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Startup meets SoftBank: Assessing the Risk-Return Relationship of Visionary Funding

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Abstract: Founder and visionary Masayoshi (Masa) Son transformed Japanese software company SoftBank into an investing conglomerate to “improve lives for all” through global technology diffusion. SoftBank's investees include startups such as WeWork, Uber, and Alibaba. For them, having Masa as an investor implies benefits, but also bears risks. After Masa’s invitation to discuss a potential investment, one co-founder of a technology venture investigates if the invitation should be accepted. While SoftBank’s traditional business is an unsuited investor due to its financial instability, the invitation should be accepted as Vision Fund 2 alone may be a viable investor, strategically and financially.

Keywords: fundraising, corporate venture capital, entrepreneurship, financial health, corporate finance

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Analysis

1. Startups are risky businesses with 90% of them failing (Patel 2015), resulting in little chances of funding from risk-averse providers of capital, such as banks. Here, Venture Capital funds (VCs) and Corporate Venture Capital funds (CVCs) enter. They invest in growth potential, not in current performance. In both structures, funds are set up and focus on an industry or technology – the investment strategy. Besides capital, investors also provide non-financial benefits, “smart money” (Banton 2020). Specifically, operational and strategic expertise and networks. While there are similarities between both, there are differences. VCs are run independently, led by General Partners (GP) and focus on financial returns. CVCs are run by a corporation and usually value access to technologies that support the parent company operationally or strategically often more than financial returns (Corporate Finance Institute n.d.). This, however, is not always the case as nowadays, there are many financially driven CVCs who focus on financial returns (Orn and Growney 2020). Furthermore, while returns are recorded at the (C)VC, a significant portion is forwarded to the fund’s Limited Partners (LPs) (VC), or the parent company (CVC) which initially provided the capital. For VCs, it is usually companies whose industrial or technological focus align with the investment strategy of the fund. While both offer benefits, there are important, distinct implications of working with both.

In terms of “smart money”, VCs likely do not have the operational experience as compared to CVCs, such as Qualcomm Ventures (Qualcomm Ventures n.d.), offering industry and operational knowledge (WhatAVenture n.d.), thereby making it a potentially more valuable investor for a startup. Additionally, its network is significantly larger than the one of a VC. While VCs, such as Sequoia (Sequoia Capital n.d.) or eCapital (eCapital n.d.) can build networks, CVCs are likely to have them by default. This benefit of a CVC is especially pronounced with global companies, simplifying internationalization. For a startup in the

technology industry, a CVC, such as Qualcomm Ventures, will therefore likely offer more value than most VCs. However, there are shortcomings to CVCs. As CVCs are initiated by corporations, investment decisions may be influenced by a corporate culture. Consequently, a deal with CVCs may include conditions that hamper growth as they prevent the startup from risky projects. The startup may not grow as quickly as it wants, which is, as opposed to the focus of return driven VC, not the one of CVCs.

2. Today, Softbank Group (SBG) has a complex corporate structure (Graph 1) but is primarily known for its vision fund segment (VF), a part of SBG's investment business (IB) and a return-driven CVC, including Delta Fund (DF), Vision Fund 1 (VF1) and Vision Fund 2 (VF2). Although SBG made other investments before, such as Alibaba, with VF1, it has seemingly instantaneously transformed SBG from a software company into a global, investing conglomerate. In reality, SBG grew over decades, and so did its investment strategy. Masa entered the US with the acquisitions of a magazine publisher, 18 tradeshows in 1995 and a majority investment of 80% in memory board provider Kingston, likely to diversify SBG's core business, SB. With the registration as a holding company in 1999 and a diversified investments approach, adding other industries, including broadband providers or telecommunication (Vodafone) to his portfolio of internet-based companies, however, Masa tried to recover his portfolio after the dot-com crash. Here, Masa entered the global technology industry with SB's investment business, SBIB, and a CVC-like approach, investing in innovative companies, including then startup Alibaba, to "improve lives for all". With VF1 in 2017, Masa officially started investing in startups with "gun-senryaku", "birds flocking together", in mind, making startups support each other, thereby offering significant, relevant value to any founder. Some investees, such as Uber or health-tech Biofurmis, truly embody his strategy of supporting the most ground-breaking cases. Others, such as real-estate broker Compass or online-shopping

platform Snapdeal emphasize that Masa is simply targeting companies already on track to industry domination, regardless of technological edge. Masa's approach with these investments is to have significant "skin in the game", essentially what any venture wishes for. He paves the way, pushing startups to grow quickly and targets successful exits, see DoorDash's or Uber's IPO, WeWork's planned IPO and Flipkart's sale to Walmart. As VF invests in different segments, niche knowledge may be lost, stressing the importance of understanding key contacts at VF to achieve optimal utilization of SBG's expertise, which was acquired by scaling itself and other technology ventures.

In this regard, Masa placed his belief that humanity's biggest challenges can be solved by technology at the core of his investment strategy and his 300-year plan, indicating a general fit for a technology venture. Importantly, he is willing to take necessary risks to realize his visions, such as founding SBG and expanding globally. There are, however, personality traits that cause challenges. His visionary, pragmatic nature causes conflicts with activist investor Elliott Management (Elliott) and failure of investee OneWeb, filing for bankruptcy after competing with established player Starlink. Furthermore, housing startup OYO struggled, suffering from Masa's go-big-or-go-home approach and failing in its attempt to enter several geographies simultaneously. He is a visionary, expecting more than ventures can handle and often ruining them through excessive risk-taking. After Uber's IPO disaster (valuation of \$75.46bn instead of \$120.00bn), Masa cancelled WeWork's IPO. At this point, he implicitly acknowledged that his investment approach is flawed, at the costs of WeWork, which now is not attractive for other investors and financially relies on Masa. For startups, these implications are dangerous and must be avoided, although initial, large tickets make it tempting to accept the risks.

3. The implications of his practices naturally attract attention. Before VF, investments such as Alibaba gave Masa the image of a tech visionary. Extreme reactions were rare. With VF1, the sentiment was neutral initially, describing Masa as a game-changer for Silicon Valley, or positive, outlining the bravery to allocate so much capital to technology. An investment from Masa was something positive. However, reactions need to be put in perspective. It is no surprise that Adam Neumann, CEO of WeWork, describes his own investor as a visionary. With VF1 and more capital allocated, public sentiment took a turn, calling Masa a “crazy man”. He is described as scaring off other investors with unreasonably high, “radioactive” offers. Furthermore, Masa is perceived as a threat to the tech industry by creating a bubble by luring startups in to avoid IPOs, remain private and receive needed capital from Masa himself. This, however, is a questionable accusation as Masa only benefits from exits, such as IPOs, and appears to have little interest in strategic value for SBG. Either way, press coverage made sure to negatively evaluate his ambitions. As opposed to investment related coverage, real consequences were only felt after the killing of journalist Jamal Khashoggi as its association with VF1’s anchor investor harmed Masa’s image and, also turned fundraising for VF2 into a challenge with interested LPs dropping out. Supposedly, it also affected Masa’s investees, which experienced a backlash for being indirectly associated with it. Contradicting, Masa was able to invest in 44 companies with VF2, although it was opened after this incident. Effectively, founders are not bothered. Understandably to some extent, as Masa had likely nothing to do with it. Even if he did, it is unrelated to his ability to support a startup and does not affect the value of his network of startups. However, given that portfolio value (PV) of VF dropped significantly in FY19, although COVID-19 played a role, founders should be aware that valuations may suffer from Masa’s “off-the-court” business, resulting in challenges when raising new capital from other investors. From a founder’s perspective, the postponed IPO of WeWork in 2019 is equally significant as it outlines implications of Masa’s investments and

the reality founders may face, being dependent on him. This type of reporting is what founders should care about as these practices may harm the startup's future flexibility, strategy and therefore, success. Any press coverage following this was simply reporting, such as the first losses of SBG after 14 consecutive quarters of profits. Overall, public interest is understandable. VF1 is among the largest investment vehicles globally and therefore, draws attention, especially with investment practices that may hurt founders. Although true in individual cases, press coverage points out primarily negative events. Masa was celebrated before VF1. Negative events such as investment failures of this magnitude, WeWork, attract attention – but they need to be set in relation to successes and fund size. Masa produces successes, such as Flipkart being acquired by Walmart in 2018 for \$4bn or DoorDash's IPO in 2019. However, these events are reported on less since investment failures occur more often than successes, especially considering that VF1 was opened in 2017 and Masa requires time to realize gains through exits. Founders seem to understand that as they do not, publicly, distance themselves but accept investments – 44 alone from VF2 since Q4 of FY19. Press coverage does not necessarily reflect reality and founders should look at actual performance to evaluate if Masa is a suited investor.

4. The evaluation of VF as an investor entails three categories important to founders. First, fund size and structure, to understand capital availability and where it comes from. Second, fund management, to investigate managerial structure and behavior necessary to run a reliable and sustainable fund. Third, performance, to draw conclusions about returns on Masa's investments.

SBG's VF is separated into three funds, DF, VF1 und VF2. In fact, given that there are LPs of which some may be purely interested in financial returns and Masa showing his desire for exits, VF1 acts like a VC initiated by a corporate, not a strategically motivated CVC. For a startup, this implies that growth is prioritized over strategic involvement. VF1, which invested \$74.9bn

(acquisition cost (AC)) in 81 companies (G2), excluding seven exits, and VF2, with 44 investees (G3) and \$6.7bn invested, both as of Q4 FY20, are of primary interest as they are investing in technology startups. While VF1 is closed for new investments since Q2 of FY19, it is a proxy used to evaluate how VF2 will perform, the fund that would invest. Importantly, VF1 has a higher average acquisition cost (AAC) of \$924.69mn (Q4 FY20) than VF2 (\$152.27mn) (G4). For founders raising \$100mn, VF2, targeting smaller investments, is therefore a suited fund in terms of ticket size. DF has only one investee and therefore, does not provide qualified insights. As opposed to VF1, which raised \$93.2bn in Q1 of FY17 (G5), VF2 raised only \$20bn as of Q4 of FY20, with Masa acknowledging that he cannot ask LPs to commit funds given the recent negative performance of VF. Founders should therefore expect follow-up investments from VF2 to be a bigger ask than for VF1, especially with the assumption that only 15%, as for VF1, \$3bn, are dedicated to follow up investments. With 44 investees in FY20 (G3), an average follow-up round is below \$100mn, the startups' initial funding goal, which would likely be exceeded in the next round. Notably, Masa committed \$33bn of \$98.6bn to VF1 and had to commit the full \$20bn to VF2 himself as LP's are hesitant to commit. With the journalist's death and VF's results (FY19), and despite Masa's attempt to boost confidence with a \$2.5bn "bridge fund", VF2 may not raise more, affecting its viability as a follow-up investor and therefore, contradicting one of the founders' fundamental requirements.

In terms of managing VF1, Masa provides \$29.3bn of \$85.4bn called in total, displaying enough confidence in his abilities to risk SBG's capital. Furthermore, VF1 alone paid out approximately \$22.5bn in total distributions (Q4 FY20), thereby expressing positive overall performance. This is relevant to founders as startups can only expect capital when there are satisfied LPs to provide this capital. Furthermore, Masa has, aside of Q3 of FY17, at least \$411.11mn, usually \$1bn or more, available in cash to pay his obligations, coupon payments. In this regard, Masa got

additional capital to invest through preferred equity, without creating additional debt with extensive formal demands. However, even without LPs for VF2, Masa already invested \$6.7bn from VF2 in FY20 (G3). Strikingly, VF1 made 44 investments within five quarters, 15 more than VF1 as of Q1 of FY18 (G2, G3). It is therefore questionable whether he truly reconsidered his investment approach. As a result, mistakes, such as inappropriate valuations, may still prevail to startups. Oppositely, dry powder (G6) of VF1 decreases incrementally with time, emphasizing that Masa never has “money laying around” to be spent impulsively. Moreover, both Dry Powder Over Debt (lowest: 4.25x, VF1, Q4 of FY20) (G8, Formula 1) and Portfolio Value Over Debt (lowest 4.65x, VF2, Q4 of FY19) (G8, F2) confirm this observation. As both are consistently above “1” (ignoring pre-investment stage of VF2, Q3 2019, -0.81x), Masa prioritizes financial sustainability by not letting obligations exceed PV or dry powder – sources of liquidity. Against what press coverage suggests, and although his investment approach may not have changed, Masa diligently manages his startup fund. Supporting this conclusion is Masa’s acquisition of Fortress Investment Management to guarantee quality of management.

