



CHAPTER 4: Case Study: Start – up in Bangalore

It is difficult to box the study of entrepreneurship into convenient sections of textbooks. This can lead us to believe that there is a set of optimal decisions which can be taken at every stage of a business's life and that the causes of business success, or indeed failure, can be traced back to the decisions of actions taken. In reality, of course, this isn't the case and, quite apart from their competence or incompetence as CEOs, entrepreneurs are hugely affected by the environment they face. In Asia, we may reasonably conclude that the opportunities provided by continuing and strong economic growth must favor the competent entrepreneur. However, while the market conditions may be positive, the Asian entrepreneur can face a more difficult environment in the more practical aspects of implementing their plans, two of the most important of which are raising cash and managing cash. To this end, we feel it appropriate to begin this section with a real-life case study that not only highlights some of these issues, but also demonstrates the passion, drive, and emotion involved in setting up a business.

The business we have profiled is called MeritTrac, based in Bangalore, India. For readers who haven't had direct experience of start-up businesses, the case provides an opportunity for them to taste some of the real issues involved in setting up a business – in particular, the commitment needed and the inevitable ups and downs of the process. For those who have direct start-up experience, this case study will hopefully help to place this in context and perhaps provide some new insights into the process. In either case, it will be a helpful introduction to the subject before we go on to discuss specific related issues in the next few chapters.

We believe MeritTrac provides a rich and interesting case study for the following reasons:

- The business was set up just before the burst of the tech bubble (discussed in the next chapter) and survived the 2001-02 recession.
- It was set up to operate in the Indian outsourcing sector. This has been one of the most interesting growth sectors in Asia in recent years, and its development has had far-reaching implications globally.
- It highlights many of the issues facing start-ups, including trying to get the first round of funding, as well as dealing with tough issues such as cash management and survival.

Although much of the teaching surrounding the setting up of businesses concentrates on the technical and analytical side of product development, business planning, and so on, in reality new business creation is a huge emotional experience. Indeed, the setting up of a new business has often been described as an emotional rollercoaster and, to this end, the style of the case study is involved rather than detached, so that readers may also experience this themselves.

“Outsourcing services to outsourcing businesses” – a start up in Bangalore

Sector background

The strengths of India in the areas of information technology (IT) development and business process outsourcing (BPO) are well known. Many large Western businesses – in particular, financial institutions – are taking the step of relocating back-office functions in India. An example of this is call centers. A customer who buys a product or service in the US or Europe may be re-routed as they call a local helpdesk number to a customer service center in Mumbai, for example. In this way, companies can make attractive savings on back-office functions due to the lower wage rates in India. This trend is deepening, as companies are basing more and more of their back-office and development functions in Asia.

The BPO and IT-related business growth has created a huge demand for employees in India- currently, some 500,000 people are employed in this sector and this is estimated to grow to some 22 million by 2008. For every 100 applicants for these posts, it is normal that fewer than five will receive job offers. This small conversion rate is a reflection of the different and specific needs of the various employers in terms of employee skill sets. To put this in perspective, a new call center needing 100 operators would need to assess some 2,000 candidates. How do these companies manage such a challenging task, particularly when they may need to run assessment centers in different cities or universities throughout India? In the absence of better options, they have tended to perform these tasks “in-house.” This can tie up vast amounts of resources. Typically, a company will need to invest in and build up this resource in terms of people and expertise in order to do the job properly. Some have used human resource consultants, which can be a useful one-off solution, but it can be expensive because of the customization required for each project.

As the BPO and IT sectors started to gather pace in 2000, it was clear that the existing assessment solutions were already suboptimal and, with the demand for assessments expected to grow to some 7.5 million per annum by 2005, there would be a growing need to a better solution.

It was against this background that a small group of entrepreneurs from Bangalore developed a vision for a new business – one which would provide outsourcing services to the outsourcers.

Getting started

In early 2000, Madan Padaki was pursuing his career in international sales and marketing with a multinational software house after having graduated from SP Jain Institute of Management –one of the premier Business Schools in India. Although he enjoyed his job, it was his dream to set up and build his own business. He was no stranger to the risks of doing this – it was the height of the dot.com boom and Madan had many friends who were either founders of or employed in start-up companies. He had observed the growth of the IT and BPO companies in India and felt there was a real need in the market to provide assessment services to meet the enormous expected growth in demand.

