High-Tech Start-Ups In Singapore: Lessons In Equity Funding From 1999 And 2000

Introduction

Significant developments took place in 1999 which may have permanently changed the landscape in Singapore for technology start-ups and investments. Stock prices on NASDAQ enjoyed spectacular growth, buoyed by Internet IPOs and the demand for Internet and technology stocks. Technology stocks in Asian markets rose in tandem.

In Singapore, the government initiated a number of measures to boost the high-tech sector. It permitted start-ups to tender for public sector projects, allowed technopreneurs to use their homes as offices, and made it easier for foreign technopreneurs to obtain long-term work permits.

The National Science & Technology Board (‘NSTB’) nurtured a conducive environment for technology start-ups and technopreneurship. It set up a S$1 billion technology investment fund to encourage incubation firms, technology investment and business angels. It also spurred research institutes to spin off their technology developments into start-up companies.

In mid-1999, the Singapore Exchange (‘SGX’) relaxed its predominantly merit-based criteria in the evaluation and approval of IPOs. Corporations without profits or a track record can now be listed on the Main Board of the SGX provided they achieve a market valuation of at least S$80 million (about US$46 million). One beneficiary of this policy was Mediaring.com Ltd, the nation’s leading Internet company in voice telephony. Its share price rose by more than 200% in the weeks after its listing in November 1999.

Technopreneurs, armed with little more than business plans and multimedia presentations, were able to raise equity funds ranging from S$500,000.00 to as much as S$4 million from the rapidly growing number of business angels; from venture capitalists, who after years of investing in mezzanine-stage companies had started to invest in start-ups; and from corporations seeking to develop a portfolio of investments in technology and Internet related ventures. In return, the technopreneurs gave away minority stakes in their start-ups.

In early 2000, the momentum to fund technology start-ups continued unabated and by March 2000, several technology and Internet start-ups filed applications with the SGX to list. Soon afterwards, the run-up in the value of technology and Internet stocks on NASDAQ and other exchanges worldwide came to an abrupt end. Overnight, valuations of start-ups plummeted, and investors became more discerning and demanding.

In this new and harsh environment, how should technopreneurs in Singapore approach the entire process of starting up on their own and of raising funds? It goes without saying that they will need a sound business model, strong management team and a solid technology grounding, but there are several lessons that can be learnt from the excesses of the start-up boom in 1999 and the recent crash in Internet and technology stock prices.
The Lessons To Be Learnt

Leave ‘Value On The Table’

One lesson is to avoid too aggressive a valuation policy. Start-ups that had taken advantage of the buoyant market to command an aggressive pre-money valuation are probably now regretting that they did not leave enough ‘value on the table’.

All start-ups will undergo several rounds of equity fundraising. At each round, investors – both new and original – will expect the company’s valuation to rise. When there is a downturn in a start-up’s prospects, its valuation drops. If its valuation had previously been too high, this drop may be steep. The company will then have an uphill task to raise additional funds.

Given the poor market sentiment at present, even start-ups with reasonable prospects are likely to face reduced valuations for subsequent rounds of fundraising. It is advisable, therefore, to start with a low valuation in order to allow for further rounds of equity investing.

Staggered Stock Options

Before the crash, start-ups were perhaps too successful in raising equity with high valuations. Often the technopreneurs themselves owned a substantial majority stake and provided smaller stock option plans for other employees. (From a tax perspective, it was more efficient to own shares rather than have options. But, in June 2000, the government introduced tax concessions on the amount of income tax payable when employees exercise stock options – this is clearly a move in the right direction.)

After months of operation and with the downturn in technology stocks, many founding technopreneurs have now left the companies they started up to work elsewhere. Unfortunately, most have continued to hold on to their shares in these companies.

Given the lower valuation in the market, it takes substantial inducement to reinforce the management ranks of a start-up with capable newcomers from outside. Prospective employees will be looking for equity or options, but there is often little room to accommodate these when the departing technopreneur continues to hold on to his shares and the company’s existing option plan only covers a small percentage of its total share capital.

Technopreneurs should therefore consider allocating a smaller tranche of equity shares, which they can keep even if they leave, and a larger tranche of equity or options that they can sacrifice or transfer back to the company if they do leave. Furthermore, it is advisable for founders to compensate themselves with generous staggered stock option plans.

Raise More Money Than Immediately Required

Another lesson learnt from the excesses of the past technology boom is that start-ups should raise more money than they need for the immediate future. In their desire to maximize valuation for the founders, it was a common practice of many start-ups to raise just enough money for the first or next phase of the business plan. The obvious logic in this was to avoid unnecessary dilution and to raise equity funds on a just-in-time basis. Moreover it was faster and easier to raise smaller amounts rather than a large sum.

Start-ups that raised substantial funds before the recent crash are well-placed to ride through this lean period in the IPO market. By spending carefully, they will have the funds to better realize their business plans, assisted to some extent by the slowdown in the number of new start-up competitors in the market.

Identify A Niche

The relatively small size of the Singapore population limits the types of start-ups to which investors are attracted. Internet corporations that ‘monetise’ or derive revenue from having a large number of members, users or visitors would be more suited to markets in North Asia and other parts of the world that have high Internet usage. The stock market valuations of such Internet corporations are still substantial in stock markets in Hong Kong, Japan and Korea even after the recent crash.
Given Singapore’s relatively IT savvy and R&D oriented workforce, start-ups should identify emerging technologies and focus on developing applications, solutions or platforms for them. The 13 research institutes and centres under the support of the NSTB and the various institutions of higher learning in Singapore can be tapped by technopreneurs and investors alike.

In pursuing technology applications, start-ups can discern for themselves their R&D or development directions by examining the types and numbers of patents in the technology areas that they are interested in. To allocate precious R&D resources they should pursue areas that are covered by fewer patents. The NSTB offers grants to help start-ups offset the costs of registering patents.

Conclusion

The Singapore environment for start-ups and technopreneurship have gone through a downturn in recent months. However, the fundamentals remain. An entire infrastructure, rudimentary but nevertheless well-grounded, to support technopreneurships and start-ups is evolving. This ranges from government-led initiatives and investment funds to privately seeded incubation funds and the growing numbers of professionals such as fund managers, investment bankers, lawyers and accountants who have become conversant with the unique requirements of technology start-ups.

A fundamental change in attitude and mindset towards risk taking and technopreneurship is occurring and there is little doubt that the recent downturn is merely a temporary setback.

Yeo Wee Kiong is an Executive Partner with the Corporate & Capital Markets Practice Group. For advice on IPOs and the provision of equity funding to start-ups, he may be contacted at wee.kiong.yeo@sg.rajahtann.com. This article was extracted from LawLines Volume II, Issue III - September 2000.