

# ENERGY CATALYST

## Investment guide: Investment readiness



## Introduction

External funding provides critical resources that allow businesses to develop new products, expand production capacity, and access new markets. For many businesses, securing financing is an essential step in establishing a foundation for long-term growth and sustainability. However, businesses must be ready to secure external funding that meets their needs. Management teams must understand their growth plans and financing needs to ensure that new funding supports, rather than hinders, their path to sustainability. Further, they must understand how external audiences will perceive their business and be equipped to negotiate with potential investors.

## Investment readiness

Investment readiness is the ‘capacity of an enterprise to understand and meet the specific needs and expectations of investors’<sup>1</sup> and it plays a critical role in determining whether a business receives funding.

Investment readiness has multiple benefits for businesses:

1. Businesses understand themselves better. Investment-ready businesses understand their capital needs and are aware of the capital available to them. Such businesses are best placed to manage external financing.
2. Businesses can engage better with investors to raise external capital. An investment-ready business can more easily raise external capital as it is prepared to meet the needs and expectations of investors.
3. Investment readiness accelerates the capital raise process. Businesses will have their documents and information prepared in advance which will shorten the due diligence process and minimize other process delays.

### What does an investor-ready business look like?

A business may consider itself investment ready when it can demonstrate it meets the criteria as displayed in Figure 1 below, with supporting documentation readily available in a company data room. Learn more about the data room in the [due diligence guide](#).

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<sup>1</sup> *Stanford Social Innovation Review, Building Impact Investment Readiness, 2014.*



Figure 1: An investor ready business

Two key components influence a businesses' investment readiness: business viability and quality of investor materials.

The first aspect of investment readiness is business viability. Management teams must demonstrate to investors that their businesses are sustainable, well-run organisations. Businesses should demonstrate a sound business model, unique value proposition, and qualified team.

The second aspect of investment readiness is having ready investor materials. Documents such as business plans, financial models, investor teasers, and memoranda should be robust and make a compelling case for investment in the business.

### Assessing business viability

To evaluate whether a business is worth investing in, investors look at multiple dimensions of the organisation, described below.