One of Madan's friends had recently founded a relatively new software development company called Diffsoft, which was developing software to manage the banks for questions used for candidate assessment purposes for a large multinational IT businesses. They got together with another friend Murlidhar, a service operations specialist and a graduate from the Indian Institute of Management, Lucknow and reviewed the whole recruitment-assessment process. After much deliberation and brainstorming, they came up with an outline business plan for a new company which could provide assessment and processing services for businesses needing to hire large number of employees.

The team felt very energized and quickly started to carry out market validation in support of their business plan – in particular they approached those major business processing or outsourcing companies who the team felt would have an ongoing need to employ large numbers of candidates with particular skill sets. They were greatly encouraged by the interest and response and felt it was time to find some financial support for their plan. They believed that raising funds of US\$1m would provide the business the right start to establish a leading position in this new area.

The reality of start-up funding

In mid 2000, the team approached 4 or 5 Indian-based venture capital companies. While they seemed to like the business idea they had some key reservations:

- **Skepticism about the market:** In particular this was an entirely new business area;
- **Concern about scalability:** The operational business model was based on an ability to provide testing for large numbers of candidates. The VCs felt that while this could be an interesting niche business, the ability to really grow it and develop a significant business – and achieve the financial returns associated with this – was less credible.
- **Experience of the team:** While the Proposed Directors, Madan and Murlidhar, had excellent CVs and qualifications, neither had any direct experience of recruiting or of setting up a business.

There were also other factors at work. The environment in which the team was trying to find investors wasn't straightforward. It was the era of the dot.com boom and VCs were focused on finding high-growth, tech-based opportunities – MeritTrac was seen as neither. Also, the amount of funding required was relatively small, with VCs typically looking to invest in opportunities that needed at least US\$3 million.

In addition, the proposal was at its very early stage – it had no full-time employees or customers. A comment from one of the VCs put the whole process into perspective: "If you think this is such a great idea, why aren't you convinced enough to leave your jobs?"

Shortly afterwards, Madan quit his job and committed himself full-time to the project. All this happened within the first month.

A sense of urgency and anticipation develops

It was now July 2000 and the general fundraising environment was starting to become more difficult. VCs in general were becoming more concerned about future economic prospects; the tech investment boom was at the end of its honeymoon period. Madan could see that they would need to develop the business quickly if they were to raise the funds they required. Gaining some paying customers to prove the business model would be the key priority.

Madan and Murlidhar, with the help of their friend from Diffsoft, decided to go ahead with setting up the business. They agreed to invest US\$10,000 between them, which would be used to establish the business entity and cover initial expenses. Madan worked from home to ensure that these costs were minimized.

Almost immediately, the move from ideas to action and commitment brought some early success. At the end of July the team won 2 orders in one day. One was a project to test 2,000 candidates across 3 cities, while the other was to handle a series of walk-in interviews. The projects were to be worth some US\$5,000. This was the trigger for the second team member – Murlidhar - to quit his job and join full time.

The need to service real customers led Madan and Murlidhar to search for office premises. Still hampered by limited resources, the team struck a deal with another start-up company. They agreed to work for 10 hours a week in exchange for some office space and 2 workstations. A further boost came in the guise of a new team member - Jayanth. A contact at one of the first customers, Jayanth was very excited by MeritTrac's business idea and, although was keen to re-enter full-time study, agreed to join as a founder director in September. This new member brought much-needed Human Resources (HR) experience to the team, having worked for an internationally renowned HR consultancy.

October brought 2 more exciting albeit small, projects. The first was to design question papers and conduct university campus testing for a multi-national customer; and the second was to assess candidates to deliver 100 software engineers for a new software development business.

