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Capital Raising for Growth by SMEs and Startups

Background

Impact of Covid-19 on Malaysia & ASEAN

Malaysia has almost 1 million small and medium-sized enterprises (SMEs) that cut across various sectors, sizes and levels of maturity and SMEs make up approximately 96% of businesses across ASEAN.*[1] In 2018, SMEs collectively contributed USD 126.3 billion (38%) to Malaysia's Gross Domestic Product (GDP) and 66% to employment. As in many developing nations, SMEs play a vital socio-economic role in driving Malaysia's growth.

Prior to the Covid-19 pandemic, the growth of SMEs was largely driven by conventional business practices, such as face-to-face interactions, physical verification, cash-based transactions (despite a high internet banking rate) as well as seminars, conventions and exhibition approaches to promote brand and narrative awareness.

Since mid-March 2020, the pandemic has accelerated deployment of digital technology by businesses and government agencies – largely due to social distancing requirements and concerns about the infection risk. Many SMEs resorted to digital technology in fulfilling the new value-chain and adapting to the 'new norm' of Low-Touch, High-Tech (LTHT).

This new norm has also fuelled a number of new startups, especially in financial technology (fintech) and digitally enabled businesses such as e-commerce, digital banking and alternative financing. In addition to the new norm, Malaysia already has a solid foundation in a high internet banking penetration, nation-wide 4G coverage and government policies that facilitate growth in this area.

Given this situation, various types of investors - including, but not limited to, crowdfunding platforms (equity and loan), venture capitalists, private equity firms, high net worth individuals and family offices (hereafter identified as "potential strategic investors") - are seeking specific opportunities to invest in the potential growth of certain SMEs and startups that are benefiting from customers' specific behavioural changes and the new norm based on the LTHT concept.

This article discusses the factors affecting fund-raising attractiveness from the perspective of potential strategic investors, with an in-depth look into certain elements based on specific business cases.

Factors Impacting Fund-Raising Attractiveness

It is natural for any business founder to focus on day-to-day matters during the startup stage. As the business matures, there are a variety of compelling needs to shift attention to strategic aspects in order to facilitate viable growth, wealth optimization and relevancy of the business's unique value proposition for the foreseeable future.

This article focuses on four key factors that independently and collectively impact the attractiveness of any fund-raising specific for a growth campaign, particularly since Covid-19 and in light of several recent corporate scandals. These factors are discussed from the perspective of potential strategic investors, focusing on the following aspects that are commonly scrutinized prior to investing for the growth phase:

1) Customer Value Proposition

2) Breadth and Depth of Talent

3) Governance, Risk Management and Compliance Competency

4) Technology as Enabler

Customer Value Proposition (CVP)

Establishing a compelling and relevant CVP is key for businesses to be attractive and viable. CVP refers to the ability to articulate clearly to prospects why they should do business with a business rather than its competitors and how the attributes of its product or service address their key issues and needs.

For prospective investors, this is one of the first factors that that they would be looking for, as a compelling CVP would enable the revenue to command higher value and, to a certain extent, generate repeat transactions or brand loyalty. For instance, the company Grab*[2] has demonstrated the ability to solve various last-mile connection issues concerning supply and demand for transportation, food & beverages, and other household needs via its digital platforms. Despite not yet being profitable, Grab is worth USD 6 billion*[3] and has managed to attract ten rounds of funding worth USD 4.997 billion to fuel its future growth. The company continues to enhance its CVP by expanding its network of riders, drivers and merchants on its digital platform to serve up to 660 million potential customers in ASEAN.

From the perspective of investors, this is a compelling CVP as Grab is in the business to solve basic issues that incumbent businesses have failed to solve for years. In addition, the solutions offered by Grab are seamless and convenient, delivered via mobile devices and right to the consumer's doorstep.

Another interesting aspect is Grab's transparency in acknowledging that it is not yet profitable because the cost to develop, maintain and continuously enhance its features requires a huge amount of investment. Such candor is rather new and may not be understood by certain conservative investors but it has proven to be compelling to entities such as Softbank Group,*[4] Vertex Ventures SEA,*[5] China Investment Corporation*[6] and Booking Holdings (formerly Priceline.com).*[7]

CVP fails

Establishing, maintaining and enhancing a compelling CVP is an extremely vital focus for any business, especially for an SME. However, we found many businesses struggle to capitalize on their CVP as they failed to either identify their target customers' key issues or were unable to produce workable solutions to address them. The following are some of the causes.