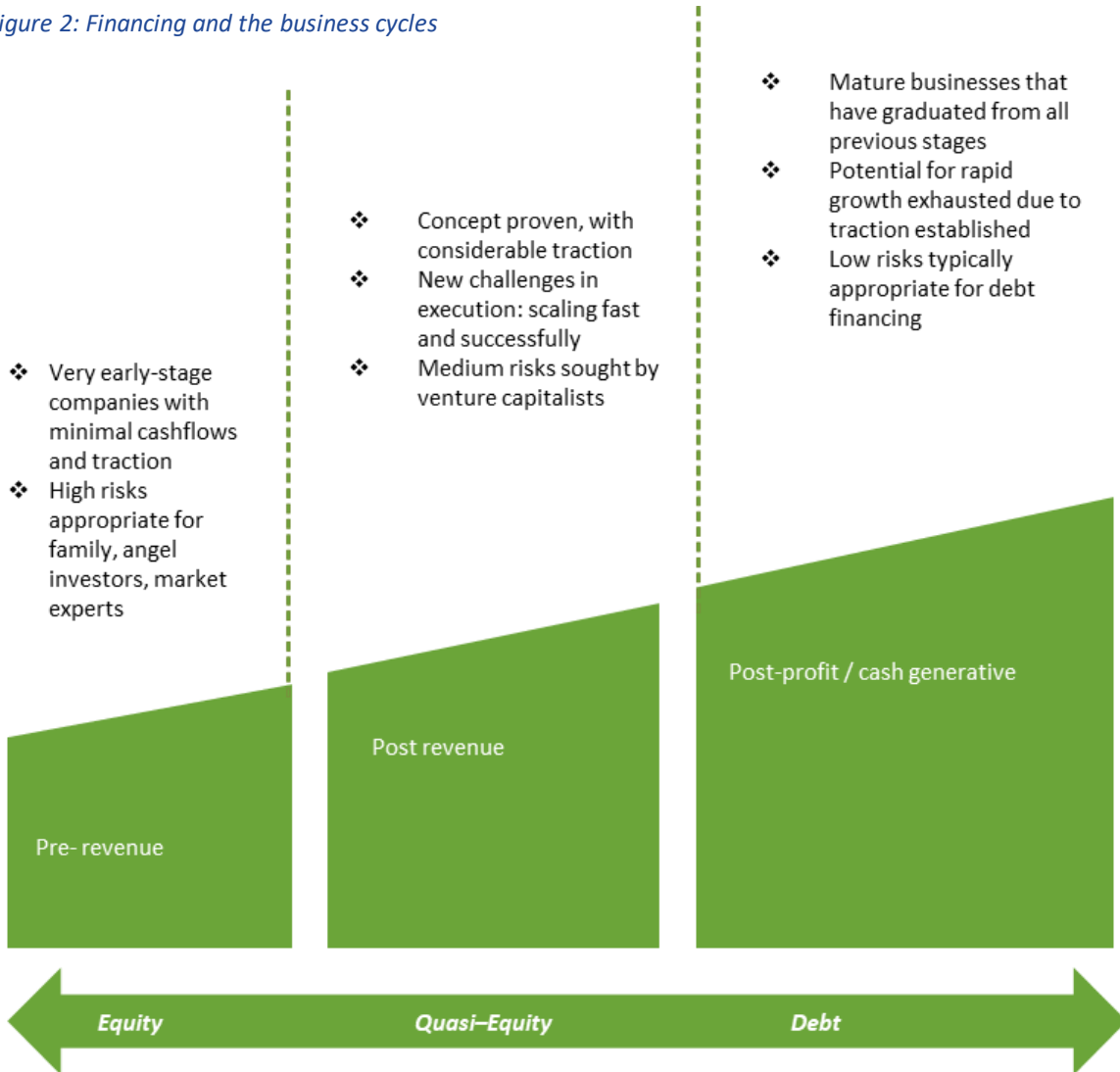
| Dimensions          | Areas of consideration  | Significance   |
|---------------------|---|--|
| Market and industry | <ul style="list-style-type: none"> <li>- Target market size</li> <li>- Product/service demand</li> <li>- Competitive landscape</li> <li>- Industry barriers to entry</li> </ul> | Understanding whether there is a significant market for the products and services, and what is the business' relative performance in the market. |

| Dimensions  | Areas of consideration  | Significance  |
|---|---|---|
|   | <ul style="list-style-type: none"> <li>- Regulatory environment</li> </ul>  |   |
| Business model and operations                     | <ul style="list-style-type: none"> <li>- Production processes</li> <li>- Product offerings</li> <li>- Strategic value chain partnerships</li> <li>- Distribution channels</li> <li>- Customer outreach</li> </ul> | Understanding of the business model, investors can identify both internal and external risks associated with scaling operations and achieving growth targets.       |
| Organizational structure                          | <ul style="list-style-type: none"> <li>- Competencies of senior management</li> <li>- Skill assessment framework</li> <li>- Employee retention and succession</li> <li>- Employee compensation</li> </ul>         | Knowledge about the team helps investors identify whether the business' employees and management have the competencies to deliver on the value proposition pitched. |
| Historical performance                            | <ul style="list-style-type: none"> <li>- Sales</li> <li>- Customer base</li> <li>- Gross and net margins</li> <li>- Cash flows</li> </ul>   | Investors need to understand the drivers of historical financial and operational metrics to understand key growth assumptions supporting projections.               |
| Growth strategy & projected financial performance | <ul style="list-style-type: none"> <li>- Company vision</li> <li>- Growth strategy</li> <li>- Detailed business plan for execution</li> <li>- Financial projections</li> </ul>                                    | A growth strategy ensures that the business is working towards achieving realistic objectives that will increase profitability and deliver more value to investors. |
| Capital need                                      | <ul style="list-style-type: none"> <li>- Capital requirement</li> <li>- Investment terms</li> <li>- Paths to exit/repay investors</li> <li>- Prior engagements with investors</li> </ul>                          | This helps investors understand what the business expects from them and its history of delivering returns on previous investments.                                  |
| Governance structures                             | <ul style="list-style-type: none"> <li>- Processes and controls</li> <li>- Board of Directors (BOD)</li> <li>- Competencies and role of the BOD</li> <li>- Statutory documentation</li> </ul>                     | Governance structures influence the implementation of the growth strategy, regulatory compliance, and efficiency of the due diligence process.                      |
| Business Impact                                   | <ul style="list-style-type: none"> <li>- Understanding of the business impact</li> <li>- Impact measurement framework</li> </ul>  | Social enterprises must demonstrate an understanding of the social impact and their impact to date to qualify for impact capital.                                   |