Although it is properly run and there are signs of positive performance, actual performance analysis provides conclusive insights. As VF1 started investing in 2017, most investees have not been exited yet. IRR therefore provides unrealized, possibly subjectively determined, “paper” gains (G9, F3). VF1 performs worse in recent quarters than it has in early quarters. This observation, however, can be expected. Valuation of first investments increased strongly in a short time-period, resulting in IRRs of 105,78% in Q2 of FY17 and values between 50% and 60% thereafter. With more investments following, more dissatisfactory results are natural, and a decreasing IRR reflects that. Additionally, COVID-19 likely caused a devaluation of VF’s total PV and explains VF2’s highly volatile IRR (G10). Since Q4 of FY19, however, IRR of VF1 is recovering from its low of 1.5%, sending positive signals about Masa’s ability to help

investees recover. Net Asset Value (NAV) (F4) mirrors this recovery, growing from a low of \$72.11bn (Q4 FY19) to \$131bn (Q4 FY20) within one year (G11). As cash and debt change marginally, the majority of this change is explained by an increase in PV. Decreases in total IRR, NAV and PV (Q4 FY19) are therefore, likely, driven by COVID-19, not necessarily Masa's practices. Therefore, these metrics should follow similarly positive trends as for VF1 before COVID-19. However, founders need to consider that Masa acknowledged weak investment judgement and is reflecting "deeply on that" If he truly reconsidered it, an increased risk aversion may provide less hyper-growth of investees. This may already be reflected in VF1's IRR in Q4 of 2020 (27,6%) being below the IRR expected initially expected by investors of VF1 (44%). Recovery from COVID-19 is also observed in Residual Value to Paid-In Capital (RVPI) (G12, F5), showing a likely return to pre-COVID-19 levels of 1.46x as NAV increases. Oppositely, Distributions to Paid-in Capital (DPI) (G13, F6), realized value created, unsurprisingly, is below "1" as gains only materialize with exits, over time. However, DPI exceeds pre-COVID-19 levels, implying that Masa can pay increasingly high distributions, supporting that VF1 is performing well. Still, founders should treat DPI with care as Masa can use capital calls, besides realized value, to pay coupons. Total Value to Paid-In Capital (TVPI, F7), combining both unrealized (RVPI) and realized returns (DPI), shows levels above "1" of 1.65x (G14), also exceeding pre-COVID levels and indicating increasingly positive performance of VF's. Similarly, Gross Multiple on Invested Capital (MOIC) followed the pattern and is, apart from Q1 and Q2 of FY20, always above 1.0x for both VF1 and VF2 (G15, F8), implying that at any given point, Masa has created some value as PV exceeds AC. Overall, VF shows positive trends in FY20. If Masa reflected on his investment approach, VF2's focus on smaller tickets should remain. As opposed to the adverse effect that a more careful investment approach may have on IRR, companies of lower funding needs and therefore, earlier development stages, likely have more growth potential and may therefore increase IRR of VF2

in the future. With a funding goal of \$100mn, and recent positive performance of VF1, VF2 is a viable choice, financially, if Masa can clarify how follow-up rounds will be financed.

Financial analysis investigates SBG's performance with a focus on SB (core operations), the entity that generates capital to be invested by Masa's investment business outside of VF, SBIB. First, as depicted in G16, SBG's overall debt-to-equity ratio (D/E, F9) grows from a low of 149,3% in 2011 to a high of 340,1% in 2015 and returns to 163,5% in 2020 as Masa allocated \$28bn to VF1 in FY16, likely forcing Masa to raise required capital for VF1 through debt in advance. Additionally, financial autonomy ratio (FAR, F10) provides insights into consequences of this debt level by underlining SBG's strong reliance on its creditors with FAR ranging from 19,06% (FY15) and 36,02% (FY11) to 28.77% (FY20) (G16). Banks prefer consistent values over 25% to extend debt and founders should therefore be concerned that SBG cannot raise debt when SB, or SBIB's investees, need it. This concern is supported by solvency ratio (SR, F11), expressing SBG's ability to meet obligations with its capital invested in, or generated by, its business. It has not been at the minimum required level of "1", or 100%, since 2012 (G16) and to founders, SB's capacity for follow-up investments is therefore questionable as its own capital needs will likely be prioritized. With Elliott's pressure, it may approach 100% in the future but with no easy access to debt (FAR), startups, still, are likely to be of second priority. With regards to SB's ability to generate profits (G17), it is notable that SB is unstable without clear trend patterns. Gross margin (F12) is arguably stable, with a slightly convex trend. After a low of 37.87% in FY15, it reached to 51.08% in FY20, almost returning to 53.61% (FY11). Other profitability margins (PM) of SB fluctuate quite significantly during the investigated time-period (EBIT Margin (F13): 9.84% in FY19; 23.88% in FY12, EBT Margin (F14): 10.43% in FY13; 22.35% in FY12, Net Margin (F15): 7.47% in FY15; 21.20% in FY16), driven by changes in other operating expenses, interest expenses, net and gains (losses) from discontinued operations. In FY19, operating expenses increased significantly, bringing EBIT

margin to 7.47%, a new low. Asset turnover (SB) (190.7% in FY13; 65.54% in FY18) (G17, F16) fluctuates as well, indicating inconsistencies in how productively SB assets are utilized. Forecasting of revenue generation is therefore a challenge. As a founder, consistency in profitability must be expected from a corporate investor as otherwise, liquidity is not guaranteed. In this regard, SB may also not be as proficient in introducing sustainable processes itself and therefore, not be able to support a startup with qualified advice. Financially, the lack of a trend poses the question whether SB can generate capital itself without raising debt, which is a challenge (FAR, SR). However, despite COVID-19, SB showed positive profitability margins throughout. Intuitively, evaluating profitability margins of IB is not appropriate as there is no comparable operational infrastructure. However, IB's net result, based on gains in non-cash item other non-operating income, affects SBG's results. In FY19, losses, mostly from VF, erased profits of SB, causing negative net results and profitability margins (G18) for SBG after 14 years of profitability. Similarly, IB contributed 50%+ to a positive net result of SBG. Given its unstable profitability and SBG's challenges to raise debt, SBIB by itself cannot guarantee liquidity and is therefore not a reliable follow-up investor.

Financial performance ratios (FPR) help drawing conclusions about the returns of SB and SBG. Importantly, it is not possible to evaluate SB's or SBG's performance relative to peers as industry benchmarking would be required. It is exclusively used to investigate stability of returns and capital structure, helping founders to evaluate further on predictability of SB's ability to be a follow-up investor. Return on Invested Capital (ROIC) (F17, G19) differs significantly between both SB and SBG. Surprisingly, excluding FY20, ROIC (SB) is less stable than ROIC (SBG). Again, for an established corporation, core operations should be more balanced, just like returns should follow a trend, thereby suggesting stability and predictability. With this much volatility, there is no ground for assuring that SB is a sustainable business, let

alone capable of funding startups in the future through SBIB. Not only do inconsistencies in net result (SB) contribute to fluctuation. Strikingly, Invested Capital (IC) (SB) (G20) increases from \$18.136bn in FY11 to \$79.252bn in FY14, resulting in a decreasing ROIC (SB) from 30.14% in FY12 to 7.67% in FY15 as net result only catches up in FY16 (ROIC (SB), 20.58%). Furthermore, and although an increase from 12.7% in FY19 to 65.1% in FY20 partly results from an all-time high in net income (\$18.988bn), a large portion of this increase is attributable to a strong decrease in IC (SB) from \$55.532bn in FY18 to \$29.167bn in FY19. It appears that SB improves performance exponentially, but this is not the case when considering that net income shows a negative trend from FY16 to FY19 while reliance on liabilities (SB) increases, even exceeding assets (SB) in FY20 (G21). Accordingly, the supporting assets-to-liabilities ratio (A/L) (F20) decreases from 3.08 in FY11 to 0.99 in FY20, supporting SB's increasing reliance on external resources to conduct its operations. With the asset deficiency in FY20 and A/L below "1", SB would most likely default on its obligations and, in fact, be insolvent. RONIC (SB) (G22, F18) suggests that there is also no trend in how incremental IC changes would incrementally improve net income. Without a clear trend, ranging from 218.81% in FY17 to -45.27% in FY20, it stresses the difficulties of predicting what changes at SB will have which impact in the future. Return on Assets (ROA) (SB) (G23, F19), however, is more stable, ranging from 4.5% (FY19) to 16.00% (FY12), implying that assets' profitability is more predictable. ROE (SB) (G24, F21) fluctuates as well, for example, from 55.92% (FY12) to 27.35% (FY13). However, equity increases consistently, meaning fluctuation results from unstable net results. Importantly for founders, as for obligations, SBG runs on significant amounts of debt (D/E) and liabilities (A/L). As there is comparably little equity, arguably high ROE values are misleading as returns are mostly financed by debt. Generally, SB creates value in the present while creating future obligations. Strikingly, SB's ability to pay them back depends on, besides declining net results (SB), SBG's IB, which is, besides SBIB, largely composed of risky venture investing

(VF), implying income uncertainty. As indicated by PMs, SB is consequently also not a reliable investor financially. As elaborated in VF's performance analysis, there is a specific way of evaluating a fund, which is considered appropriate to the remainder of IB, SBIB, to reflect that Masa used the CVC approach shortly after 2000, deeming ratio analysis for SBIB as inappropriate. However, it displays IB's, especially VF's, impact on overall performance of SBG. Paradoxically, IB, investing in highly risky assets, is responsible for ROIC (SBG)'s stability. ROIC (IB, 11.71%) impacts ROIC (SBG, -4.62%) sufficiently to eliminate a positive ROIC (SB, 12.72%) as in FY19 (G19), the first time SBG reported a loss in 14 consecutive years, caused by an \$18bn loss from VF. Additionally, ROE (IB) pulls up ROE (SBG), making SBG seemingly attractive to equity investors until FY18, supposedly giving Masa the chance to raise capital through equity and to provide liquidity to SB. Returns are misleading. SB's contribution to total IC, and therefore, equity, is so low in FY19 (17.1%), even negative in FY20 (-0,7%), that ROE (SBG) has no significant meaning. Consequently, equity investors may not be convinced of SBG as they understand the impact of IB. Masa's access to capital is therefore questionable not only for debt, but also equity, strengthening financial uncertainty.

While FPR analysis provides insights into how IB affects SBG's overall performance and implications of capital structure, Z''-Score (Z'') (G25, F22) provides insights into financial health, displaying the probability of SBG, and hypothetically, SB as a standalone business, to face financial distress in the future. Z'' (SB) and Z'' (SBG) show a similar, descending pattern. Strikingly, small differences confirm conclusions from capital structure, FPR and PM analysis. IB provides, despite its high-risk nature, stability for SBG. SB moves within the grey area with a descending pattern, touching the safe zone at 5.85 in FY12 and shortly sliding into the distress zone (3.77) in FY18, before recovering to the grey zone in FY19 (4.46). With this trend, and an increasing chance of facing financial distress, SB cannot be expected to be able to invest

millions, even billions, in a startup. For founders, this is a major concern. Furthermore, SB likely remains in a state in which it may face financial distress without improvements in Z'', specifically capital structure. In FY18, for example, Z'' (SB) dropped by 1.5. Here, X4 (F23) alone fell by 0.43 to 0.5 as SB liabilities grew by 171.26% to \$45.566bn, indicating that the maximum possible decline in SB's assets before becoming insolvent is 50%. This is concerning as SB's assets fell by 187.52% the same year. With these factors, future financial support cannot be guaranteed from SBIB. If IB, including VF, is included, Z''(SBG) values are higher in every year with more stability, especially in FY18, even climbing to the safe zone in FY20 (5.99). Concludingly, with this volatility in financing structure, SB as a business would likely face bankruptcy without IB's, especially VF's, strong recent performance. Even if debt is issued based on Z'' (SBG), there are likely strings attached that force Masa to optimize SB first. With a high debt level (D/E: 163,5% in FY20, G16), unstable FPRs, especially ROE, and PMs, it is unlikely that Masa can raise capital, rendering SBIB an unlikely future investor.

Credit ratings confirm the difficulties of raising debt. Moody's, Standard and Poor (S&P) or the Japanese Credit Rating Agency (JCRA) indicate the risk of a debtor defaulting on obligations. As depicted in G26, Moody's and S&P are on the same, medium level of BB+/Ba1 although they slightly differ in FY12 and FY13 (S&P: BB+/Ba1 and BBB/ Baa1) and FY18 (Moody's: BB-/Ba3). Overall, credit ratings do not present SBG as a creditworthy company although JCRA is optimistic about SBG with ratings of A-/ A3 to SBG, even A/ A2 in FY12 and FY13. This rating, far more positive than SBG's rating implied by Z'' (SBG), must be treated with care as it is possibly extrapolated to positively present a company with the same country of origin. Regardless, banks using JCRA as a reference may extend debt easily. For founders, however, internationally dominant credit ratings should be more convincing of SBG's creditworthiness given a potential bias of JCRA. Although S&P and Moody's are more

accurate, they are still too high and do not reflect the actual risk of debt issuers. Even worse, credit ratings may be outdated as seen in FY14, when S&P took another year to reflect a change of the implied credit rating. Relying on external credit ratings therefore poses the threat of inaccurately assessing SBG's health and overestimating its ability to raise debt. Founders should therefore refer to implied credit ratings, confirming SBG's lack of creditworthiness, and conclude that especially SB's health does not promise future liquidity and financial support, confirming conclusions from PMs, FPRs and Z''(SBG, SB) analysis.