- **Poorly defined customer segment**
  A good value proposition hinges on a clearly defined, specific customer. Many businesses are keeping their customer definition broad, thinking that this would increase their revenue potential. However, this is wrong as marketing efforts to a broad audience will confuse customers, and as a result the business will suffer without a clearly defined customer segment.

- **Ambiguous narrative and branding**
  Many businesses identify key words to summarize and communicate the value they offer. Customers are missing the context and meaning of the company's culture which results in confusion, ambiguity and misunderstanding as well as declining relevance from the customer's view.

- **Too common CVP**
  A compelling CVP should be able to answer this question: "How is your product or service or company different from the competition?" If there is no difference, customers will not care.

From the perspective of potential strategic investors, a compelling CVP is a 'must-have' factor with almost no room for negotiation. It has to be precise, relevant and compelling always, period.

Breadth and Depth of Talent

The approach of potential strategic investors to evaluating an opportunity to drive growth can be described by a horse-racing analogy. Investors look at three aspects: the Jockey (i.e., founder and senior management), the Horse (i.e., the business model) and the Race Course (i.e., the vertical industry).

Potential investors tend to prioritise the breadth and depth of talent among the founder and senior management to fuel and drive the next business growth, and in many cases, the founders believed that they would remain relevant for the foreseeable future. However, we noticed that this is not necessarily the case, as the growth phase requires different skill sets and mindsets, and thus, different approaches from those needed to found a business.

A key consideration that 'the Jockey' needs to understand is the impact of the transition of a business from startup to growth phase. It is a dream of every founder to be a Bill Gates or an Anna Roddick, each of whom founded a large company and led it for many years. However, in reality, versatile founders are a very rare breed as most of them surrendered management control especially when the business transitioned to the growth phase.

According to an article in the *Harvard Business Review*,*[8] by the time a business is 3 years old, 50% of founders are no longer the CEO, a year later only 40% remain at the top and less than 25% lead their business to initial public offerings. The general assumption is that founders would facilitate any initiatives that would increase the chance to make more money and grow. However, many studies have shown that founders made less money in the startup phase and hence were reluctant to handover management control as they would suffer financially once the business transitioned to the growth phase. Many investors discovered that founders made business decisions that conflicted with wealth-maximizing principles, especially if the business focused on solving social issues (e.g., financial inclusion), leading fundamental changes (e.g., filling the unserved and underserved gap for financial services), or competing against long-standing issues (e.g., digital KYC as a utility platform). Figure 1 summarizes the options facing the founder regarding control and financial gain.

Potential investors are looking for a founder, a Jockey, who is rational and mature enough to adapt to the needs of the business. This is their key concern since founders often believe that only they can effectively lead the business irrespective of its performance and trajectory.

Potential strategic investors searching for growth opportunity definitely do not want to consider having to manage a rebel Jockey (founder and senior management) who would potentially ride in the opposite direction and risk losing the race, no matter how noble, inspirational and passionate the Horse would be.

Figure 1: The Trade-off Entrepreneurs Make

CONTROL OVER COMPANY	FINANCIAL GAINS: WELL BELOW POTENTIAL	FINANCIAL GAINS: CLOSE TO POTENTIAL
LITTLE	**Failure**	**Rich**
COMPLETE	**King**	**Exception**

Source: Harvard Business Review

Governance, Risk Management and Compliance (GRC) Competency

YES Bank and Wirecard are technology-enabled and fintech companies with reputable institutional investors that have been funding their growth and global expansion from startup until recently. These companies have policy statements, a GRC mission, but they have failed in these aspects of their business.

In reality, the GRC aspect of a business is often considered to be less important by potential strategic investors and most entrepreneurs, especially in relation to business growth of SMEs and startups. The GRC aspect is often seen as a hindrance to growth due to its emphasis on 'what-if' circumstances and risk assumptions. The two cases discussed below show the importance of GRC competency for business success.