## Business lifecycles

Businesses must grasp the common sources of finance and their interaction across lifecycle stages before initiating a capital raise. The available capital options are usually contingent on the business stage and existing cashflows (see Figure 2). Understanding this connection is crucial for selecting appropriate funding sources effectively. Each capital option carries a different risk and reward profile, which in turn impacts which investor type will be most appropriate at each business stage.

Figure 2: Financing and the business cycles



Pre revenue businesses with minimal cashflows are perceived as higher-risk and are unlikely to be able to support debt repayments. Equity investment that compensates for higher risk through higher returns to investors does not require immediate cash outflows from the business and may be more appropriate at an earlier stage. Alternatively, grant financing that may or may not be repayable may also be accessed to finance projects and operations.

Post revenue businesses that have proven business models are significantly de-risked but still require reinvestment of cashflows for growth. Quasi-equity, whose terms can be tailored to business needs may be most appropriate and are detailed further in the “Special instruments” commercialization guide.

Lastly, cash generative companies have lower risks and generate sufficient cash flows to service debt. Detailed information on these instruments is provided in the [equity](#), [debt](#), and [special instruments guides](#).

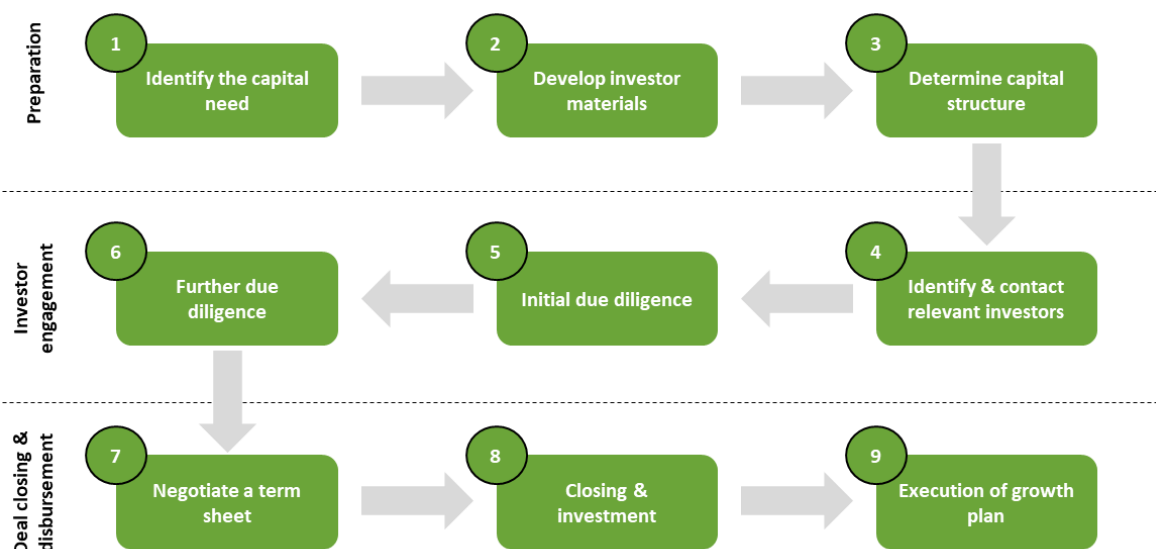
## The capital raise process

Raising capital refers to the process of acquiring funding or financial resources to finance the operations, growth, or investment needs of a business. It is a multi-step process that is preceded by internal preparation and determination of funding needs and objectives then an external facing phase that involves reaching out to investors and closing the deal. The process typically takes between three and eighteen months, depending on the type of capital, but could last longer.

It can be summarized into nine steps, which can be consolidated into three main categories: preparation, investor engagement, and deal closing.

The preparation stage comprises of inward-facing activities that the business needs to undertake to establish the need for external investment, the capital structure, the merits, and demerits of external investment, and organizing materials for investor review. This stage is broadly referred to as investment readiness and is discussed in greater detail below.

Figure 3: Summary of the capital raise process



### 1. Identify the capital need

Before pursuing external capital, businesses need to refine their growth strategy and evaluate their capital need. They should identify which aspects of the business they want to finance and determine

how funding those objectives aligns with their long-term goals. By connecting funding needs to their strategy, business leaders can assess whether their operations can be funded internally, and if not, whether it is the right time to raise external capital.