5. A startup raising its Series C funding round needs an investor which can support the startup in realizing its ambitions. While there are benefits, there are implicit and explicit risks associated with SBG, SBIB, VF and Masa. A general benefit is Masa's expertise in scaling a business, having scaled a Japanese software company to a global conglomerate. Furthermore, the benefit of SBG's network is particularly pronounced as SBG places technology at its core, globally, suggesting a large pool of potential clients and partners. Another benefit is that follow-up investments such as in Compass or Grofer, and bail-out packages such as a \$2bn investment in WeWork are likely if Masa remains convinced of the startup's potential and has his vision. This vision however, for founders, is a big risk as it is not always realizable. OYO's expansion failed, OneWeb filed for bankruptcy, WeWork faced financial challenges and became financially dependent on Masa after being pushed to accept capital, without needing it. Uber's IPO disappointed. Masa may also change his vision along the way, leaving startups stranded with broken term-sheets or eliminate founders as he did with WeWork's CEO. He is unpredictable and can ruin a startup by convincing them of his overly ambitious vision. However, given the number of investments in VF1, 88, and VF2, 44, extreme events are outliers. Also, their impact can be proactively moderated by not granting Masa too much equity and avoiding irrationally low or high valuations, denying his special requirements, thereby

preventing difficulties with new investors as well as dependence on, and power for, Masa. Importantly, risks and benefits differ depending on whether SBIB or VF invests. As Masa leads both, founders may believe the source of capital would not matter, but there are striking differences.

The key differentiator between both SBIB and VF is their inherent business nature. With SBIB, there will be governance structures associated with SB that are required by debtors, Nikkei 225 or Elliott. Consequently, a startup's need for risk-taking cannot always be shared, creating misaligned incentives, agency problems. Furthermore, a startup such as WeWork, receiving \$18.5bn, partially from SBIB, certainly enjoys Masa's attention. Whether this applies to startups receiving only \$100m remains unanswered and founders must be aware that "small" equity investments might be deprioritized if more important, SB related matters require Masa's (financial) attention. Supporting this argument is SB's financial situation, including volatile PMs, FPRs, capital structure (D/E, A/L) and expected challenges to raise capital from both debt and equity. Z'' (SB) concludes that SB, excluding IB, would likely be insolvent. From a financial (health) perspective, SBIB is therefore not a reliable long-term partner. Oppositely, VF2 has the sole purpose, and more likely than SBIB, resources to execute follow-up investments. Investees are the core of VF2's business model and therefore, Masa's focus. Startups' successes define Masa's performance which has been positive for VF1, although below investors' IRR expectations of 44%. VF2 promises continuous financial support to startups, precisely what founders are looking for. With its size of \$20bn and Masa's intention to grow startups, VF2 provides a more favorable environment to founders – as long as Masa can guarantee that follow-up investments are possible financially. Operationally and strategically, however, cooperating with SBIB provides significant benefits if a startup can utilize SB's operational, but questionable, expertise, and network, a key benefit of a corporation

in the same industry. Furthermore, a strategic value to SB is likely implied, emphasizing that Masa has objectives besides financial returns and therefore, may not write-off the investment if financial performance or progress do not satisfy his expectations. Oppositely, this risk may be present at VF, as seen with Snapdeal's write-off. Another risk of VF is that there is no transparency on Masa's investment approach. His "reflection" may just relate to the amount he invests in one startup, explained by a significantly lower AAC of VF2. As he already invested in 44 companies with VF2, the question remains whether he is more diligent on individual investments and consequently, reduces the risk of making decisions with unfavorable consequences for a startup. With these risks in mind, the strongest benefit of VF2 besides its goal to grow startups is "gun-senryaku", enabling investees to learn current best-practices from startups that faced, or currently face, similar challenges, offering a stronger and more accurate value proposition than SBIB can offer.

Based on organizational and financial aspects, and although SBIB offers benefits strategically and operationally, VF2, part of VF, is the only entity considered as an investor. Financial health of SB alone, and therefore, investment capacity of SBIB, are so unpredictable that follow-up investments cannot be counted on. The invitation should be accepted to have an informative conversation with Masa, focusing on vision, future funding capacity of VF2, and valuation. While Masa can grow technology ventures, he can also guide them into existential crises. A conversation will help founders understand which of the two outcomes they can expect.

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Appendix

Table 1: Overview of formulas

Number	Concept name	Formula	Concept Definition
1	Dry Powder over Debt	$\text{Dry Powder}_{(t)} / \text{Debt}_{(t)}$	Solvency measure, indicates the ability of the investor to cover the fund's obligations with liquid assets, expressed as a multiple, e.g. 1.0x
2	Portfolio Value over Debt	$\text{Fair Value}_{(t)} / \text{Debt}_{(t)}$	Solvency measure, indicates the ability of the investor to cover the fund's obligations by liquidating the portfolio assets, expressed as a multiple, e.g. 1.0x
3	Unrealized Internal Rate of Return (IRR)	$\sum_{t=0}^T \frac{\text{Net cash flow}_{(t)}}{(1 + \text{IRR})^t}$ $+ \frac{\text{Terminal value}_{(T)}}{(1 + \text{IRR})^T}$	Overall performance metric, theoretical % portfolio return if the portfolio were liquidated at a specific point in time

4	Net Asset Value (i.e. Terminal Value)	$\text{Fair Value}_{(t)} + \text{Cash}_{(t)} - \text{Debt}_{(t)}$	Indicates the fund's net value after paying all liabilities
5	Residual Value to Paid-In-Capital (RVPI)	$\text{Net Asset Value}_{(t)} / \text{Called Capital}_{(t)}$	Indicates the unrealized value created with the fund expressed as a multiple, e.g. 1.0x
6	Distributions to Paid-In-Capital (DPI)	$\text{Distributions}_{(t)} / \text{Called Capital}_{(t)}$	Indicates the realized value created with the fund, expressed as a multiple, e.g. 1.0x
7	Total Value to Paid-In-Capital (TVPI)	$(\text{Net asset value}_{(t)} + \text{Distributions}_{(t)}) / \text{Called Capital}_{(t)}$	Indicates the total value, unrealized and realized, created in the fund, expressed as a multiple, e.g. 1.0x
8	Gross Multiple on Invested Capital (MOIC)	$\text{Fair Value}_{(t)} / \text{Acquisition Cost}_{(t)}$	Gross return metric at a specific moment in time if the portfolio were liquidated, does not account for any management or transaction fees that

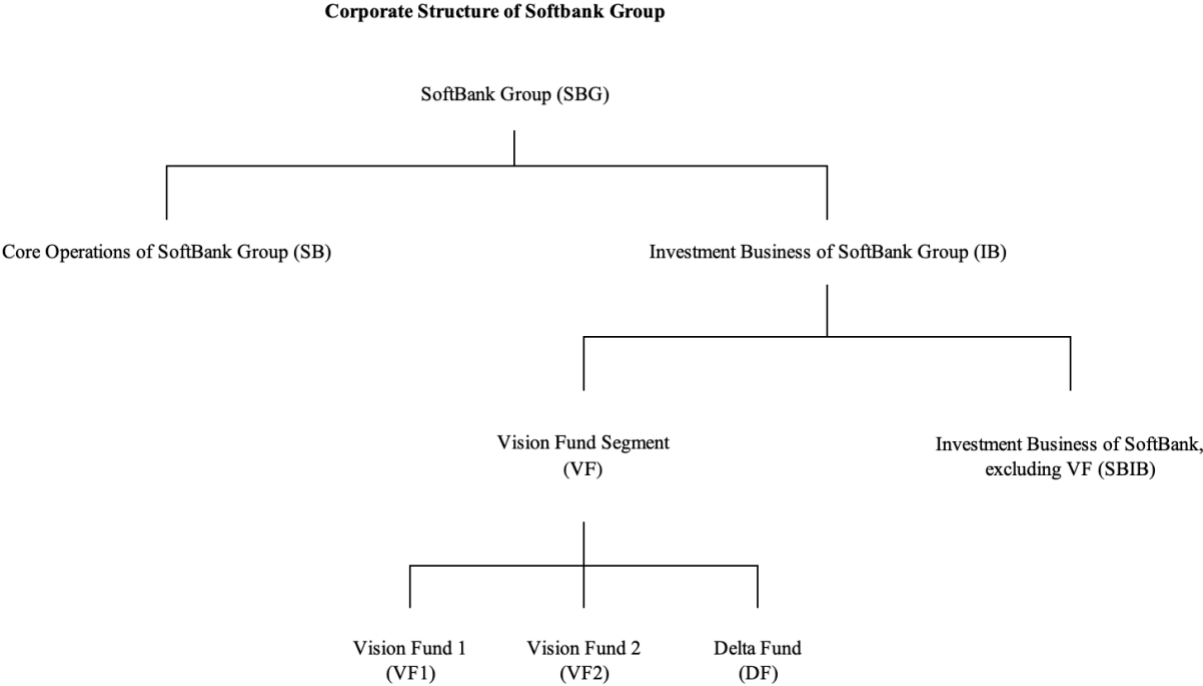
			arise from the liquidation, expressed as a multiple, e.g. 1.0x
9	D/E Ratio	$\text{Debt}_{(t)} / \text{Equity}_{(t)}$	Expresses to what extent the business is financed by borrowed capital
10	Financial Autonomy Ratio	$\text{Equity}_{(t)} / \text{Total Assets}_{(t)}$	Indicates the firm's independence towards its creditors. Bank's like it >"0.25"
11	Solvency Ratio	$\text{Equity}_{(t)} / \text{Total Liabilities}_{(t)}$	Indicates the firm's ability to meet its obligations using the capital that has been invested or generated by the firm. Banks like to see values >"1"
12	Gross Margin	$\text{Gross result}_{(t)} / \text{Revenues}_{(t)}$	Indicates how efficiently a company can generate profits

13	EBIT Margin	$EBIT_{(t)} / Revenues_{(t)}$	Indicates how efficiently a company can generate profits
14	EBT Margin	$EBT_{(t)} / Revenues_{(t)}$	Indicates how efficiently a company can generate profits
15	Net Margin	$Net\ Result_{(t)} / Revenues_{(t)}$	Indicates how efficiently a company can generate profits
16	Asset Turnover	$Revenues_{(t)} / Total\ Invested\ capital_{(t-1)}$	Indicates how effectively assets are used to generate revenues
17	Return on Invested Capital (ROIC)	$Net\ Result_{(t)} / Total\ Invested\ capital_{(t-1)}$	Return on all resources invested in the business/ business unit/ product line/ etc.
18	Return on New Invested Capital (RONIC)	$(Net\ Result_{(t)} - Net\ Result_{(t-1)}) / (Total\ Invested\ Capital_{(t-1)} - Total\ Invested\ Capital_{(t-2)})$	Measure of incremental changes in net result resulting from incremental changes in invested capital

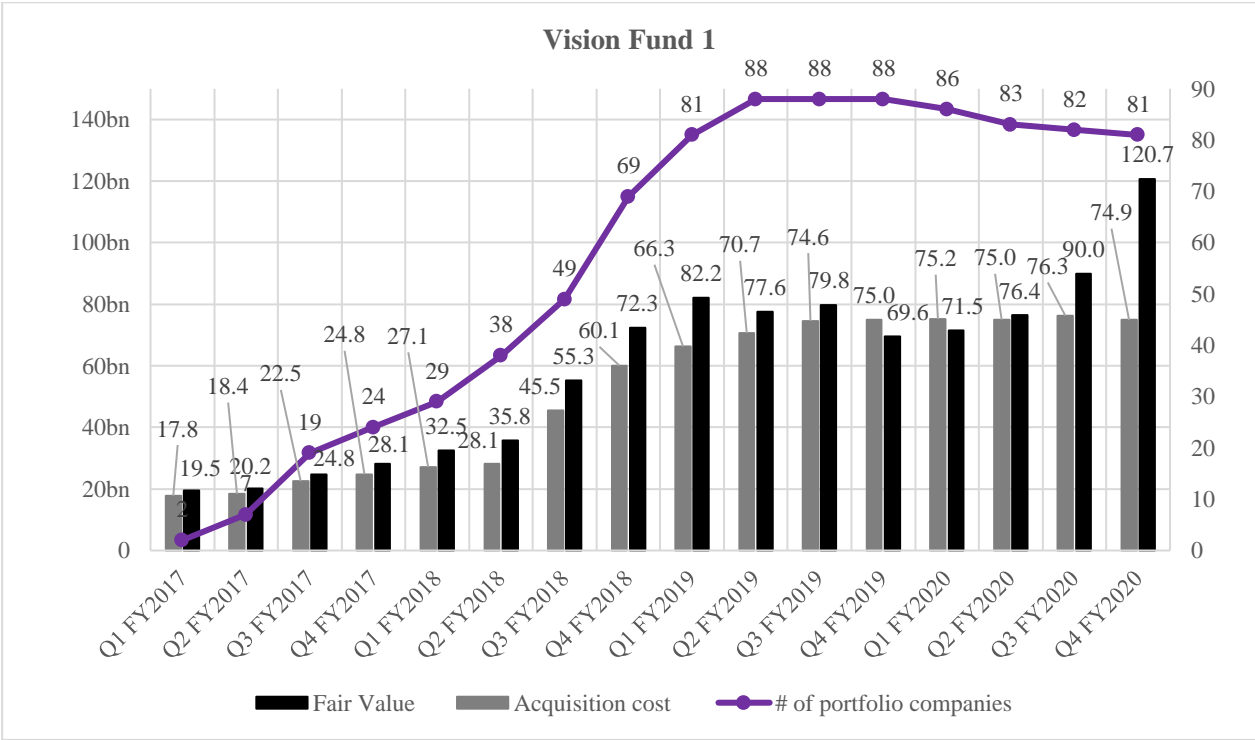
19	Return on Assets (ROA)	Net Result _(t) / Total Assets _(t-1)	Indicates how efficiently assets are used to generate net result
20	Assets/ Liabilities	Assets _(t) / Liabilities _(t-1)	Indicates financing structure of operations
21	Return on Equity (ROE)	Net Result _(t) / Equity _(t-1)	Return shareholders receive for their equity investment
22	Z''-Score	$3.25 + 6.56 * X_1 + 3.26 * X_2 + 6.72 * X_3 + 1.05 * X_4,$ <p>where $X_1 = \text{Working Capital}_{(t)} / \text{Total Assets}_{(t)}$, $X_2 = \text{Retained Earnings}_{(t)} / \text{Total Assets}_{(t)}$, $X_3 = \text{EBIT}_{(t)} / \text{Total Assets}_{(t)}$, and $X_4 = \text{Book Value Equity}_{(t)} / \text{Book Value Total Liabilities}_{(t)}$</p>	Adapted version of Altman's Z-score model for non-manufacturing that are either private or public, indicates whether a company is heading towards financial distress, score can indicate "safe zone", "grey zone", or "distress zone", and be used to determine a

			company's implied credit rating
23	X4 of Z''	Market Value Equity _(t) / Total Liabilities _(t-1)	Indicates the maximum possible decrease in assets from a given level of a company before insolvency