Case #1 – Yes Bank

A licensed private bank in India, Yes Bank was put under moratorium by the financial regulator as a result of its poor response to the central bank's asset quality reviews in 2017 and 2018. Unfortunately, despite knowing the weaknesses highlighted, Yes Bank's senior management continued to under-report its non-performing assets during 2018 to 2019. It also continuously provided false assurances to the financial regulator that it was restructuring its business model to improve the quality of its balance sheet and liquidity management, while in actual fact, there were no serious efforts being made. Yes Bank continued its reckless lending practises based on unrealistic grounds such as accepting 'personal guarantee' from certain tycoons as collateral for huge loans which clearly violated the prudential requirements of the financial regulator.

As a result, potential strategic investors were uninterested in Yes Bank's purported business restructuring plan despite its being the 5th largest private bank in India with total assets that once stood at USD 36 billion. The rogue nature and approach of the founder and Managing Director, Rana Kapoor, who compromised GRC across the business, was a sign that Yes Bank's growth plan was not aligned with many investment tenets. According to *The Financial Times*, Yes Bank's Managing Director (MD) "took to the extreme the lending and accounting practices rife in India's banking sector." This blatant misbehaviour is apparent in Figure 2 which compares non-performing assets ratios at private banks in India during 2018 and 2019.

The Reserve Bank of India dismissed and arrested Rana Kapoor in late 2018, and the new management raised USD 270 million in an effort to revive Yes Bank, but it was too late as the repercussions from the previous blatant disregard of GRC standards had dented its reputation too deeply and shaken the confidence of potential strategic investors.

Case #2 – Wirecard

The recently discovered extent of accounting and misrepresentation at Wirecard has a different twist as it started from 2008 and unearthed both structural and reckless elements at the heart of the scandal. Wirecard is neither a startup nor an SME; it is listed in Germany on the prestigious DAX 30 with market capitalisation of USD 25 billion and with global operations spanning from its Berlin headquarters to Dubai and Singapore.

The extent of the alleged accounting scandal took a turn for the worse in October 2019 upon the publication of a *Financial Times* article with a subheading stating that certain "internal documents from the payment company point to a concerted effort to fraudulently inflate sales and profits." *9 The then CEO, Markus Braun, dismissed this allegation and stated that "a dozen measures to improve compliance, including the appointment of a new chairman of the supervisory board in 2020" were being taken to address all concerns raised above. More recently, it was discovered and confirmed that USD 2 billion purportedly safely kept the Philippines is unaccounted for and allegedly held at an obscure location instead of in the banks as claimed. In several key ways, Wirecard went against the GRC fundamentals including:

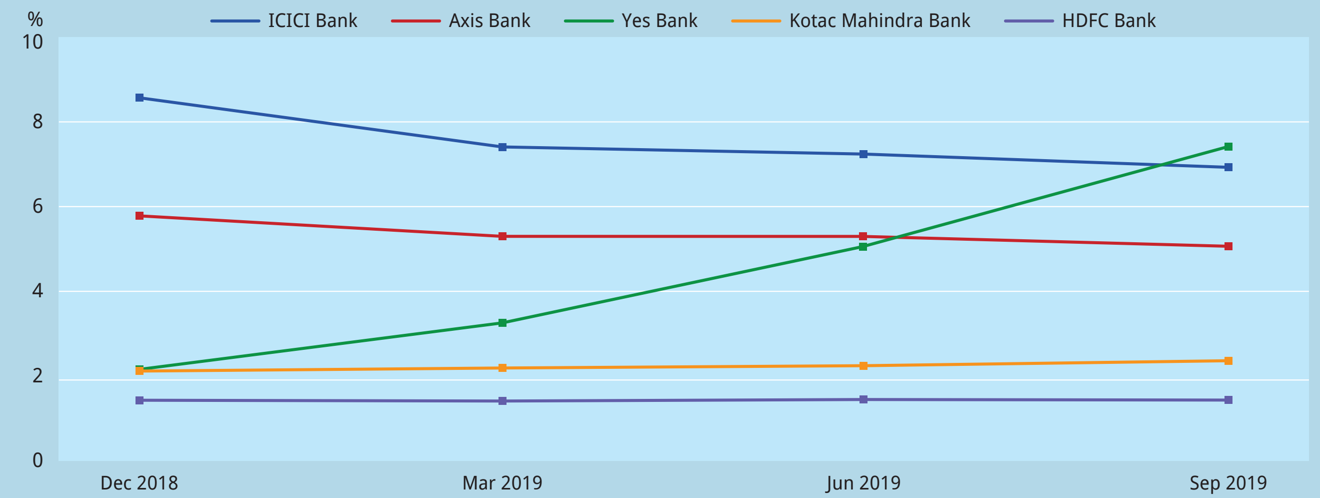
- Failure of the external financial auditor to receive and verify Wirecard's bank statements since 2017;
- Poorly explained business relationship that has no economic rationale and attributes: a foreign entity, e.g., a partnership with a Dubai-registered "3rd party acquirer" called Al-Alam that allegedly contributed half of Wirecard's profit in 2016;
- Dismissal of concerns about inflated sales and profit numbers of numerous subsidiaries across Asia that resulted in multiple raids of its Asia regional headquarters by Singapore's Police commercial crime unit.

