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Investment Readiness Toolkit N°3

for: SME BlueImpact Asia

GUIDANCE REPORT:

Raising Equity Finance – Strategies & Resources for SMEs

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PREFACE:

PURPOSE OF THE TOOLKIT

This document provides the narrative of the Investment Readiness Toolkit ("the Toolkit") for SME BlueImpact Asia. This initiative was established by a consortium of Asian Development Bank (ADB), United Nations Development Programme (UNDP) and the United Nations Environment Programme (UNEP). In 2022, the consortium produced the Blue Economy Knowledge Product (BEKP) –Financing the Blue Economy which called for a blended finance initiative to mobilise investment for a sustainable blue economy focusing on Small-Medium Enterprises (SMEs). SME BlueImpact Asia is executed primarily by Ocean Assets Group (OAG), with support from the consortium of ADB, UNDP and UNEP.

OAG runs a parallel program for blue economy SMEs in the Global South: BlueDeals. The digital platform of BlueDeals hosts the Investment Readiness Toolkit, with user-friendly media tools to make the content of this Report more accessible to SMEs and other stakeholders.

Recommendations for actions and resources are designed to help SMEs in the blue economy to efficiently raise capital in today's marketplace. Each section includes detailed step-by-step guidance, sample pathways and documents. Links to supporting experts and institutions will also be provided should SMEs need to seek additional support. Users may access the sections most relevant to their needs:

I. UNDERSTANDING THE SME FINANCE ENVIRONMENT

II. ACCESSING DEBT FINANCE

III. ACCESSING EQUITY FINANCE

IV. UNDERSTANDING IMPACT METRICS

V. DEVELOPING BUSINESS PLANS

It is our hope that this Toolkit will speed up the financing of sustainable enterprises upon which the coastal communities and marine ecosystems of Asia and the Pacific depend. *Note: Since the Toolkit is directed primarily at managers of SMEs, with whom this initiative has a close relationship, we will address the reader henceforth as "You".*

A. WHY CHOOSE EQUITY FINANCE?

Equity finance, while offering certain advantages, also has its pros and cons for SMEs. Let's examine them in more detail:

1. Pros of Equity Finance for SMEs:

a. No Debt Repayment:

You do not have to make regular debt repayments or pay interest on the equity investment. This provides more financial flexibility, particularly in the early stages when cash flow might be uncertain.

b. Shared Risk:

Equity investors share the risk of the business. If the business faces financial difficulties or fails, the burden is spread among the investors. You are not solely responsible for repaying the investment if the business underperforms.

c. Access to Expertise and Networks:

Equity investors often bring industry knowledge, experience, and networks to the table. They can offer valuable insights, guidance, and connections that can accelerate SME growth, open new opportunities, and enhance the chances of success.

d. Long-Term Partnership:

Equity financing usually involves a long-term partnership between SMEs and investors. This can provide stability, ongoing support, and strategic input, which can be valuable for sustainable growth and development.

e. Potential for Higher Returns:

If the business succeeds, equity investors stand to benefit from the growth and profitability. As shareholders, they can share in the company's success through dividends, capital gains, or an eventual exit through a sale or initial public offering (IPO).

2. Cons of Equity Finance for SMEs:

a. Loss of Ownership and Control:

When you raise equity finance, you dilute your ownership stake in the company. Investors become shareholders and gain influence over strategic decisions. You may have to give up some degree of control and decision-making authority.

b. Sharing Profits and Control:

You must share future profits with equity investors. You may also need to consult and obtain approval from investors for significant business decisions, which can potentially slow down the decision-making process.

c. Potential Conflict of Interests:

As shareholders, equity investors may have different objectives and priorities compared to SMEs. Conflicts of interest may arise in areas such as dividend distribution, growth strategies, exit plans, or the timing and method of selling the company.

d. Information Disclosure Requirements:

When you bring in equity investors, you may be required to provide them with detailed financial and operational information. This level of transparency can be time-consuming and may restrict your ability to keep certain information confidential.

e. Valuation Challenges:

Determining the value of the company and negotiating equity terms can be complex. You may need to engage in valuation exercises and negotiate with investors to establish a fair value for the equity investment, which can involve time and costs.

> It's important for you to carefully consider your specific needs, growth plans, and the trade-offs associated with equity financing. Understanding the implications of equity finance and conducting thorough due diligence on potential investors are crucial to making informed decisions about the best financing options for the business.