Another attempt at raising funds

MeritTrac had come a long way in 6 months. By November 2000, the business had:

- four customers – two of which were blue-chip names;
- A founding team with a complementary set of skills and experience;
- An office space (of sorts); and
- Revenue of \$10,000

The team re-approached some VCs, again hoping to raise funds of around US\$1million, but found that their interest in start-ups had waned even further. They seemed to have a growing skepticism about the ability of start-ups to generate acceptable returns, and were beginning to focus on later-stage opportunities which already had products, customers and positive cash flow. The team spent much effort providing the VCs with background information, forecasts and scenarios. In fact, the request for more information seemed to be taking up more time than they were actually spending on the Business. Even so, all this was to no avail and the VCs seemed no nearer to making a decision either way. In the end, the team realized that the discussions were going nowhere. They felt that proceeding down this path would have little chance of success at this stage, and would just continue to take up a lot of their time, effort, and emotional energy. Instead, they decided to take another look at their business plan to see what they could achieve if they raise a smaller amount of money.

After completing their review, the team calculated that by raising only US\$2,00,000 to US\$2,50,000 now, they could take the business to a point in 2 years where it could achieve cash break-even. Their experiences of the last few months had given confidence that sales of US\$5,00,000 would be achievable in the first year of operation, and that this could rise to US\$6 million by the third year.

The revised business plan reduced expenditure wherever possible. The following items were identified as the key priority for the smaller pool of money they were now targeting:

- Setting up office premises that would be appropriate to service blue-chip client base the business intended to target;
- Hiring employees; and
- Developing Content

The team considered the need for working capital to finance the credit they would need to extend to their potential customers. They decided not to include this, as the lower level of funds meant the projected growth wasn't so aggressive and should be manageable. Besides many of their customers would be well-known international businesses and therefore potentially good payers.

With the new and lower fundraising target of US\$2,00,000 to US\$2,50,000, the team felt that instead of needing to approach VC firms, they could now approach high-net-worth businessmen, or “business angels” who were often on the look out for this kind of alternative investment opportunity. They contacted second-third-tier accountancy firms in Bangalore, as these seemed traditionally to have strong relationships with the type of individuals MeritTrac was seeking.

They were fortunate to catch the eye of some interested businessmen, but after meeting a few came away with the impression that although these were savvy businessmen, they were also very aggressive deal-doers who would invest little and ask for a lot. Although they were interested in investing in early-stage businesses, they seemed to have a low risk profile. This manifested itself in their need to control their money once invested and to have the lion’s share of the return. One potential investor with whom they had several discussions seemed to sum it up – they gained the impression that he would be extremely worried about his money and would probably be want to communicate with them at least on a daily basis. Another potential investor had a very high personal profile, which made the team feel that they would be too exposed as a business to his reputation going forward. They felt they needed more of a longer- term investor, who understood their business and would be helpful, rather than become a type of micro-manager.

One of the accountancy firms suggested they approach agri-businessmen. Agriculture as a sector had been doing well over this period, and many of the businessmen involved had enjoyed a period of sustained personal wealth creation and were beginning to consider alternative investment opportunities. These businessmen had been less caught up in the private investment boom in the cities, it was thought they might take a more enlightened approach. MeritTrac was introduced to one such businessman, a Mr.Ranganath, who lived in a small town not too far from Bangalore. Apparently, he had US\$2,00,000 to US\$3,00,000 spare in cash and was interested in exploring this type of ‘alternative’ investing. The first meeting, which took place in a hotel proved very disappointing for the team. The only question the businessman asked during the meeting, which included a detailed to the presentation by the team about their business, was whether they preferred to drink coffee or tea!!

The team felt despondent. They were pitching either to aggressive and potentially smothering business angels from the cities or to apparently less savvy and passive ones from the countryside, and having no luck with either.

Shortly afterwards, though, Mr. Ranganath got in touch again and arranged another meeting. It seemed that the team – used to the quick-fire meetings of the city - had misunderstood his approach to business and relationships. At this next meeting, the team felt that some connection was made and the chemistry and trust it created seemed both mutual and positive.

Discussions continued over the next two to three weeks. Finally, at the end of November, Mr. Ranganath declared his intention to invest and the discussions switched to how much and for what stake. With no benchmark valuation for the

business, this was going to be a difficult discussion. They all agreed to approach a certified public accountant CPA in Bangalore to provide a valuation that would be a basis for discussion. The CPA used various methods, including discounted cash flow, price to earnings (PE) ratio, and economic value added (EVA), and eventually came up with a valuation of US\$3 million.

