and therefore the one that matters the most. If you face difficulties on a fraction of the local market, it might be even more difficult to capture even larger market. As such, to be realistic, your SOM projection needs to consider:

1. **The quality of your product itself.** Will people buy from you?
2. **Marketing plan**. How far and wide can you realistically market your product to your target?
3. **Competition.** You won't be the only player; hence your SOM depends on their strength in the market.

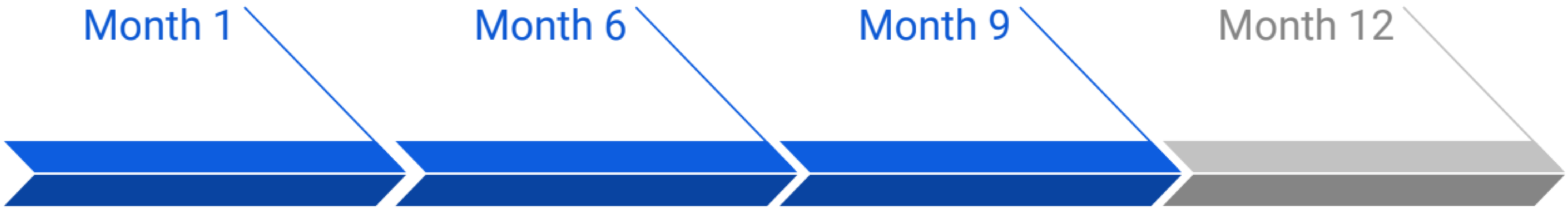
If you can service your projected SOM in a time period that you've set, then your business gains credibility. You might be able to increase the market share and **reach a more important penetration of the SAM** which would deliver a higher revenue and more ROI for the investors.

Once you have demonstrated your ability to penetrate the local market and eliminate risks, investors can start looking at how you can expand and increase the company's penetration within the **TAM**, **i.e. upscaling your product to be even bigger.**

Milestones Planning

You have identified the cost of your operations and your revenue potential based on the market size. The opportunities are endless and your growth trajectory could go a long way. It is therefore important that you establish **milestones that signify the development stage of your company.**

Consider the following example of a company's 1 year plan:



Stage 1:
Launch the Business

- Getting the basics together

- Market testing

Stage 2:
Product Development

- Concentrating on solution development

- Hiring star tech talent

Stage 3:
Aggressive Marketing

- More spending on marketing
- Activations
- Hiring C-level employees

Stage 4 and further:
Expansion

- Outreach to other markets

Milestones Planning

At the end of each stage is your milestone: be it launching your MVP or having a certain number of customers buying your product. By having milestones, just like a product roadmap, you know your achievements and measurement of success.

In relation to raising capital, you are **specifying how much capital is needed to fund those milestones one by one**.

By splitting the company's development into stages and milestones, you are making it easier for the investors if it's the right time to invest in you and when they are supposed to exit and sell their shares to other investors who might fund your next business stage.

In short, a milestone is beneficial for:

1. **Giving clarity on to what extent the investors are funding.**
2. **Making it obvious for investors that this is the time to invest.**
3. **Signalling the time when they could sell their ownership stake.**

Milestones Planning

The logic behind this is that if an investor feels confident that your business is viable and on track to hit its milestones, they know that once the company succeeds, your company will be more valuable to the market because your success has eliminated some risks, such as market validation. As such, investors want to have some stakes in your business right before ‘launch’ for example, so that they can get in before your business is too valuable for them to invest.

The bottom line is that when milestones are combined with data on your market size, your valuation could be positively leveraged.

Our learnings about the 3 previous guideposts ultimately boils down to help you articulate the following sentence during your investment meeting.

“This is the market potential of my product [number of the market size], and this is what I can accomplish now to be able to serve that market [the milestones], which will require this much [amount of expense/investment].”

In this way, you can determine set up startup valuation as well as your investment ask.

Other Common Data Points

Aside of the previous preparations, there are a couple of other **determinants based on your current situation** that can influence the valuation of your business.