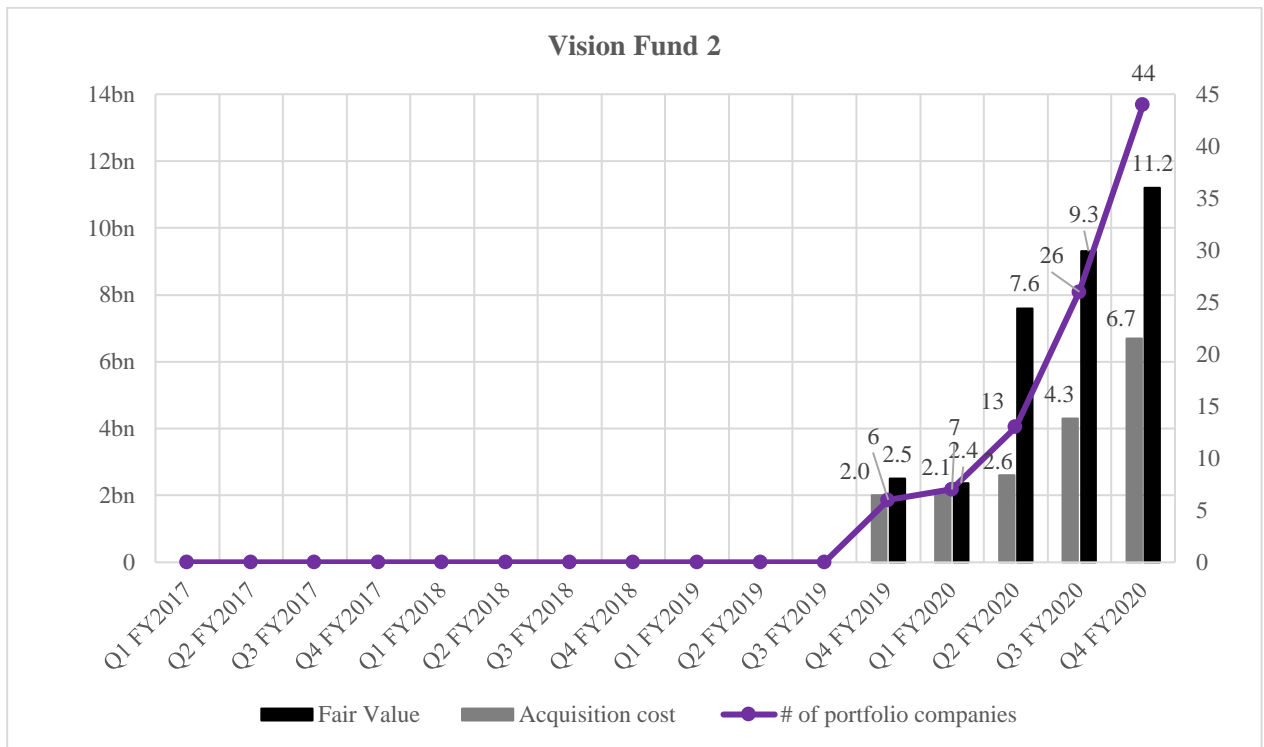
Graph 1: Corporate Structure of SoftBank Group



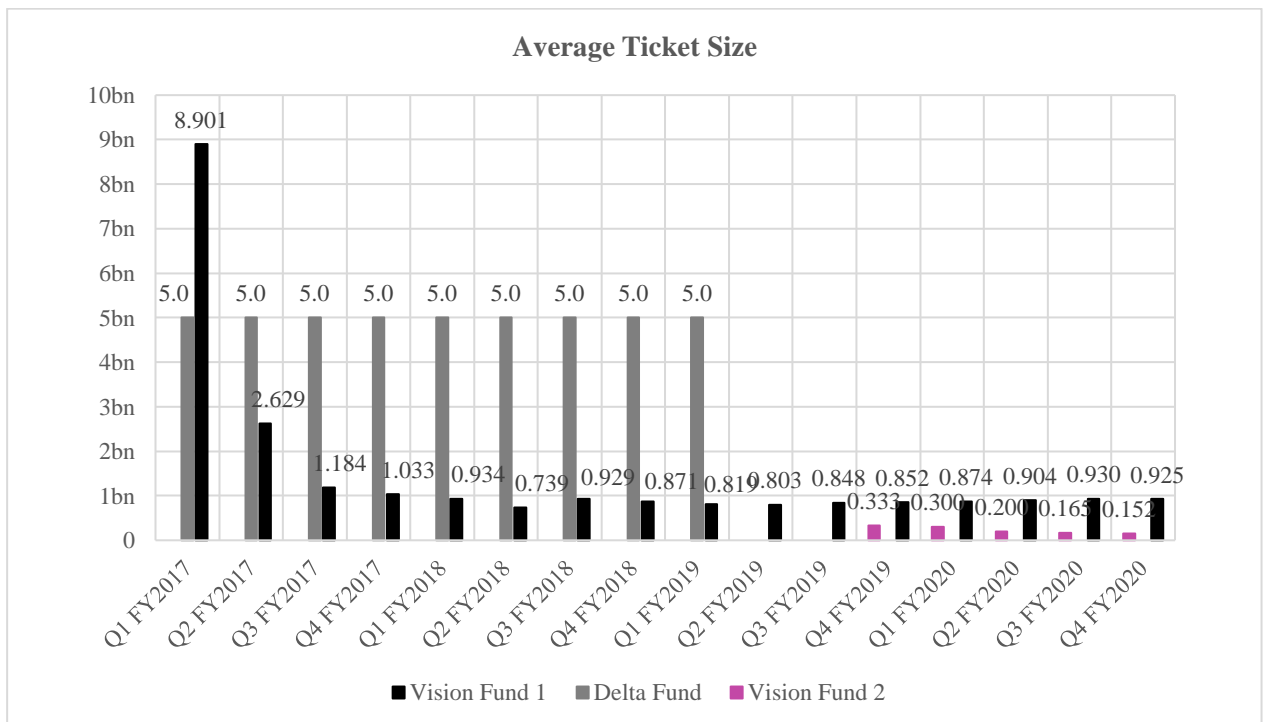
Graph 2: Vision Fund 1: Fair value, acquisition cost and number of portfolio companies



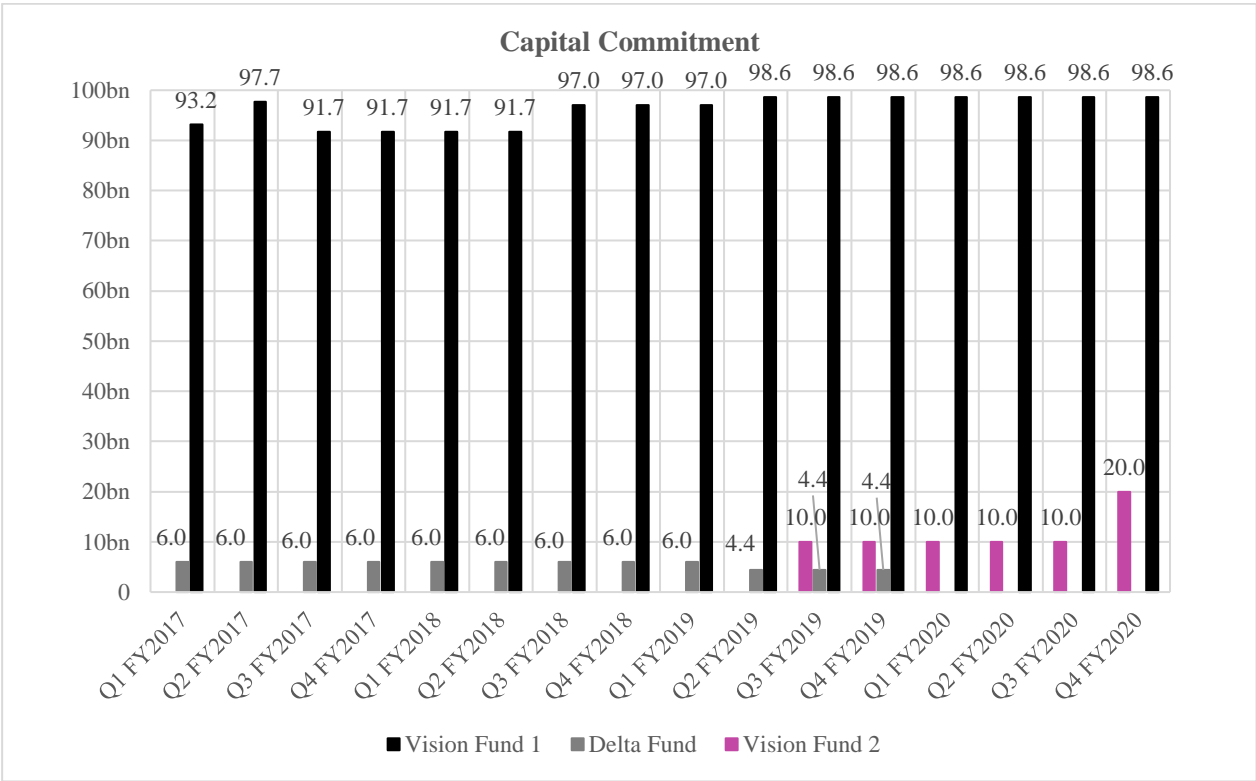
Graph 3: Vision Fund 2: Fair value, acquisition cost and number of portfolio companies