The MeritTrac team was elated with this valuation, which seemed a testimony to the hard work they had put into the business over the last six months. This elation, unfortunately, was short-lived. The angel investor was shaken by the outcome. He found it difficult to understand how a business, still at a very early stage, could be valued so highly and wondered how he could get an attractive return if his entry price was US\$3 million. He had heard of the high valuations associated with the dot.com companies, but this was a very different business, and even the dot.com businesses were starting to see more realistic valuations. Mr.Ranganath proposed a counter-offer of a US\$50,000 investment for 51% of the business – which valued the business at just under US\$100,000. This brought the team back to earth very quickly and made them consider a realistic response. They moved away from the benchmark evaluation techniques they had used for the initial valuation and concentrated more on what was really important in terms of the business and their aspirations.

They knew that the business would need another round of fundraising later and were reluctant to use more than 20-25% at this stage because of the overall dilution to management's equity stake. They also argued that over-dilution of management's equity in the business could have a negative effect on their drive to run the business – and this wouldn't be good for the angel investor either. The third key issue for them was the amount to be raised. They had already revised their business plan to accommodate a lower investment and didn't want to reduce this further, as it would start to compromise the viability of the business going forward. To counter these arguments, though, the current lack of other funding options put them in a difficult negotiating position.

After 15 days of intense negotiation, they agreed to an investment of US\$200,000 for 27%. This valued the business at approximately US\$740,000. Mr. Ranganath agreed to this as long as management also invested another US\$10,000 between them.

The structure of this investment was to be as follows:

- **Phase 1:** US\$100,000 invested for 27% to be released in tranches. The first was to be US\$30,000.
- **Milestones to be achieved:** A number of objectives – both financial and non-financial - were also set to be achieved before the balance of the Phase II US\$200,000 could be drawn down. These included:
 - six new customers;
 - setting up of offices;
 - development of content – in particular a question bank; and
 - Commence work on an on-line testing module

- **Phase II:** After six months there would be a review of progress, and satisfactory achievement of milestones would trigger the outstanding balance of US\$100,000 – and the injection of \$10,000 from the management team. All this would then be invested over another 18 months.
- **Other Conditions:** Mr.Ranganath also wanted other rights and controls, including:
 - A seat on the board of directors of the company
 - his approval required for any expenditure over US\$2,000;
 - A monthly review of progress;
 - Tag-along rights (if the management team found a buyer for their shares, then he had the option to be included at the same price); and
 - The right to sell his shares, as long as the board approved

To balance this, MeritTrac also gained agreement from Mr Ranganath to the following:

- Mr.Ranganath would forfeit an agreed number of his shares if he was unable to complete phase I funding.
- For the first time, the full-time team members would be able to draw a salary of US\$350 per month.

The team engaged a lawyer friend to pull all these terms and conditions together in a shareholders' agreement, which they and Mr.Ranganath signed at the end of December.

The first tranche of US\$30,000 was drawn down in January 2001. The team was in celebratory mood.

Money in the bank!

With a very healthy bank account, and more money on its way, the team were able to put their plans into action with some confidence.

Their priority was to rent some suitable office space and begin recruiting key employees. As their office would also double as a testing centre, it was important for it to look presentable and professional – both to their high profile customers and also to the candidates they would be testing. By the end of January, the team had found some suitable premises and allocated US\$20,000 to US\$30,000 to fit it out to a suitable specification. They also recruited clerks to cover administration and finance and an operations manager. In February they added a software team to develop their online assessment product. A further US\$20,000 was drawn down from the Phase 1 tranche leaving a balance of US\$50,000 remaining.

On the sales front the team also made some good progress. A couple of large orders from two leading multinational corporation (MNC) software development centers in March brought in around US\$12,000.

By review time in May, the business had met all the milestones laid down by Mr.Ranganath to release Phase II money – but at that point it had used only half of the Phase I funds. This meant there was US\$50,000 outstanding from Phase I, and \$100,000 (plus an extra US\$10,000 from management) still to be drawn down to grow the business. The future looked rosy...

Problems from an unexpected quarter

By mid - 2001 the economic climate was starting to change for the worse. Despite this, MeritTrac had continued to grow steadily, adding more customers including, for the first time, a business process outsourcing company. This was a breakthrough for the team, who believed that the growth of their business would be driven by the growing demand of the BPO companies which were starting to develop strongly in India.