The Wirecard scandal is a repeat of the Enron scandal in which the senior executives recklessly dismissed numerous concerns and brushed them aside in pursuit of growth and financial gains. Fortunately, despite being dismissed repeatedly and investigated for alleged insider information collusion for short-selling, The Financial Times steadfastly pursued the Wirecard case for five years as it has similar traits to prior accounting scandals such as Enron and WorldCom.

Lesson learned

Potential strategic investors are not able to identify early a business's weakness in GRC competency, as it is subjective, complex and largely dependent on the risk appetite of each investor. For fiascos in-

Figure 2: Non-Performing Assets Ratios at Indian Private Banks



Source: Care Ratings

volving Yes Bank and Wirecard, the extent of both scandals could only be quantified after the fact and no investor would claim that they managed to avoid huge losses by not 'investing' in these companies because they knew what was going on or would happen. This is the one area that has no early-warning signs for potential strategic investors in managing or mitigating the risk impact when it materialises.

Technology as Enabler

Technology as enabler is a relatively new factor that seasoned potential strategic investors need to relearn given the involvement with technology by many businesses–either by leveraging technology to pivot the business or by using technology as a key component within the original product or service. An example of the first type is the 169-year-old Western Union company which in 2006 leveraged technology to pivot from telecommunications to money services, focusing on money remittance and currency exchange businesses. An example of the second type of technology driven company is PayPal, which has undergone many permutations since 1999 yet retains its nature as a payments company.

In Malaysia, almost 40% of demand for growth funds came from SMEs and startups related to vertical payments such as payment gateway, open-loop e-wallet, non-bank mobile-money issuers, and money services business (i.e., currency exchange and international remittance). One company that has successfully embraced technology for growth is Merchantrade, which was founded in 1996 as a brick and mortar currency exchange and remittance provider and has evolved as one of the most innovative entities with digital offerings for payment services, money services business and mobile services.

Merchantrade's founder, Ramasamy K. Veeran, expedited growth with funds from strategic institutional investors in 2009 (Sumitomo Corporation) and 2014 (Axiata). A large portion of the funds received was invested into technology and business process automation that have increased speed, security and brand trustworthiness, from customers' perspective.

Despite the success of Merchantrade in deploying technology as a key growth enabler, the majority of payment businesses have been unable to emulate this path for growth largely due to the founder's reluctance to pivot their approach and seek alternative funding sources away from the traditional incumbent financial institutions and government funding agencies.

From the perspective of prospective strategic investors, the founder's aspiration and vision to invest in technology, and where needed to pivot the business, is a must-have ingredient for future growth. Among interactions with approximately 200 licensed money services business in Malaysia, a majority expressed unwillingness to dilute their management control in exchange for funds to invest in technology or a business pivot, as well as a complacency due to the steady stream of revenue from their loyal customers.

Emphasis by prospective investors

The author also spoke to crowdfunding platforms (equity and loan), venture capitalists, private equity firms, high net worth individuals and family offices to understand their views and expectations, in particular regarding investing for growth via technology deployment. The following are the findings:

- The majority expects their investee companies to invest in business process automation that would drive revenue, cost reduction, data-related technology (i.e., acquisition, behaviour, analytics) and efficiency.