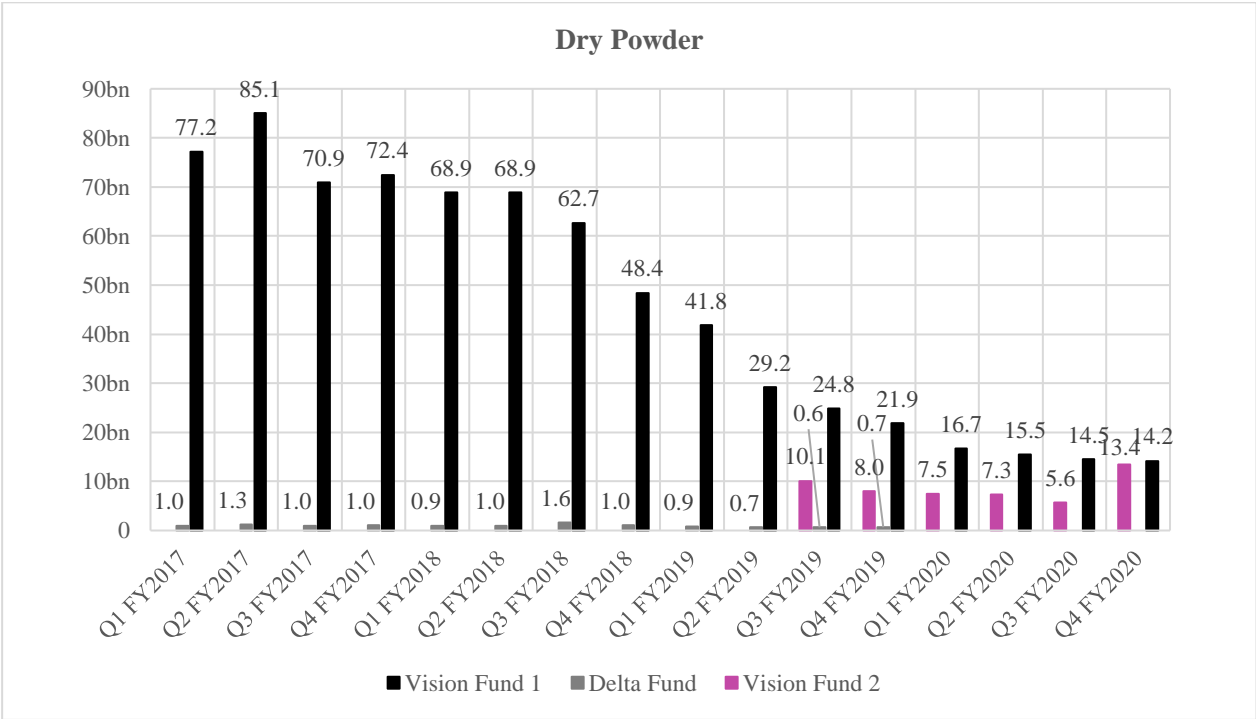
Graph 4: Average Ticket Size



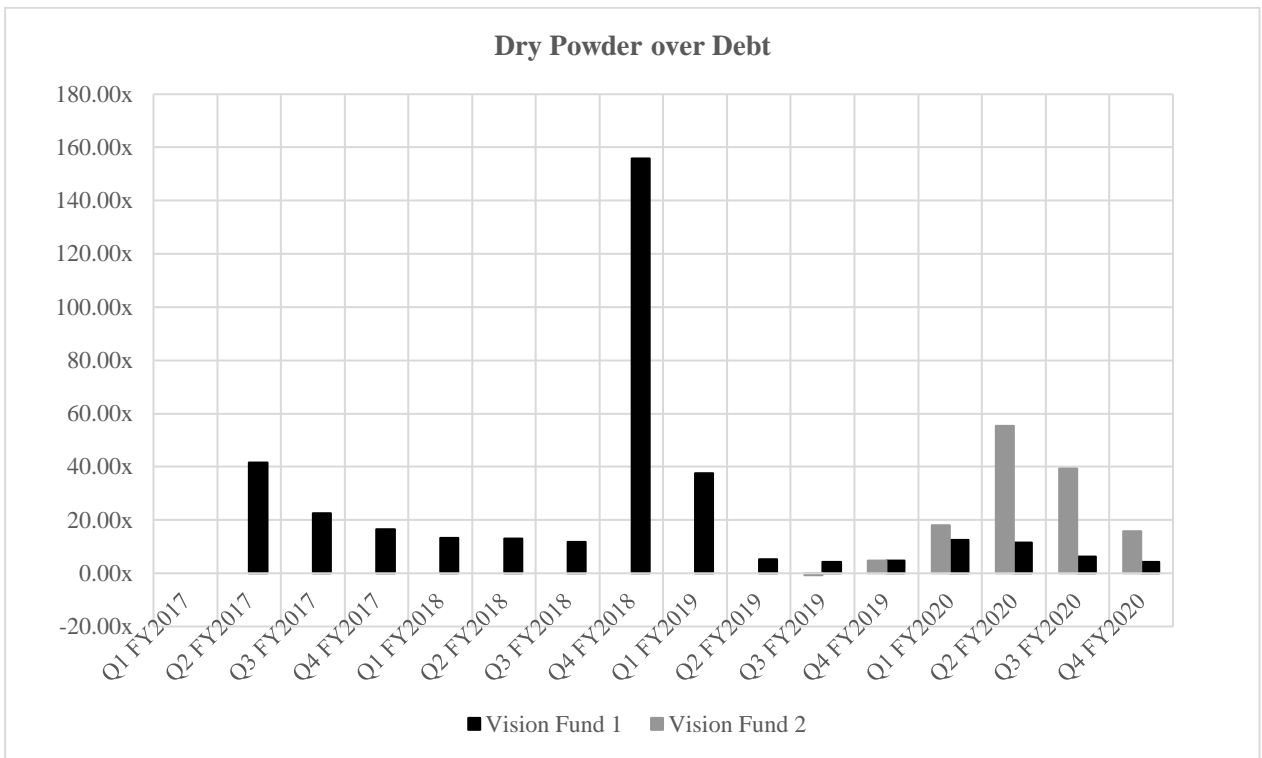
Graph 5: Capital Commitment



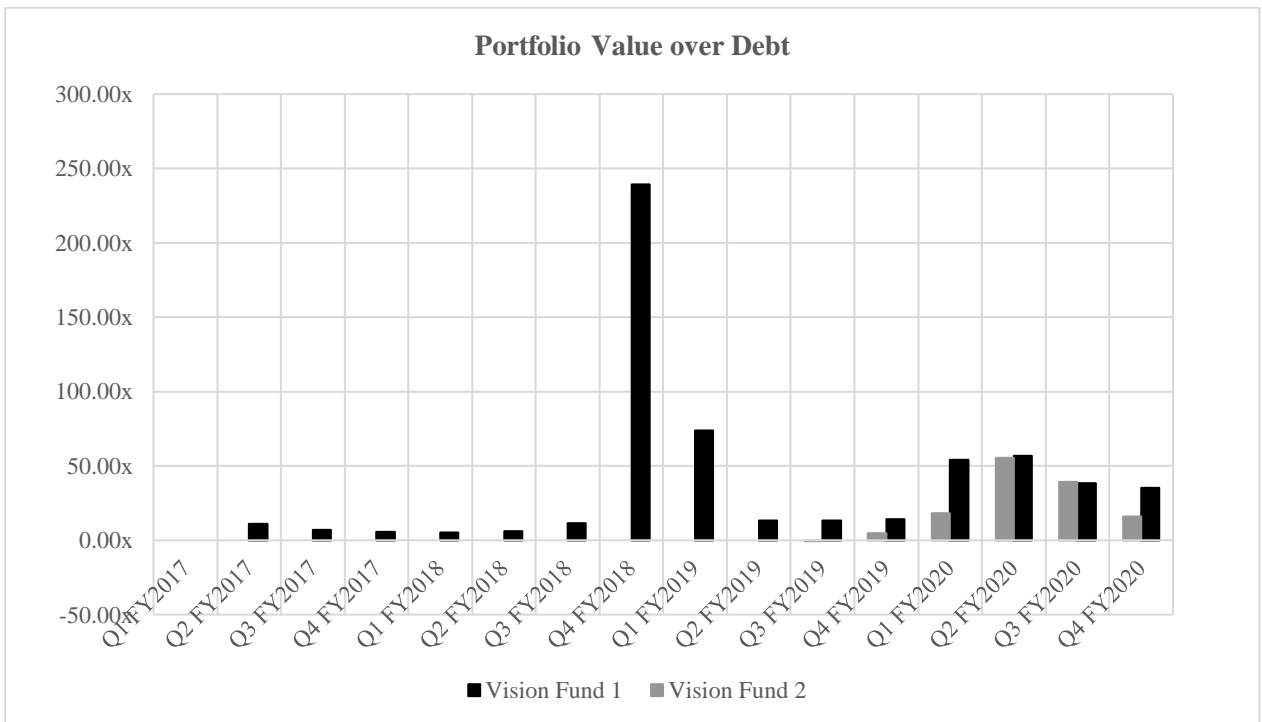
Graph 6: Dry Powder



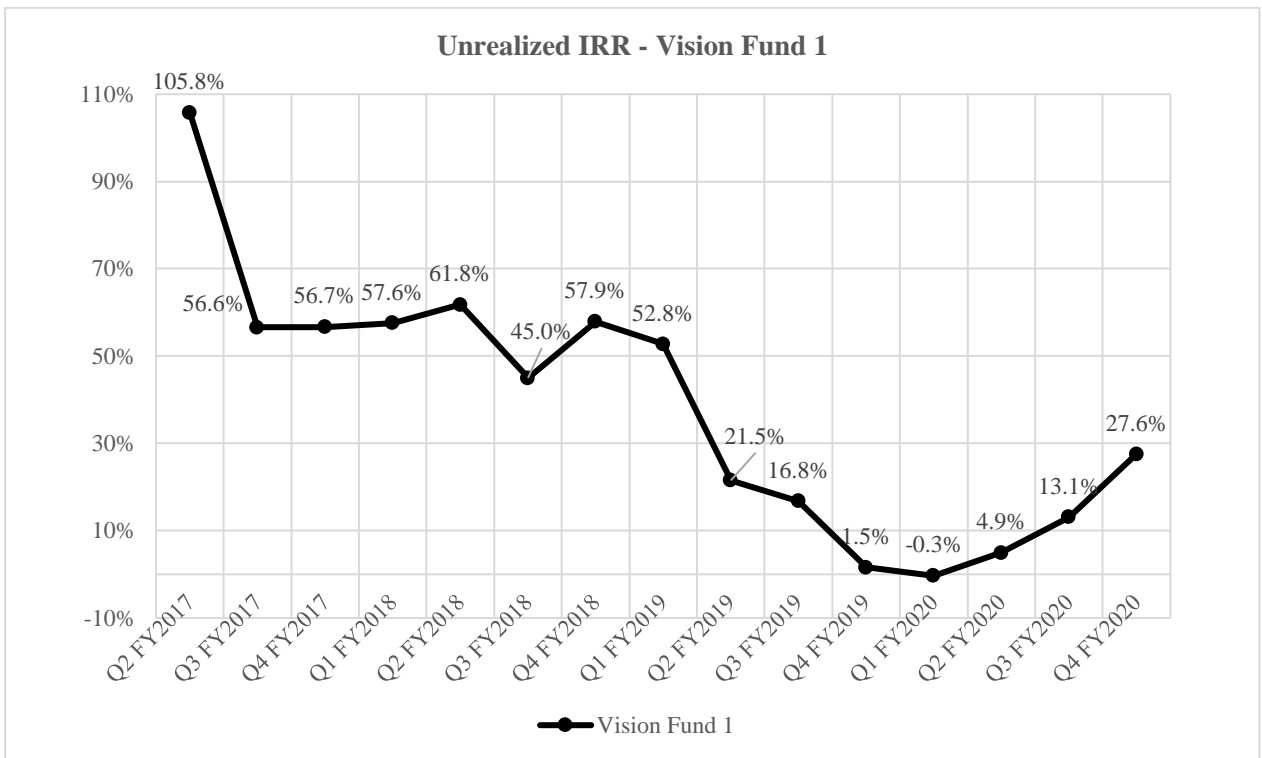
Graph 7: Dry Powder over Debt



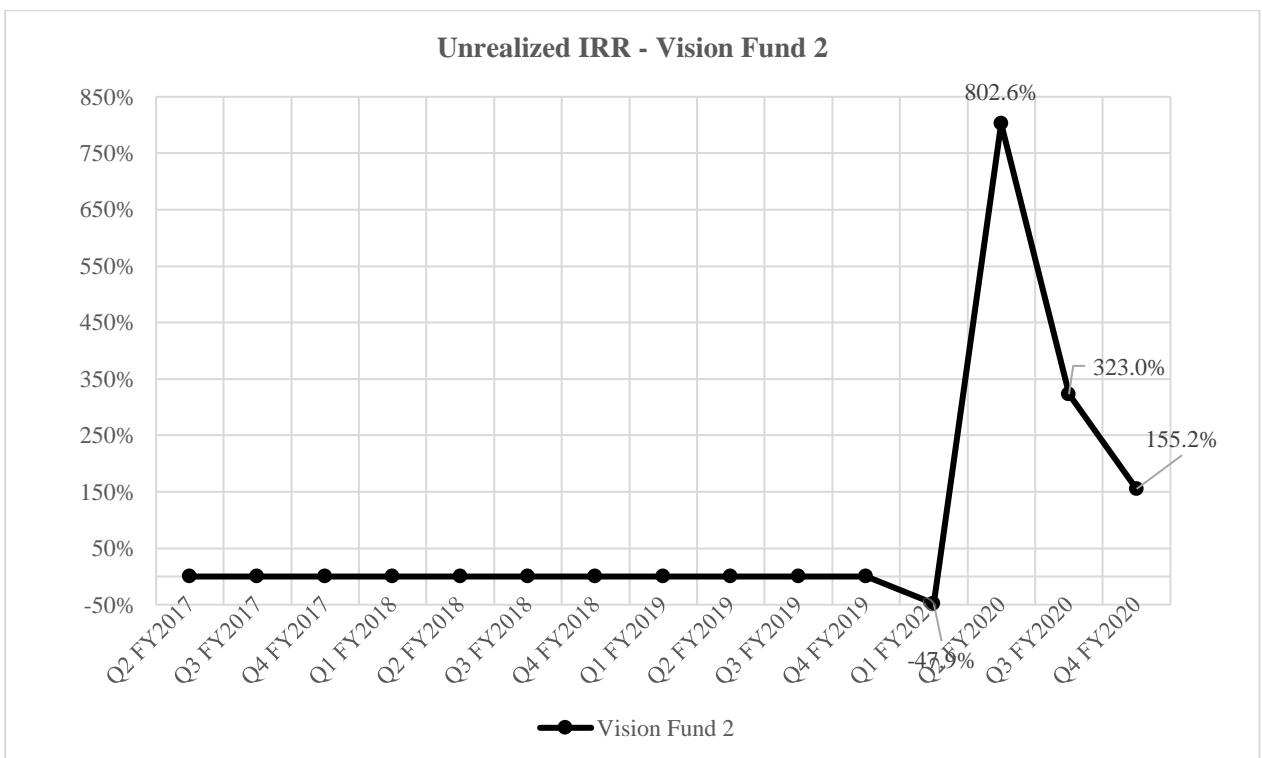
Graph 8: Portfolio Value over Debt



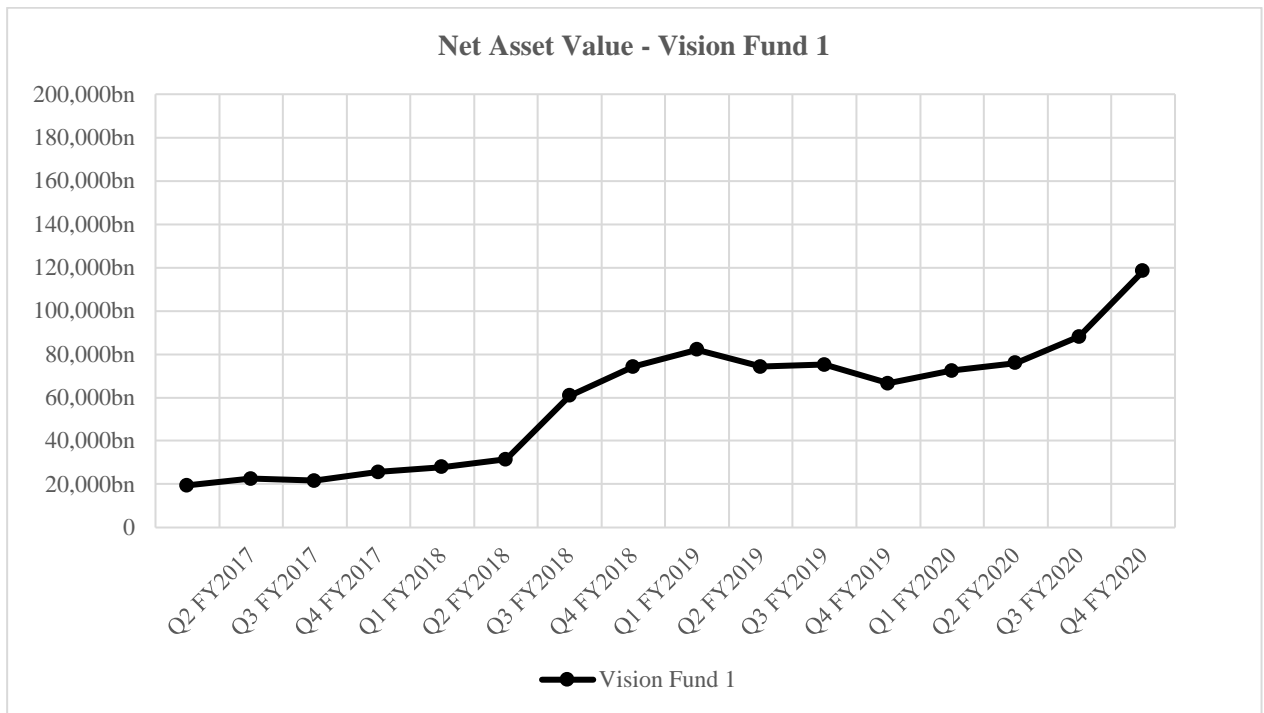