Unfortunately, the angel investor – like many wealthy individuals at the time - had begun to experience financial difficulties caused by heavy investment into the stock markets. He agreed at review time to release the final US\$50,000 of the committed Phase I funds but delayed making the payment. There were continuing promises of money, but it never materialized. Finally, a check was received, but it was returned by the bank due to lack of funds.

The unfortunate events of September 11,2001 not only worsened the angel's investor's position, but also started to affect the business.

The final quarter of 2001 saw sales fall rapidly. The business now had a monthly cash outflow (sometimes referred to as its "burn rate") of US\$4,000 supported by a monthly income of US\$400. This quarter also coincided, somewhat unfortunately, with the addition of another key team member – Mohan Kannegal, who was a specialist in technology and content development. Mohan was Madan's classmate from the Business School and was initially involved in helping to put together the business plan. He chose to join the company full-time in December after completing an assignment in London. Also in December Mr.Ranganath advised the team that he could only invest another US\$20,000 from the remaining undrawn balance of US\$150,000.

This was a low point for the team, who saw in New Year 2002 with dread. They felt as though they were staring down the barrel of a gun. With a monthly cash burn rate of US\$4,000 and only US\$6,000 left in the bank they had only one-and-a-half months left before they would run out of cash.

To make matters worse, it was at this point that the team saw at first hand the stark reality that sales don't equate directly with cash. The December revenue of US\$400 became a bad debt when one of their smaller customers also ran into financial difficulties. The team still had a strong relationship with Mr.Ranganath, who they felt would help them out, but even this avenue became a dead end as he

confirmed he would be unable to help for at least another six months due to his own financial problems.

The team turned to one of the original four shareholders in the company, Diffsoft, which still seemed to be making cash from its own business activities. They asked if Diffsoft could provide them with US\$5,000 to US\$6,000 to tide them over the next couple of months. However, like many small businesses, the company was focused on conserving cash to ensure its own survival in 2002. Diffsoft made the hard observation that, unless MeritTrac could survive on its own then it would have no future. This had a profound effect on the team, who were shaken and it led them to consider their future...their dreams.

Survival plan

It didn't need too much deliberation for the team to decide that their business model was still relevant and they were fully committed to seeing it through, even in the face of their current dire situation. They felt that the cause of their current problems was mostly external and if they could ride out the next six months or so then they could embark again on growing the business. With only US\$6,000 in the bank and minimal to no cash inflow, the only way for them to survive would be to conserve cash with drastic cost cutting. At this point their monthly costs were as shown in Table 4.1

Table 4.1: *Monthly costs*

| Item | US\$ |
|---------------------|--------------|
| Directors' Salaries | 1,000 |
| Employees' Wages | 2,000 |
| Office Overheads | 1,000 |
| Total | 4,000 |

Their plan was simple and potentially effective. They decided they would need to stop all salary and wage payments, leaving only the office overheads of \$1,000, for which they had enough in the bank to cover six months of running.

The team called a meeting of all the employees, which numbered eight including the three full-time directors. The employees had been very loyal so far, and the directors felt it was important to tell them exactly what the position was and to be clear about their plan to deal with it. They needed the full support of the employees if their plan was to work. Accepting zero wages for up to six months with no guarantee of a job afterwards was a big thing to ask. Losing any of the employees would be a blow for the business – due to cash constraints, it had only recruited absolutely essential staff and having to re-recruit later would slow up business growth significantly, as well as compromise some of the ongoing customer projects.

To their surprise and immense relief, not one member of staff wanted to leave. All agreed to forego their salaries to help the business survive. The team was greatly encouraged and promised the staff they would pay salaries as soon as the business received revenue. They also pledged a transparent accounting system to support this. In short, any cash from customers would be divided up amongst all the employees – but if no cash then no salaries.