B. TYPES & SOURCES OF EQUITY FINANCE

You can access equity finance from various sources. The main types and sources of equity finance for SMEs include :

1. Angel Investors:

Angel investors are high-net-worth individuals who provide capital in exchange for an equity stake. They often invest in early-stage or startup companies and can offer not only financial support but also expertise, mentorship, and industry connections.

2. Venture Capital (VC) Firms:

Venture capital firms specialise in providing equity financing to high-growth potential startups and SMEs. They invest larger amounts of capital in exchange for an ownership stake in the company. Venture capitalists often play an active role in the business and support its growth through strategic guidance and access to their networks.

3. Private Equity (PE) Firms:

Private equity firms invest in established SMEs with growth potential. They typically provide larger amounts of equity capital in exchange for a significant ownership stake in the company. Private equity investors often focus on operational improvements, restructuring, or expansion strategies to enhance value and generate returns.

4. Crowdfunding:

Crowdfunding platforms allow SMEs to raise equity capital from a large pool of individual investors. Through online platforms, you can pitch your business ideas or projects to a wide audience and receive investments in exchange for equity shares. Crowdfunding provides an opportunity to access capital while also building a community of supporters.

5. Strategic Investors:

Strategic investors are established companies that invest in SMEs with complementary business interests. These investments often involve partnerships or collaborations that provide you with industry expertise, distribution channels, access to new markets, or technological resources.

6. Initial Public Offering (IPO):

An IPO involves listing the SME's shares on a stock exchange, allowing the public to purchase the company's equity. This option is typically suitable for more mature SMEs with substantial growth prospects. IPOs provide significant capital infusion and liquidity but require meeting regulatory requirements, compliance, and ongoing reporting obligations.

7. Government Programs and Grants:

Some governments provide equity financing programs or grants to support SMEs' growth and innovation. These programs can be sector-specific or focused on certain growth stages. They may offer favourable terms, co-investment options, or support for research and development activities.

8. Friends and Family:

SMEs may seek equity financing from friends, family members, or close acquaintances who believe in the business's potential. This informal source of equity finance can be more accessible and flexible, but it's important to carefully navigate personal relationships and establish clear agreements to avoid future conflicts.

> It's crucial for you to assess the suitability of each source of equity finance based on their specific needs, growth stage, industry, and long-term goals. Engaging with experienced advisors, networking within relevant business communities, and exploring multiple funding sources can help you identify the most appropriate equity financing options for your business.

C. IMPACT & ESG DATA FOR EQUITY FINANCE

To attract equity finance from impact investors or those focused on environmental, social, and governance (ESG) factors, SMEs can leverage impact and ESG data in the following ways:

1. Measure and Report Impact:

You should develop robust impact measurement frameworks to assess and quantify their social and environmental impact. This involves identifying relevant impact metrics, collecting data, and tracking progress over time. By providing transparent and credible impact reports, you can demonstrate your commitment to generating positive outcomes and attract equity investors who prioritise impact.

2. Align with Sustainable Development Goals (SDGs):

You can align your business activities with the United Nations Sustainable Development Goals (SDGs). By showcasing how your operations contribute to specific SDGs, you can attract investors with a shared focus on addressing global challenges and achieving sustainable development.

3. ESG Integration:

Incorporate ESG considerations into the core business strategy. You can adopt responsible business practices that address environmental risks, promote social inclusion, and ensure strong governance. This includes implementing sustainable supply chain practices, promoting employee well-being, reducing environmental footprint, and enhancing corporate governance structures. Highlighting ESG integration can attract investors who prioritize sustainable and responsible investments.

4. ESG Reporting and Certifications:

You can voluntarily disclose your ESG practices, policies, and performance through ESG reports or frameworks such as the Global Reporting Initiative (GRI) or the Sustainability Accounting Standards Board (SASB). Obtaining third-party certifications or labels related to sustainability, such as B Corp certification or carbon-neutral certification, can also provide credibility and attract ESG-focused equity investors.

5. Stakeholder Engagement:

You should actively engage with stakeholders such as employees, customers, suppliers, and local communities to understand their needs, concerns, and expectations. By demonstrating strong stakeholder relationships and incorporating their feedback into business practices, you can enhance your social licence to operate and appeal to investors who value strong stakeholder relationships.

6. Storytelling and Impact Narrative:

You should effectively communicate your impact and ESG efforts through compelling storytelling. This includes sharing success stories, case studies, and testimonials that highlight the positive outcomes generated by the business. You can leverage various communication channels, such as your website, social media, or impact reports, to engage investors and convey their commitment to sustainability and impact.