## 2. Develop investor materials

Preparing documents like a business plan, financial model, investor teaser, and investor memorandum is essential for businesses seeking investment. These documents provide comprehensive information about the company, its growth plans, and funding requirements. The business plan outlines goals, strategies, and market analysis, while the financial model offers projections and insights into the company's financial health. The investor teaser provides a compelling overview, grabbing investor attention, and the investor memorandum offers in-depth details for due diligence. Altogether, these documents help investors gain a thorough understanding of the business and make informed investment decisions.

## 3. Determine the capital structure

Capital structure refers to the combination of various funding sources that a business uses to finance its activities. Businesses should ensure they attain the appropriate type of financing based on their life cycle stage to ensure growth objectives are aligned with overall financial stability.

## 4. Investor identification and outreach

After understanding their capital needs, businesses should use investor networks (e.g., [Energy Impact Investors](#), [PFAN](#)) business databases (e.g., Crunchbase), and investment events (e.g., Sankalp) to identify relevant investors who fit the capital type and size requirements of the business.

Once the management team identifies suitable investors, they should reach out to the investors through “warm” introductions which are made through mutual contacts, or “cold” outreach which involves introducing their business to new investors via tailored messaging.

## 5. Initial due diligence

During this stage, businesses must be prepared to undergo a thorough investigation and analysis to support potential investment decisions. Investors will review key documents, interview company personnel, and assess financials to understand the company's operations, market position, and growth prospects. It is essential for the business to be transparent, organized, and responsive during this stage, providing the necessary information and addressing any concerns to instil confidence in potential

investors. A successful due diligence process can lead to stronger investor trust and pave the way for successful fundraising endeavours. Learn more about [due diligence](#).

## 6. Negotiate a term sheet

A **term sheet** is a document that outlines the commercial conditions for a potential investment. It is not a binding document, but it guides the development of a final investment agreement. To optimize their capital raising efforts, businesses may benefit from engaging a consultant with market intelligence expertise to assist in navigating term sheet negotiations. While this approach can be beneficial for many companies, it may not always be applicable, especially for early-stage businesses. Some startups rely on informal networking, seeking advice from other experienced founders to gain market intelligence and insights without involving external consultants. Tailoring the approach based on the company's specific needs and resources is essential for ensuring successful fundraising outcomes.

## 7. Further due diligence

Further due diligence may involve site visits, as well as interviews with customers, suppliers, and other value chain players. The level of scrutiny may vary based on the type of investors, with equity investors typically delving deeper. This step requires considerable time and involvement from senior management and advisors on both sides, as the information gathered is used to advise on the final investment agreement.