Graph 9: Unrealized IRR – Vision Fund 1



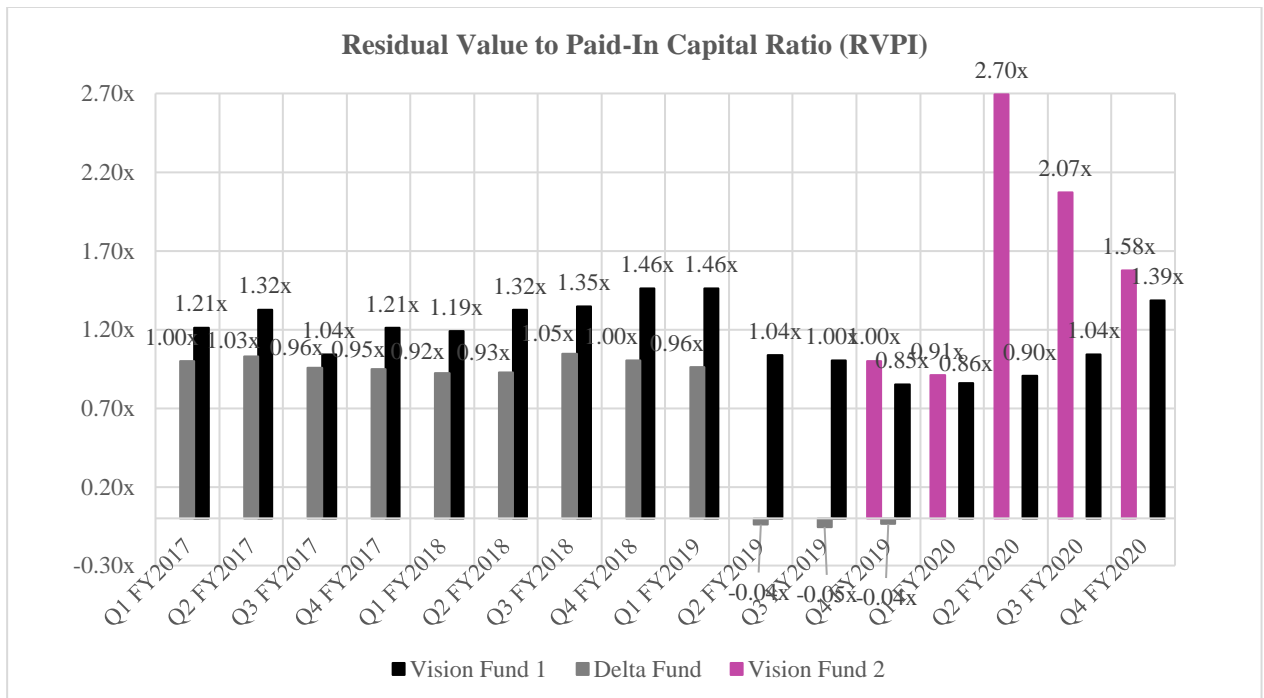
Graph 10: Unrealized IRR – Vision Fund 2



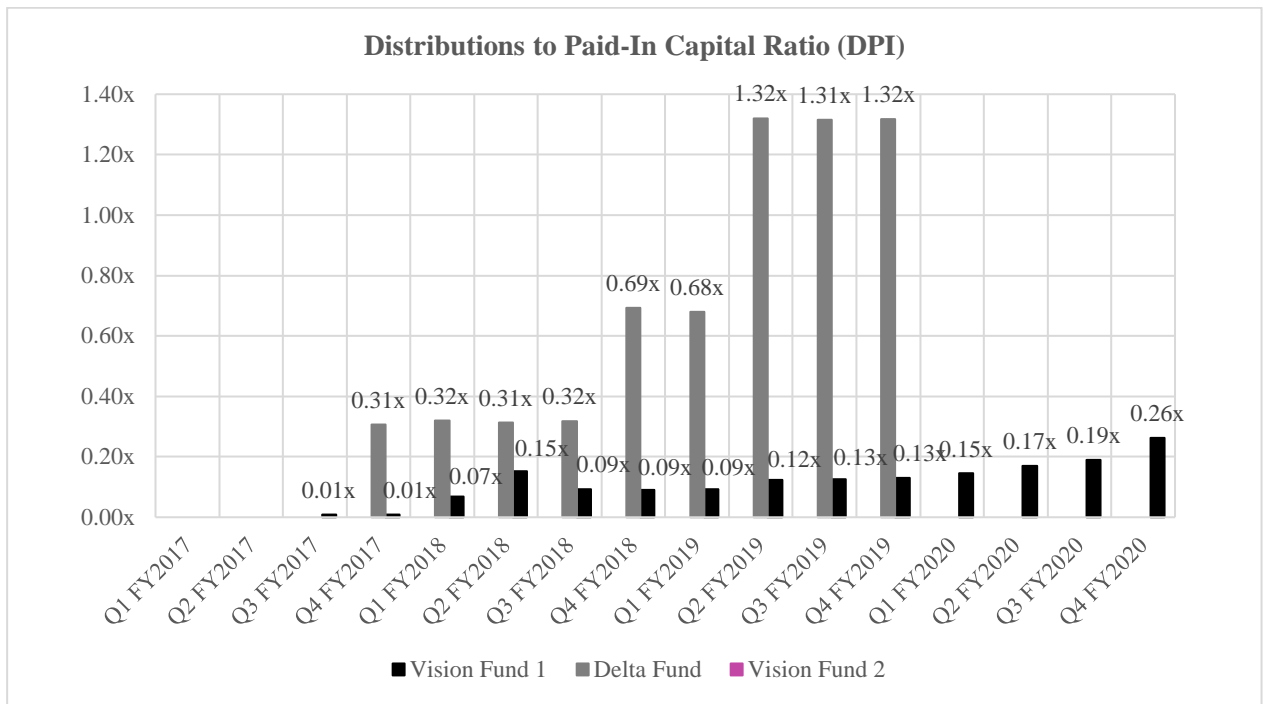
Graph 11: Net Asset Value – Vision Fund 1



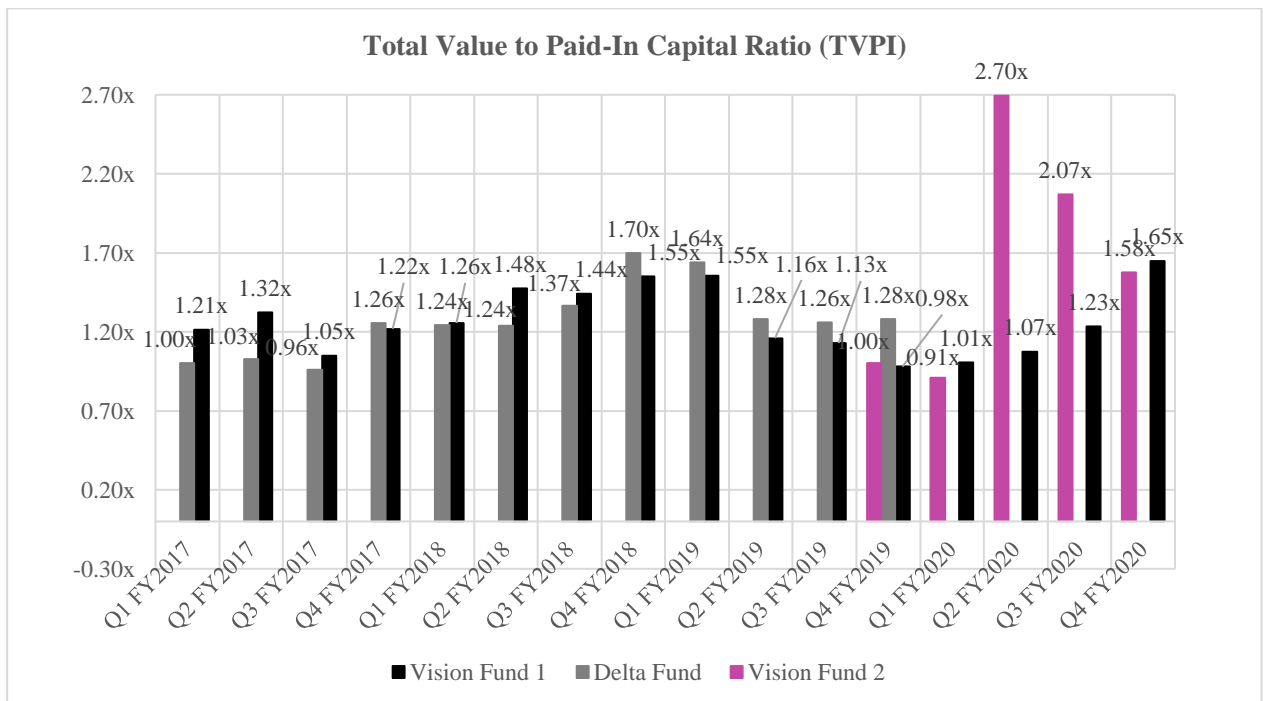
Graph 12: Residual Value to Paid-In Capital (RVPI)



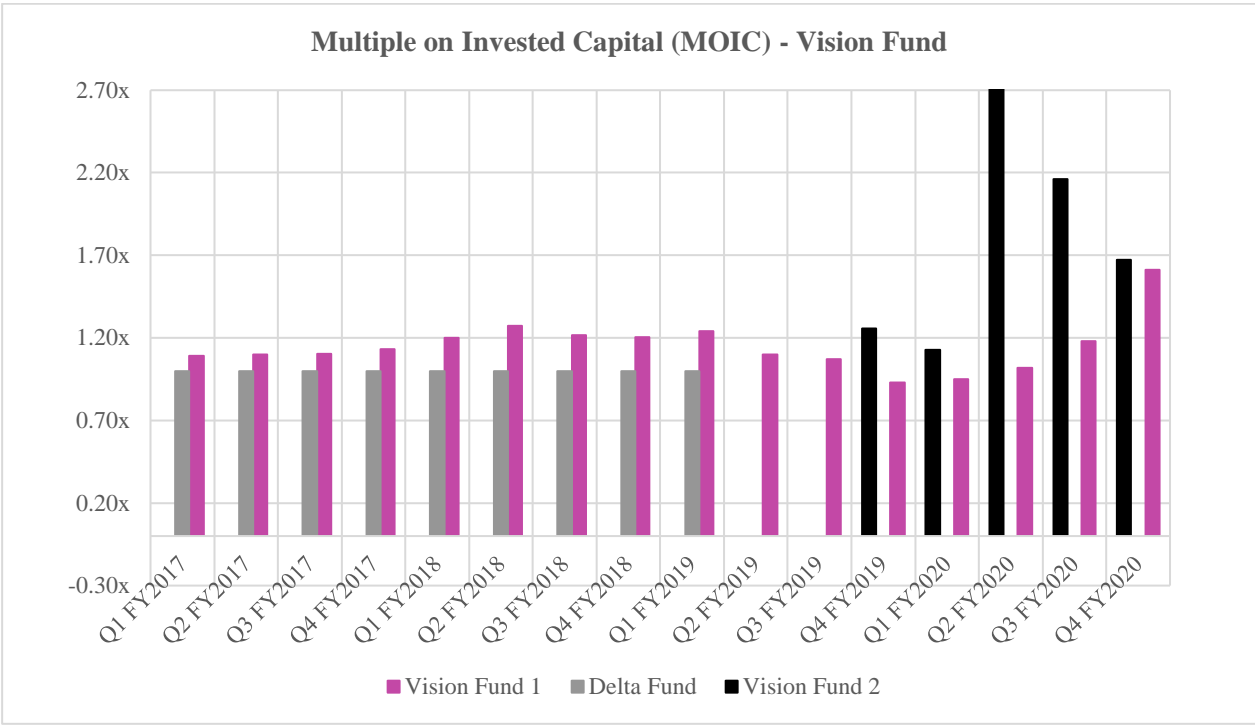
Graph 13: Distributions to Paid-In Capital (DPI)