- More than 50% expect improvement to be made in the capability to cross- and up-sell existing products or services leading to revenue optimization via repeat transactions, i.e., improved brand loyalty and stickiness.

- About 60% expect new business development and expansion of existing horizons via inorganic approaches (e.g., mergers, partnerships) for faster revenue growth and improved cost effectiveness.

Conclusion

This article highlighted pertinent expectations of prospective strategic investors about investing for the growth of SMEs and startups. The expectations are as follows:

- Growth must be driven by a CVP that is clear, well-articulated and unique.
- The founder and senior management's breadth and depth of talent need to be aligned with that of investor's who are willing to fund growth according to the business CVP. This usually requires the founder and senior management to allow certain dilution of management control in order to accommodate new perspectives and facilitate gains in sustainable growth.
- Willingness to invest depends on GRC competency to ensure constant checks and balances.
- Deployment of technology as growth enabler is expected to improve the synergy of products and services and horizontal expansion.

Notes

*1 Asian Development Bank

*2 https://www.grab.com/my/

*3 Grab's valuation as quoted by Forbes

*4 https://www.softbank.jp/en/corp/

*5 https://www.vertexventures.sg/

*6 http://www.china-inv.cn/en/

*7 https://en.wikipedia.org/wiki/Booking_Holdings

*8 The Founder's Dilemma

*9 Financial Times article dated 15 October 2019

Disclaimer
This article offers the author's personal opinion based on observations during 22 years of direct and indirect involvement as a financial regulator, banker, head of compliance, entrepreneur and fintech industry advocate in Malaysia and the Asia-Pacific region.
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Mohammad Ridzuan Abdul Aziz (Ridzuan) has over 20 years of regulatory, compliance and technology experience in the Asia-Pacific region. He provides business-oriented regulatory advice, solutions and consultancy to banks, remittance companies, fund management entities, broker dealers (equity and derivatives) on regulatory requirements, compliance risk management, licensing, business viability and implementation of fintech and regulatory technology (RegTech).
Ridzuan is currently WorldRemit's Country Director for Malaysia and Head of ASEAN Business. WorldRemit is one of the fastest growing global online-only remittance providers headquartered in the UK, operating in over 50 countries and servicing more than 5,000 corridors.

As the current president of the FinTech Association of Malaysia he is particularly focused on promoting the combination of onshore, Labuan mid-shore and Islamic talents for various stakeholders and the Malaysia digital economy.

Ridzuan is a member of the international advisory panel of the Labuan Financial Services Authority and the Malaysia Innovation Policy Council. Both roles provide him a unique perspective on onshore and mid-shore optimization of Malaysia's competitive advantage in the fintech eco-system.

Ridzuan founded RHT Compliance Solutions in 2013 and CS Technology Solutions Sdn Bhd in 2016. Both firms provide RegTech advisory consultancy for established fintech firms seeking assistance on regulatory matters in Malaysia, Singapore, Indonesia and Hong Kong.

In 2017, Ridzuan was CEO of Sedania As Salam Capital Sdn Bhd, a patented fintech solution provider that utilizes mobile airtime as the commodity for Tawarruq Contract for Shariah compliance financing provided by 40 financial institutions in Malaysia.

Ridzuan was Head of Compliance at Macquarie Capital Securities Malaysia from 2005 to 2009 and at Nomura Securities Malaysia from 2009 to 2013. His last designation was Executive Director for Asia (ex-Japan), responsible for regulatory compliance, transaction monitoring and supervision for 11 markets in APAC (ex-Japan)

He was a regulator with the Kuala Lumpur Stock Exchange (1998) during the Asia financial crisis, at the Securities Commission (2001) and then redeployed to a joint task force between the Securities Commission and Bank Negara Malaysia during the formation of the investment bank (2002).

Ridzuan graduated from University of Wales, Aberyswyth (1997) with a BSc in Economics, majoring in Accounting and Finance. He obtained his MBA, specializing in Management Information Systems from the International Islamic University Malaysia (2005).