## 8. Closing and investment

A finalized term sheet is presented to the investor's investment committee for approval, upon which it is then translated into an **investment agreement** by legal counsel. This sets out the capital commitment, timelines, and the terms and conditions of the investment.



## 9. Execution of growth plan

Once the deal has closed and funds have been disbursed, the business should be prepared to execute on a short-term roadmap, such as a 100-day plan, to ensure that it hits key milestones. Some investors deploy capital in tranches depending on whether the business meets these milestones, and a roadmap will help achieve them. Businesses should also send regular progress updates to their investors that include highlights of the business' operations, key performance indicators (KPIs), important hires, and requests that the business has for its investors.



## Factors that indicate the ideal timing for a capital raise

Timing plays a vital role when considering a capital raise for your business. By evaluating your business's stage, growth prospects, and funding requirements, you can strategically plan your approach to securing investment and attracting the right investors.

| Ideal timing factors for a capital raise  |   |   |
|---|---|---|
| Key   | Factor  | Description   |
|    | <b><i>Business validation and milestones</i></b>      | Start thinking about a capital raise when your business has achieved significant validation and key milestones. This includes demonstrating product-market fit, generating traction with customers, and reaching important development or revenue milestones. Successful validation highlights the viability of your business model, making it an opportune time to seek capital. |
|   | <b><i>Market demand and growth potential</i></b>      | Evaluate the market demand for your solution and the growth potential within your target market. If there is a pressing need for innovative energy technologies and a growing market with the potential for significant expansion, it may be an ideal time to consider a capital raise.   |
|  | <b><i>Scalability and capital requirements</i></b>    | Start considering a capital raise when your business model is primed for scalability and expansion. Determine if additional funding is necessary to accelerate growth, scale operations, or develop and deploy energy technologies at a larger scale. Assess your capital requirements and ensure that the funding sought aligns with your growth plans and resource needs.       |
|  | <b><i>Team expertise and execution capability</i></b> | Evaluate the strength and expertise of your team in executing your business plan. Consider a capital raise when your team possesses the necessary skills, industry knowledge, and technical expertise to drive growth and navigate the challenges of the energy sector. Having a capable team increases the confidence of potential investors in your business.                   |

## Barriers to a successful capital raise

### Business constraints

**Inadequate preparation:** Failing to prepare sufficiently e.g., failing to have complete financial statements, business plans, and other documentation may lead to delays in the capital raising process.

**Lack of a compelling value proposition:** A company's value proposition should highlight the unique benefits and competitive advantage that the company offers to its users. Without a compelling value proposition, attracting investors becomes challenging, as they may not see the potential for significant returns on their investment.

**Weak financial performance:** Poor financial performance as demonstrated by declining revenue, low-profit margins, high leverage, etc., can discourage investors from participating in a capital raise. Companies, therefore, need to demonstrate solid financial plans and performance to attract investors.

### Investor constraints

**Lack of investor interest or competition:** Factors such as market saturation, unfavourable industry conditions, low market liquidity, lack of business differentiation etc., may diminish investor capacity or interest to provide finance, thus prolonging the capital raise process.

**Risk appetite and investment criteria:** Investors tend to have specific preferences such as business stage, industry focus, risk capacity, geographic considerations, and investment sizes. If a company's offering does not align with an investor's risk profile or investment criteria, it becomes a barrier to obtaining funding, causing the capital raise process to stagnate.

## Further reading

Discussion paper on investment readiness programs - <http://www.oecd.org/global-relations/45324336.pdf>

Building impact investment readiness - [https://ssir.org/articles/entry/building\\_impact\\_investment\\_readiness](https://ssir.org/articles/entry/building_impact_investment_readiness)

Capital structure - <https://corporatefinanceinstitute.com/resources/knowledge/finance/capital-structure-overview/>