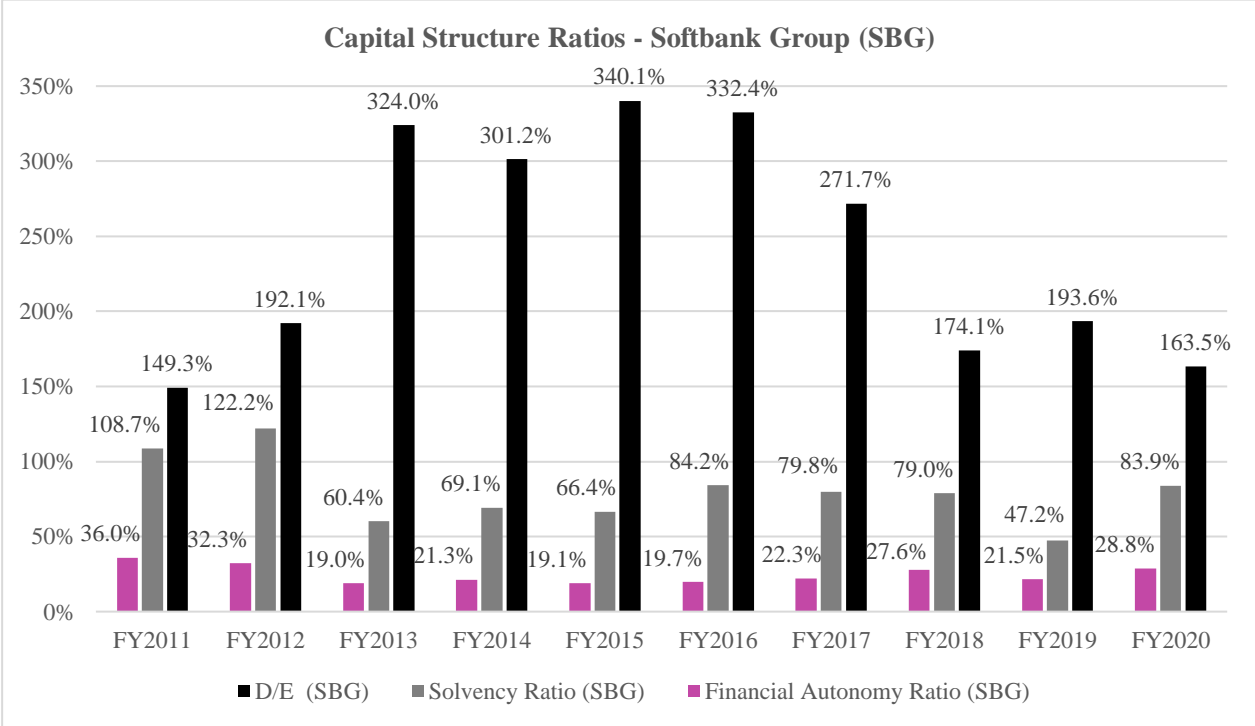
Graph 14: Total Value to Paid-In Capital (TVPI)



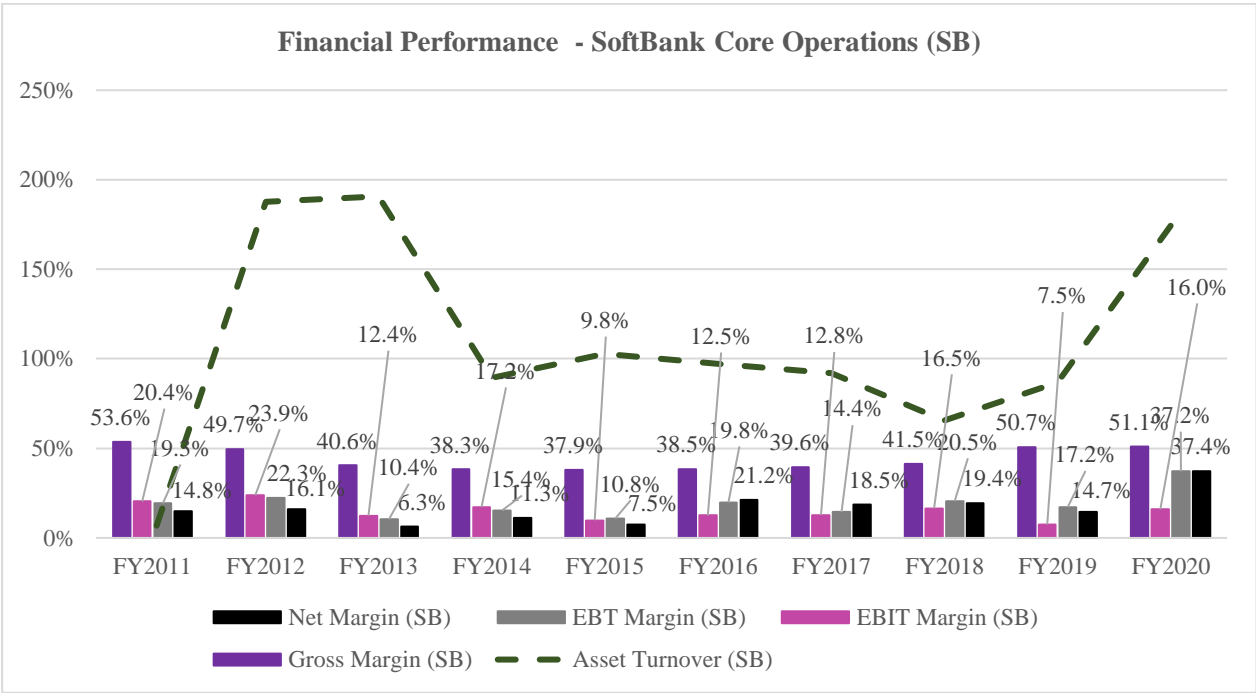
Graph 15: Multiple on Invested Capital (MOIC) - Vision Fund



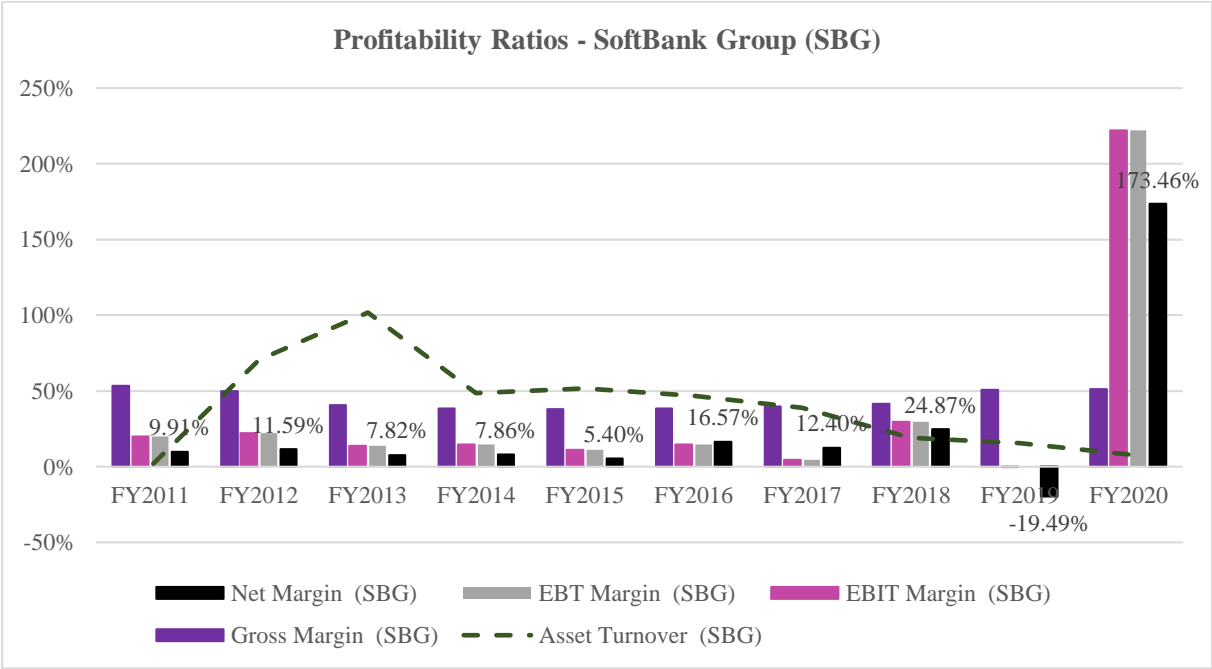
Graph 16: Capital Structure Ratios – SoftBank Group (SBG)



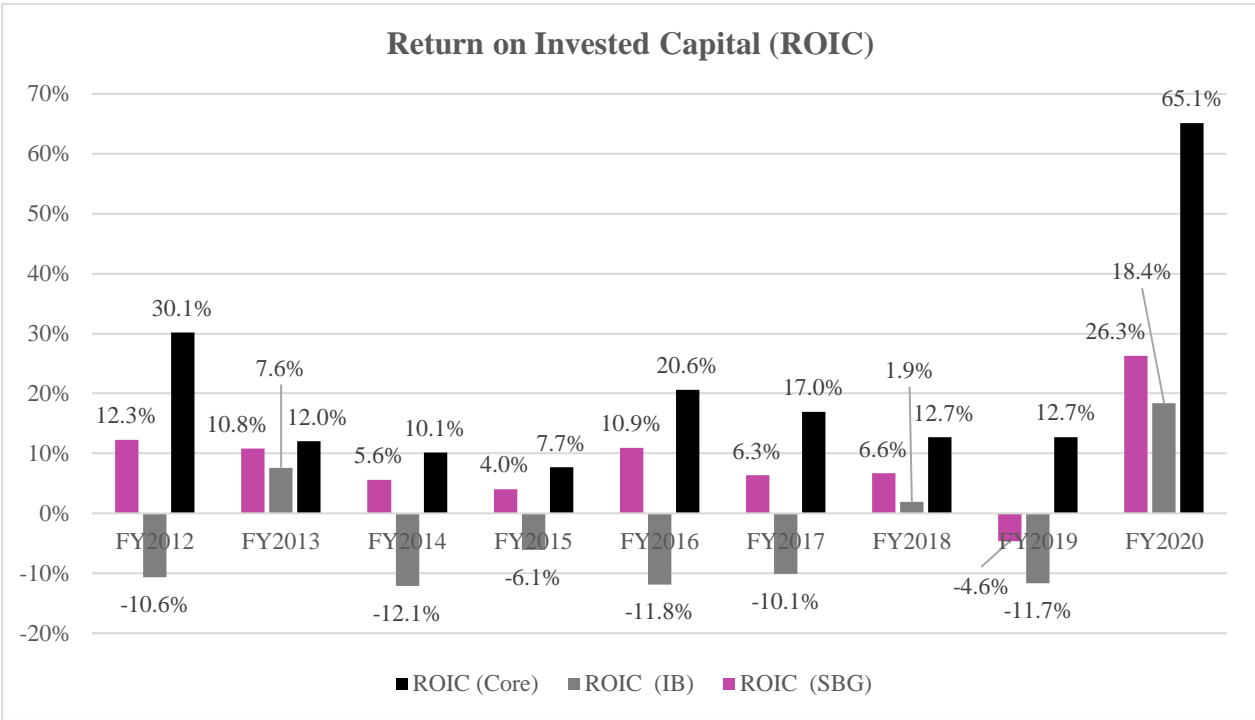
Graph 17: Profitability Ratios – Softbank Core Operations (SB)