Take a look at some of the most common data projections that you can use to leverage your valuation:

1. **The founders' background**
   Investors would like to be sure that they are backing a team destined for success. They are not just investing for a profits-making idea, they are **investing into people**. If you and your team exhibit skills diversity that can complement each other (such as having a marketing expert, strategist, and a programmer together), have domain expertise on top of industry experience and commitment to see things through, then your team is an arsenal to assure the investors. There are particular mindsets and certain energy that investors love and seek in some entrepreneurs, so groom yourself mentally as well. They do check your track record on paper, but the personality is what really matters.

Other Common Data Points

2. **Unique value proposition**
   This is highly crucial especially in seed round funding. You need to explain in great detail how your solution can solve the problem. The challenge is how you could make it **unique and outstanding** compared to the current players. The more unique your product is, the more valuable your valuation is.

3. **Viable business model**
   You will need to answer this question: “Will you have a revenue stream?” Remember, investors are running a business, and they want to see **how your business generates money**. The more customers can use your product, the better your market opportunity becomes. This will influence your income projection, and subsequently your valuation. You also need to conduct a competitors check how crowded the market is.

4. **Funding competition**
   With your situation analysis at hand, you can predict how attractive your company is to the investors. Do you have little competition in the market? Can your revenue be realistically measurable? If so, then you might see multiple interested VCs competing for the shares in your company. **The more competitive the investment funding among the VCs**, the higher you can boost your valuation.

Other Common Data Points

5. **Comparables and preceding investment**
   For each funding stage, there is usually a certain **realistic range that serves as a threshold** on how much money they're willing to invest. If your company is currently in the seed stage, then it would be beneficial if you can find how other companies with a similar business model and size performed before and make comparisons to justify your valuation.

6. **Economic outlook**
   This is the most unpredictable data point as you **rely on current economic performance** in the market you're operating. In the early months of Covid-19 pandemic, the economy was sluggish which forced the market down and so did valuations. But once the market rebounds, so does valuations. You need to pay attention and adjust accordingly.

With these data points in mind, we hope it can give you a clearer picture on the complex process of raising capital, and the **central role of any product or service that you will develop and manage** once you start your career.

Determining Your Startup Valuation

Having determined your research and planning, your next step would be aimed to **finding out your startup valuation** and **agreeing upon it with the investors** who you'll meet.

There are two terms that are used as signposts when talking about a startup value, which are:

- **Pre-money valuation:** The value of your company before any investment is made.
- **Post-money valuation:** The value of your company in addition to the funds invested.

For example, if you and an investor agreed that your pre-money valuation is at US$3 million and you receive US$ 1 million in investment, then your post-money valuation stands at US$4 million. This means that, in exchange for the investment, your share of the company is 75%, because the investor now owned the 25%. This is how equity works.

Your post-money valuation will be influenced by the market potential of your business. This is why you need to research your cost, market size, your business milestones, as well as other data points so that both sides can agree on your business prospects.

Pitch Perfect!

What is Pitching Process?

Pitching is essentially an art of presenting and convincing others to invest in your idea.

Investment pitch is not exclusively utilized by entrepreneurs towards investors. Intrapreneurs will also need to master pitching skills to get your foot in the door.

How will this affect the investment?
A great investment pitching can make obtaining financing for your startup much more likely, or in the case of intrapreneurship, to get your idea accepted by your company' management. In this case, at the early stage, investors are mostly the price maker, pitching is the right time for you to show strong impressions to them.

The rule of thumb is to ensure that your story is **complete, compelling,** and **interesting**. The goal is to explain why your idea/startup is an attractive investment opportunity.

What to Prepare

Prior to meeting your investor or management, you need to prepare the following items to ensure that you've come prepared:

01
Presentation Deck (Slides)
A material to explain deeper about your company which will use when meeting with the investors.

02
Elevator Pitch
A short statement describing your idea and vision.

03
One-Pager
As the name implies, it's a short document summarizing your business and projections, as well as the key aspects of the deal.

04
Minimum Viable Product
Bringing what you have created will provide clarity on how you develop a solution and how you translate it to a product. It doesn't have to be a physical product; demo slides are acceptable. Recall your learnings on MVP module.