7. Engage with Impact and ESG Networks:

You can actively participate in impact and ESG networks and communities. These networks provide opportunities for knowledge sharing, collaboration, and visibility among potential investors. Engaging with these networks can help you build relationships with like-minded investors and access relevant funding opportunities.

> It's important for you to ensure that your impact and ESG data are accurate, reliable, and independently verified whenever possible. Investors increasingly value robust impact and ESG data that demonstrates a clear understanding of the business's sustainability practices and its contribution to positive social and environmental outcomes.

D. EQUITY: HOW TO APPLY & SUCCEED

Applying for and succeeding with SME equity financing requires careful preparation and execution. Here are some steps to help you navigate the process:

1. Understand Your Funding Needs:

Determine the specific funding requirements of your SME, including the amount of capital needed, the purpose of the funds, and the stage of your business. This will help you identify the right type of equity financing and target suitable investors.

2. Develop a Compelling Business Plan:

Create a comprehensive and compelling business plan that outlines your company's mission, vision, market opportunity, competitive advantage, growth strategy, financial projections, and exit strategy. Highlight the potential return on investment for prospective equity investors.

3. Identify Target Investors:

Research and identify potential investors who have an interest in your industry, stage of business, and funding requirements. This can include venture capital firms, angel investors, impact investors, private equity firms, or crowdfunding platforms. Consider their investment criteria, sector focus, and track record to ensure alignment with your needs.

4. Build Relationships:

Establish relationships with potential investors before seeking funding. Attend industry events, conferences, and networking forums to connect with investors and build rapport. Engage with relevant communities, such as entrepreneurship networks or startup accelerators, to gain exposure and access to potential investors.

5. Create a Compelling Investor Pitch:

Craft a concise and compelling investor pitch deck that effectively communicates your business opportunity. Clearly articulate your value proposition, market potential, competitive advantage, financial projections, and use of funds. Highlight the impact your SME can make and the potential for sustainable growth.

6. Seek Expert Advice:

Consider seeking guidance from experienced advisors, such as business mentors, consultants, or lawyers with expertise in equity financing for SMEs. They can provide valuable insights, review your business plan and pitch deck, and help refine your funding strategy.

7. Prepare Due Diligence Materials:

Anticipate investor due diligence by preparing relevant documentation, such as financial statements, legal contracts, market research, intellectual property details, and operational metrics. Organise these materials to facilitate the due diligence process and instil confidence in potential investors.

8. Negotiate Terms and Valuation:

When engaging with potential investors, be prepared to negotiate the terms of the investment, including equity stake, valuation, governance rights, board representation, and exit options. Understand your bottom line and key negotiation points but remain open to finding mutually beneficial solutions.

9. Conduct Thorough Due Diligence:

Just as investors perform due diligence on your SME, conduct your own due diligence on potential investors. Evaluate their track record, reputation, industry expertise, value-add capabilities, and alignment with your long-term vision. Choose investors who can bring more than just capital to the table.

10. Maintain Transparency and Communication:

Once you secure equity financing, maintain transparency and open communication with your investors. Provide regular updates on business progress, financial performance, and strategic milestones. Nurture the investor relationship and leverage their expertise, networks, and support to drive growth.

> Remember, securing SME equity financing can be a competitive and challenging process. Persistence, resilience, and a well-prepared funding strategy are key. Adapt your approach based on feedback, learn from each interaction, and remain focused on building a sustainable and successful business.

RESOURCES

A. CHECKLIST

1. Required Documents for SME Equity Finance

a. Business Plan:

A comprehensive business plan that outlines the SME's mission, vision, target market, products or services, competitive analysis, growth strategy, and financial projections.

b. Executive Summary:

A concise summary of the business plan that highlights key points about the SME, its value proposition, market opportunity, financial performance, and funding requirements.

c. Financial Statements:

Recent financial statements, including balance sheets, income statements, and cash flow statements. These should be prepared in accordance with generally accepted accounting principles (GAAP) or an appropriate accounting framework.

d. Projections and Forecasts:

Financial projections for the next three to five years, including revenue forecasts, expense estimates, and anticipated cash flow. These projections should be supported by underlying assumptions and explain the basis for growth expectations.

e. Valuation Analysis:

A valuation analysis or valuation report that justifies the SME's current value. This may include market comparables, discounted cash flow (DCF) analysis, or other valuation methodologies.

f. Cap Table:

A capitalization table (cap table) that outlines the company's ownership structure, including details of existing shareholders, their percentage ownership, and any outstanding options, warrants, or convertible securities.

g. Legal and Corporate Documents:

Copies of legal and corporate documents, such as the Certificate of Incorporation, Articles of Association, shareholder agreements, partnership agreements (if applicable), and any licences or permits relevant to the business.

h. Intellectual Property (IP) Documentation:

Details of any intellectual property owned by the SME, such as patents, trademarks, copyrights, or trade secrets. Include copies of relevant IP registrations or applications.

i. Market Analysis and Competitive Landscape:

A thorough analysis of the target market, industry trends, competitive landscape, and the SME's unique selling proposition (USP). This should demonstrate the SME's understanding of its market and its competitive advantage.

j. Management Team Information:

Detailed profiles of the management team, including key executives and their relevant experience, qualifications, and track record. This helps investors assess the team's ability to execute the business plan and drive growth.

k. Due Diligence Materials:

Prepare a data room or virtual data room containing additional due diligence materials, such as customer contracts, supplier agreements, employment contracts, regulatory compliance documents, insurance policies, and any legal or operational information relevant to the business.

l. Marketing and Sales Strategies:

Outline the SME's marketing and sales strategies, including target customer segments, marketing channels, customer acquisition costs, and sales pipelines. This demonstrates the SME's approach to generating revenue and scaling the business.

m. Exit Strategy:

Provide information on the SME's potential exit strategy for investors, such as IPO plans, acquisition opportunities, or other exit scenarios. Investors want to understand how they can realise a return on their investment.

B. FURTHER RESOURCES

2. FOR SME EQUITY FINANCE IN ASIA & PACIFIC

When seeking equity finance for SMEs in Asia and the Pacific, there are several resources and platforms that can help connect you with potential investors. Here are some resources you can explore:

Asia Development Bank (ADB):

ADB provides various programs and initiatives to support SMEs in the Asia-Pacific region. They offer access to finance, investment facilitation, and business development services. Visit their website (adb.org) to explore their programs and resources.

Asian Venture Philanthropy Network (AVPN):

AVPN is a network of social investors and philanthropic organisations focused on creating positive social impact. They have a member directory that includes investors interested in supporting SMEs in the region. Visit their website (avpn.asia) to learn more.

Impact Investment Exchange (IIX):

IIX is an impact investing platform that focuses on Asia and the Pacific. They connect SMEs with impact investors and provide access to capital and expertise. Explore their website (iixglobal.com) to learn about their impact investing initiatives.

Emerging Markets Private Equity Association (EMPEA):

EMPEA is an industry association focused on private equity investment in emerging markets, including Asia. Their website provides research reports, data, and resources on private equity and venture capital: https://www.empea.org/

India Private Equity and Venture Capital Association (IVCA):

IVCA is an association that promotes the private equity and venture capital industry in India. Their website provides industry news, reports, and resources for entrepreneurs: https://www.ivca.in/

Southeast Asia Venture Capital and Private Equity Association (SEAVCA):

SEAVCA is an association that represents the venture capital and private equity industry in Southeast Asia. Their website offers information on financing options, industry insights, and resources for entrepreneurs: https://www.seavca.org/

Angel Investment Networks:

There are several angel investment networks operating in the Asia-Pacific region. Examples include Angel Investment Network, AngelList, and AngelCentral. These platforms connect entrepreneurs with angel investors who are interested in supporting early-stage businesses.

Crowdfunding Platforms:

Consider utilising crowdfunding platforms that focus on SMEs and startups. Examples include Kickstarter, Indiegogo, and Crowdo. These platforms allow you to showcase your business and raise funds from a wide range of individual investors.

Local Venture Capital Firms:

Research venture capital firms that specifically invest in SMEs in the Asia-Pacific region. Explore their websites and reach out to them directly to understand their investment criteria and application processes.

Business Incubators and Accelerators:

Look for local business incubators and accelerators that provide funding and support to startups and SMEs. These organisations often have networks of investors and can facilitate introductions.

Government Funding Programs:

Check with your local government agencies for funding programs available to SMEs. Many countries in the Asia-Pacific region have initiatives aimed at supporting SMEs and fostering innovation and entrepreneurship.

Chambers of Commerce and Trade Associations:

Engage with local chambers of commerce and industry-specific trade associations. These organisations often have connections to investors and can provide guidance and resources.

Networking Events and Conferences:

Attend networking events, conferences, and pitch competitions focused on entrepreneurship and investment in the Asia-Pacific region. These events provide opportunities to connect with potential investors and learn from industry experts.

> Remember to tailor your approach and materials to the specific requirements and preferences of each investor or platform. Be prepared to present a compelling business case and demonstrate the potential for growth and impact.