The key objective of survival for the next six months was achieved, but there was also another side effect of the survival plan. Unwittingly, the business now had in place perhaps the most effective employee incentive scheme possible. As salaries now had a direct relationship to cash received from sales, all staff now looked earnestly for ways to drive the business and bring in customers. From January to March 2002 the business embarked on a collective exercise of marketing to an average of 50 companies per week and looked at developing aptitude courses to prepare candidates for tests

During this three month period, the business was rewarded with sales of US\$5,000 – considerably higher than the US\$400 per month at the end of 2001. By June, all the hard work really paid off, with sales back up to US\$10,000 per month. The business had four new customers, including another from the BPO sector. More importantly, all the salaries were now back to normal.

July turned out to be a record month with sales of US\$15,000. With the worst now over, MeritTrac continued on its steady growth path for the rest of 2002. Celebrating New Year 2003 was a very different affair for the team than the previous year – it brought with it the promise of an exciting year ahead as their business went from strength to strength. By the end of the financial year at March 31, 2003, the business had recorded sales of US\$125,000 and a net profit of US\$15,000.

Growth brings a different kind of cash problem

The expansion that the business was now experiencing brought a new and unexpected cash issue to the fore. Sales were increasing every month, but cash was getting extremely tight. The team realized that the business was starting to experience the growing pains associated with a lack of available cash to cover working capital. The working capital dynamics of the business in respect of growing sales were as follows:

- Operating costs were typically 50% of sales. These had to be paid within the month they were incurred and included salaries, overheads, and variable costs such as hire of testing facilities when operating outside of Bangalore.
- Payment terms given to customers were typically 30 days which meant they were given one month credit.

February 2003 was a record month with sales of US\$22,000 followed by only US\$20,000 sales in March. The next quarter got off to an excellent start with sales of US\$25,000 in April, after which they continued to grow at a fast rate. Sales doubled to US\$50,000 in May and grew by half again to US\$75,000 in June. This was great for profitability (see Table 4.2) but it opened up another type of cash problem

Table 4.2 *Operating Profit, First Quarter, 2003*

| | <i>April</i> | <i>May</i> | <i>Jun</i> |
|-------------------------|--------------|------------|------------|
| Sales | 25,000 | 50,000 | 75,000 |
| Costs @50% of sales | (12,500) | (25,000) | (37,500) |
| Operating Profit | 12,500 | 25,000 | 37,500 |

With the type of growth MeritTrac was experiencing, the cash flow movements during the month had little resemblance to the profit achieved in the same month. However, with its policy of 30 day payment terms (see Table 4.3), the cash flow seemed to be able to work with a small headroom even when sales were doubling – as long as costs were held fairly constant at 50% of sales.

Table 4.3: *Cash Flow First Quarter, 2003 (Assuming 30 day payment terms)*

| | <i>April</i> | <i>May</i> | <i>Jun</i> |
|---------------------|--------------|------------|------------|
| Receipts +30 days | 20,000 | 25,000 | 50,000 |
| Payments (Costs) | (12,500) | (25,000) | (37,500) |
| Net Cash | 7,500 | 0 | 12,500 |
| Cash Balance | 7,500 | 7,500 | 20,000 |

However, reality proved to be very different. The team learnt that customers typically didn't pay their bills on time – and the idea of paying within 30 days just didn't seem to fit with market practice. Some just asked for longer payment terms – a request MeritTrac found difficult to turn down given their focus on growing sales and a customer base. The team was half correct in its assumptions about their blue chip multi-national customers: while they proved to be reliable payers, they turned out to be some of the slowest.

Apart from some customers who were deliberately slow payers and stalled with the usual excuses, payments from others were delayed due to the lack of regular payment mechanisms – every payment seemed to require a new process. A further drawback was customers wanting contracts carried out at short notice. The effect of this was that MeritTrac often operated without a formal service agreement in place. This, of course, made it difficult to get payment. The operations teams that placed the work were less interested in the administrative details of organizing payments,

and the management team found they had to deal with legal and finance departments before checks would be signed.

With the team keen to grow the business and make the most of the sales opportunities and grow long-term customer relationships, the cash payment issues were a constant source of potential conflict. MeritTrac's small size also seemed to put them in a weak bargaining position. The problem, however, was very real and the effect of stretching average customer payment terms to 60 days – which itself still remained a challenge – can be seen in Table 4.4.

