Rbs and walnut cases aandd

Business

Background Walnut Venture Associates is a small group of angel investors with backgrounds in the software industry. RBS is a small software company that makes billing and enterprise management software specifically targeted at other software companies. RBS and Walnut are deciding whether Walnut should invest in RBS, and then if they are willing, whether RBS finds the terms of the deal satisfactory. This case memo illustrates that the venture capitalists are looking for good managers in a particular industry, while entrepreneurs typically think funding is dependent on having a good idea.

It also discusses why or why not RBS and Walnut might be a good fit for each other. What Venture Firms Want Industries not Companies Venture firms are focused on particular industries, not just great companies. Software itself (i. e. the stuff RBS' customers sell) is also in the high growth portion of their S-curve, growing 5 times faster than the rest of the economy.

Software of RBS' type (" vertical solutions") is replacing in-house solutions. According to the case, the software industry is the fastest growing segment of the US economy (1997).

This fits with where the venture firms would like to be. The industry is at the right timeframe in terms of its maturity. Further, the timing of the deal was right because of the current high availability of capital as well as the explosive growth of the network, which has added value to all aspects of software. One risk in this is that there are no direct competitors offering nearly exactly what RBS is.

Thus if they do not move quickly, and other companies can offer what they do, someone else may survive an industry shakeout. The Right People

As stated in both the article on business plans and the article on how venture capital works, having the right personnel in place is critical for venture funding. Evidence of this can be seen in the Walnut-RBS case by the very early and prominent listing of resumes for O'Connor, Ford, and Milligan in the case memo. Further, Walnut and the other investors are adamant about the need for a controller, as well as certain additions to management.

They even go so far as to list personal reference checks for Lane Ford as a deal condition. Further, the investors demonstrate the importance of management y placing " key man insurance" on Bob O'Connor. Low Risk with Potential of High Return A Low Risk Firm Like most venture companies, Walnut is following an initial set of investments in and loans made to RBS by UST. Further, Mid-Atlantic is also interested in investing in the company showing the follow-on effect, and at the last minute, perhaps because of the others, a third firm, EVC, wanted in as well. Aspects of the company itself also reduce the risk of investing. RBS' sales growth is 65% over previous year.

RBS already has a product, they are profitable, and they have been around for several years.

The firm is at the right spot in its lifecycle for a capital injection. RBS is ready to grow its sales and marketing as well as its balance sheet. Product development would likely continue with or without this capital, though this development is one of the stated purposes of this financing. A Good Fit Another means of mitigating risk is for Walnut to stick with what they know.

They are doing this both through the software industry and through geography.

Walnut is in the Boston area, and is looking to fill capital needs in New England. This coincides well with RBS being in Braintree.

Further, MA has the second highest concentration of software in the union. (Table 2) The size of funding was also correct for this deal. It is important that the VC firms be matched with ideas of the right size. If they are tracking $1 million investments and $100 million investments, it seems fairly obvious which investment is more likely to get the coaching and help that it needs.

Walnut, however, prefers the $250K – $1M market, which is a little more on-par with what RBSD is after. Strong Returns The venture desire for strong returns is reflected in the structure of the deal.

The investors are setup to hold mostly series A preferred. They get paid back first. The firm’s long term plans are also in line with the VC desire for a quick return on equity.

RBS is seeking to “ harvest” the company within 3-5 years, either through acquisition or IPO. According the HBR venture capital paper, a 10x return over 5 years is expected in order to yield average fund returns of 20%. Walnut and the other investors would hold roughly 1/3 of the company ($2M / ~$6M valuation). Thus in an ideal world they are hoping for a valuation of $60M in 5 years. This seems somewhat excessive for the projected revenues for the next 3 years.