Table 4.4: *Cash Flow, First Quarter, FY2003/4 (Payment terms of 60 days)*

| | <i>April</i> | <i>May</i> | <i>Jun</i> |
|---------------------|--------------|------------|------------|
| Receipts +60 days | 22,000 | 20,000 | 25,000 |
| Payments same month | (12,500) | (25,000) | (37,500) |
| Net Cash | 9,500 | (5,000) | (12,500) |
| Cash Balance | 9,500 | 4,500 | (8,000) |

Overall, the growth in sales the business was experiencing, together with the lengthy and erratic process of receiving payment from customers for work completed, proved a lethal combination in terms of cash management for the business. The whole of 2003 was spent fighting a cash battle, and the team regularly had to temper their euphoria at winning sales orders with the necessity to pay salaries late. At one point, the position became so difficult they were forced to take out personal loans to provide a cash float.

Thankfully, the business survived, and by January 2004 it had grown sales to US\$100,000 per month and was moving from strength to strength.

What options lie ahead?

The team had just endured what can be described as a two-year emotional rollercoaster ride with their business. The ride started at the beginning of 2001, when the euphoria of raising their first outside capital and setting up the business properly soon dissipated into gloom when the full amount failed to materialize and the general economic situation quickly deteriorated. With disaster staring them in the face by the end of 2001, a realistic but tough survival plan brought them another six months of trading time and saw them through to a new dawn of growing sales. However, the growth experienced by the business over the ensuing 12 months took the team totally by surprise and they felt as though they had been flung from one survival situation into another just as tough as they fought the cash management battle.

This bright team knew the theory about managing a growing business, but rarely attempted to apply them in 2003. In their own words, they were "just too busy."

By the final quarter of 2004, MeritTrac was a very different business. It had:

- regular monthly sales of US\$150,000 to US\$200,000 and growing;
- provided services to over 80 customers in the IT and BPO space;
- assessed over 400,000 candidates – the run rate was 15,000 to 20,000 per month across some 15 cities in India; and
- 125 full-time employees with a further 700-plus certified test administrators across India.

In addition, the business faces a buoyant market. The team believe the market for their services was growing at some 200-300% per year and in line with their original expectations. On the downside, however, they still have working capital problems and the cash situation is beginning to feel like a drag on their growth.

This led them again to look at raising capital to fund the growth. On the one hand, they were daunted by the prospect of starting another fundraising process. The last one had been extremely time-consuming and had been unsuccessful in many respects. This time, they would probably need to raise at least US\$1 million which would be beyond the reach of most private investors. This meant going through a process with a venture capital fund with no prospect of success at the end.

On the other hand, the growth of the business going forward was always going to be constrained by the available cash. The prospect of being overtaken by a well-funded competitor in this new market niche was very worrying. An investment of new cash would enable them to maintain their current position as market leader in their field and be strong enough to take on bigger customers. Overall, they would be able to grow much faster with new funding.

Originally they had thought to approach some VC funds again. Those funds still operating after the recession were well aware of the opportunities the market upturn was bringing and were on the lookout for new investment proposals. More recently however, there had been a new and interesting development. They had been approached by a small number of their larger customers who were very interested in MeritTrac's business model, and keen to discuss some form of strategic investment. In some ways this seemed an attractive option as the customers were already familiar with the business and the market opportunity. The team was concerned though, about the potential conflicts of interest that may arise if some of their customers, who were often also competitors, became shareholders.

So by the end of 2004, the team facing some tough decisions. The key questions facing them were:

- Should they raise money or continue to grow within their own resources?
- How much should they raise?
- Who should they raise it from?
- What to do about the customers who are interested in becoming strategic investors?

CONCLUSION

We are grateful to the directors of MeritTrac for allowing us to share intimately in both their triumphs and struggles. In doing so, we have been able to experience the drive, commitment, and resourcefulness required to set up a new business in Asia. With the progress that MeritTrac has made, management is now blessed with a relatively broad selection of options. However, the biggest challenge for them is that at US\$1 million, the amount of capital they are looking to raise is still too small for formal venture capital, but probably too big for individual investors. In addition, while they have the opportunity to grow fairly rapidly, they are still not likely to fall comfortably into the target market of VCs, which are generally looking for fast-growth, technology-backed businesses. In the next chapter, we will explore some of these issues further – in particular, the type of funding environment that faces exciting early-stage businesses such as MeritTrac.