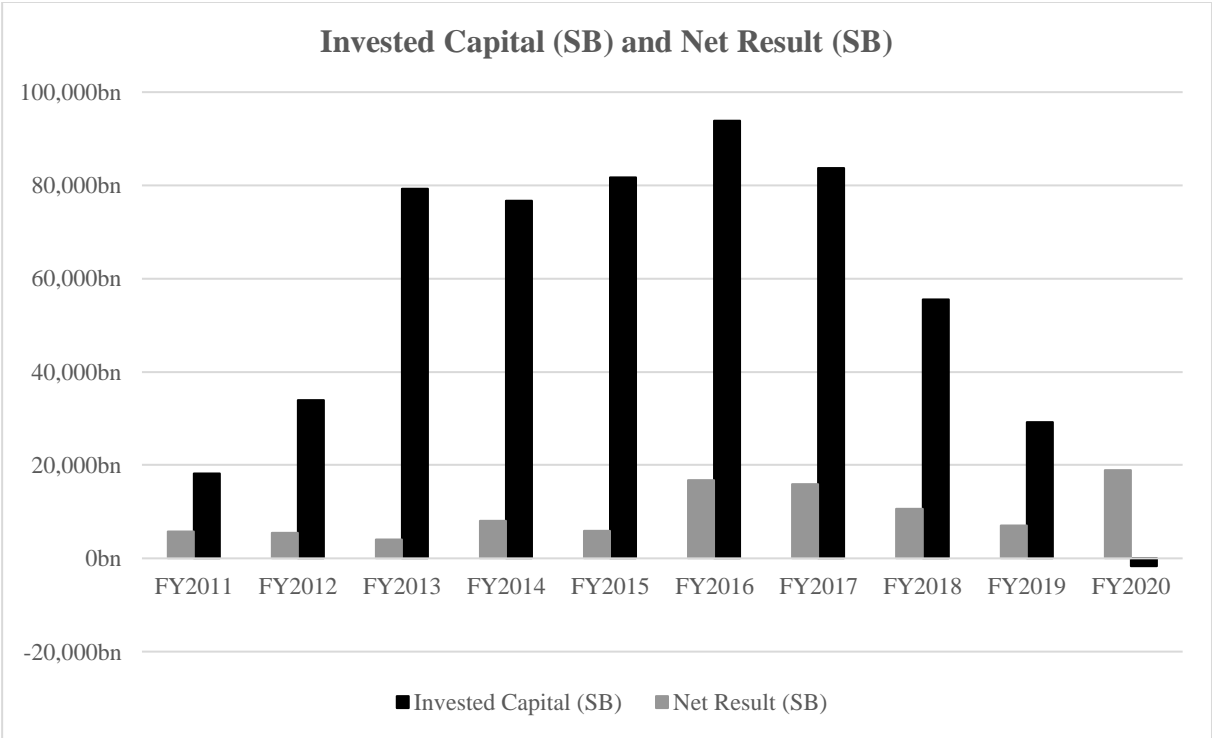
Graph 18: Profitability Ratios – Softbank Group (SBG)



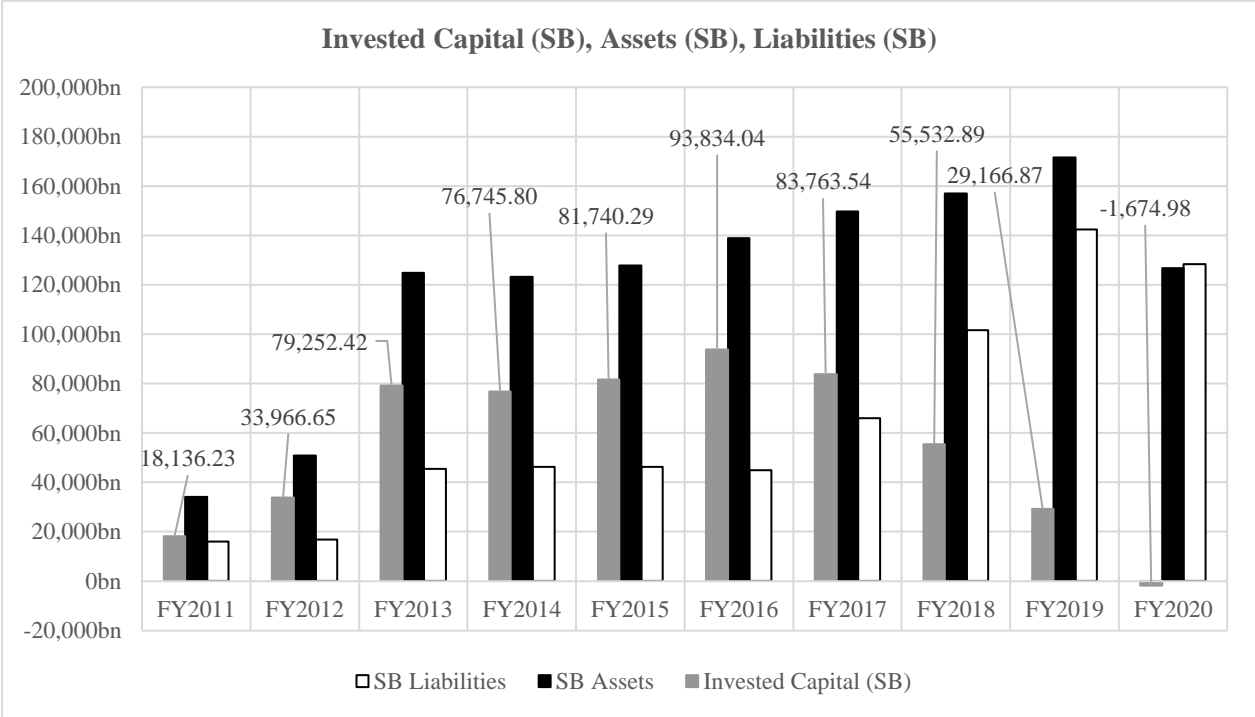
Graph 19: Return on Invested Capital (ROIC)



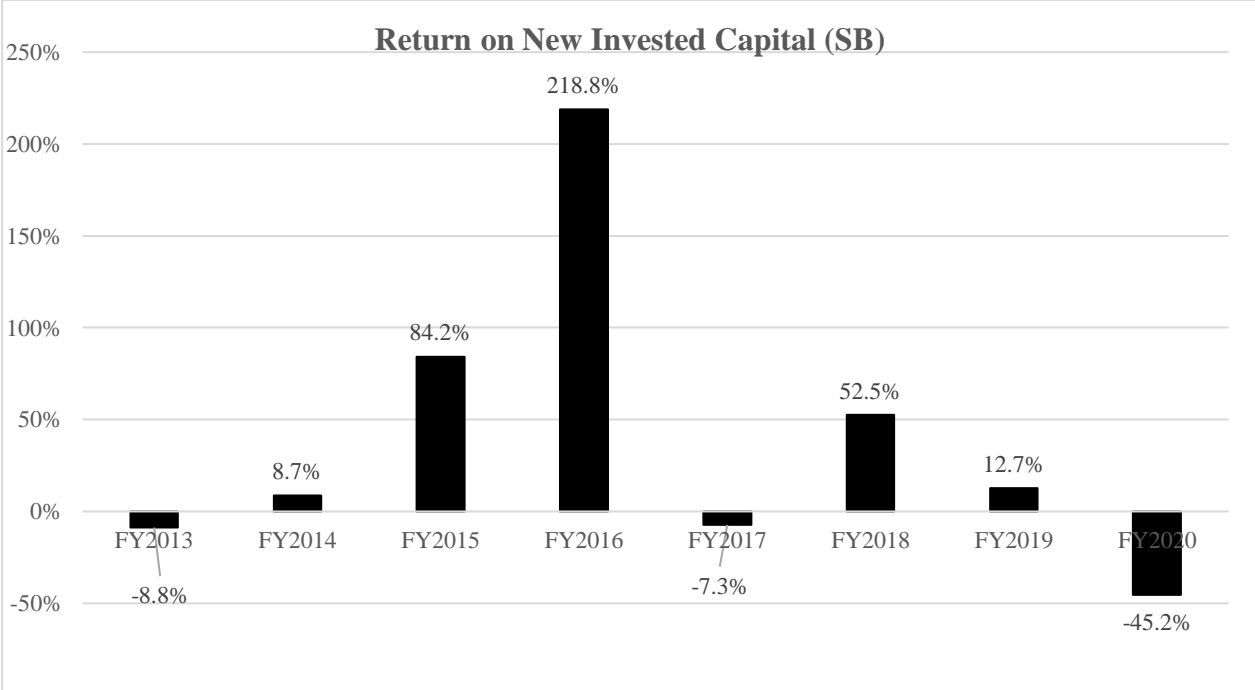
Graph 20: Invested Capital (SB) and Net Result (SB)



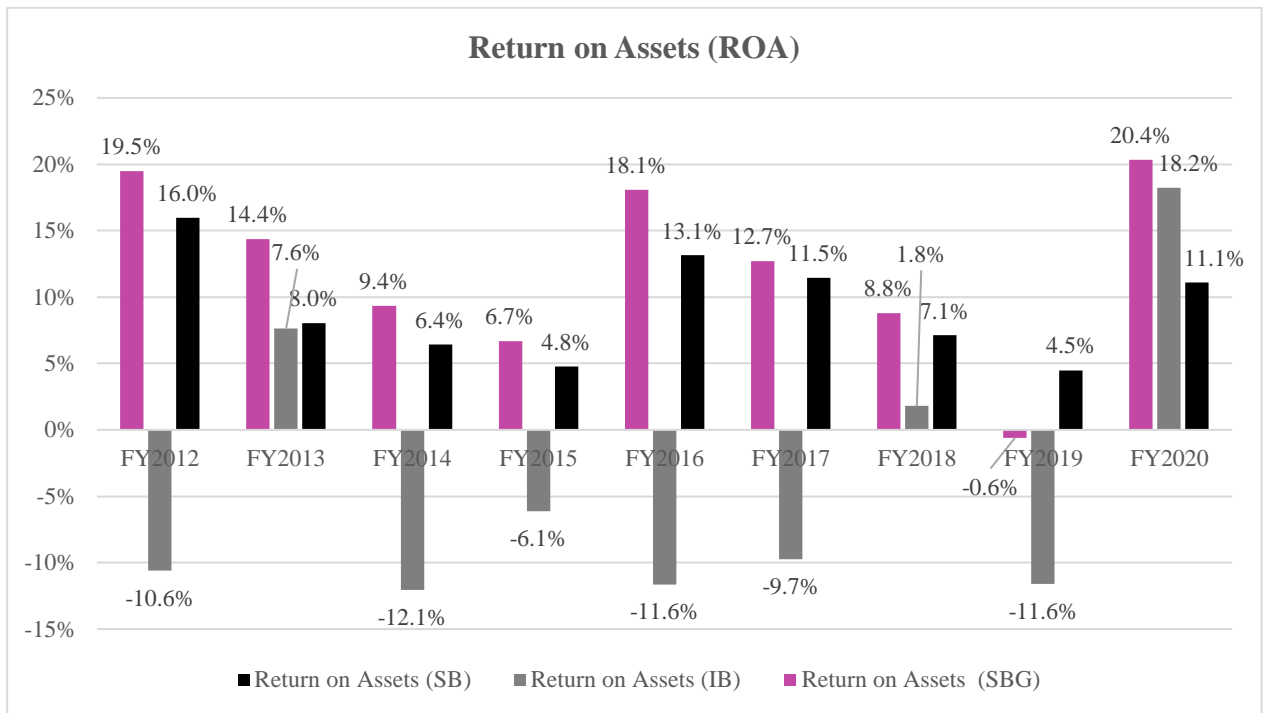
Graph 21: Invested Capital (SB), Assets (SB), Liabilities (SB)



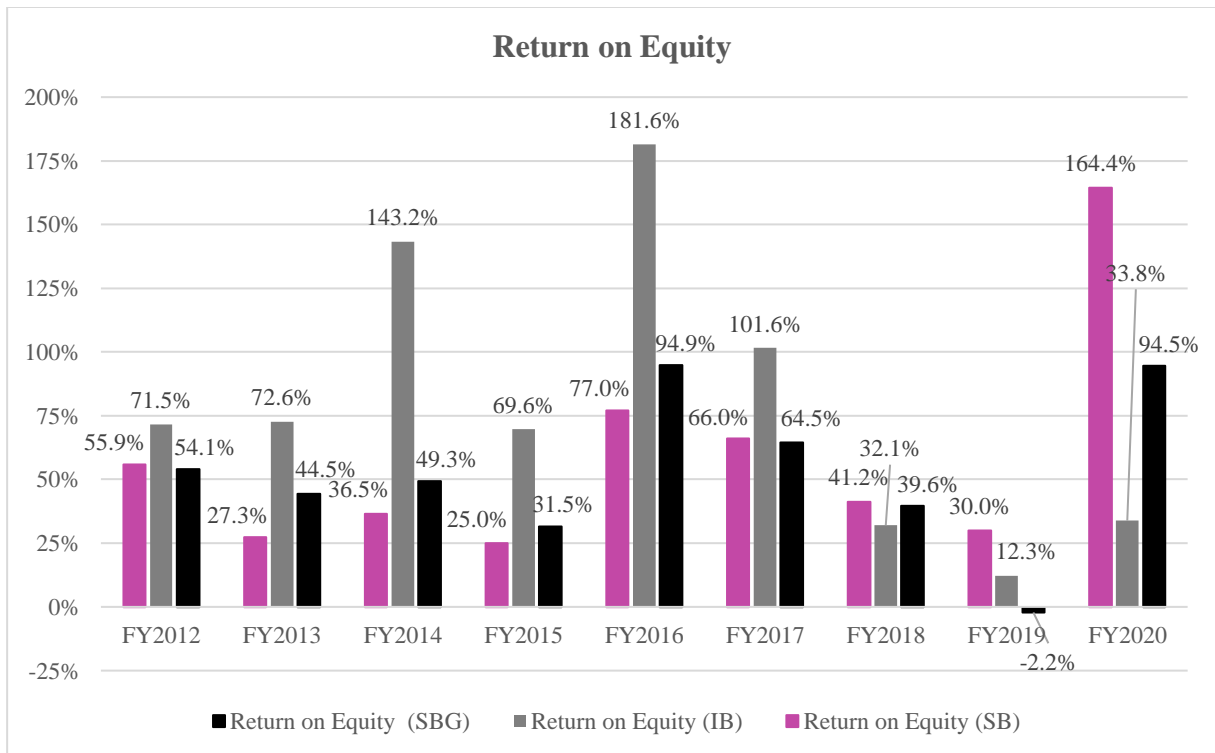
Graph 22: Return on New Invested Capital (SB)



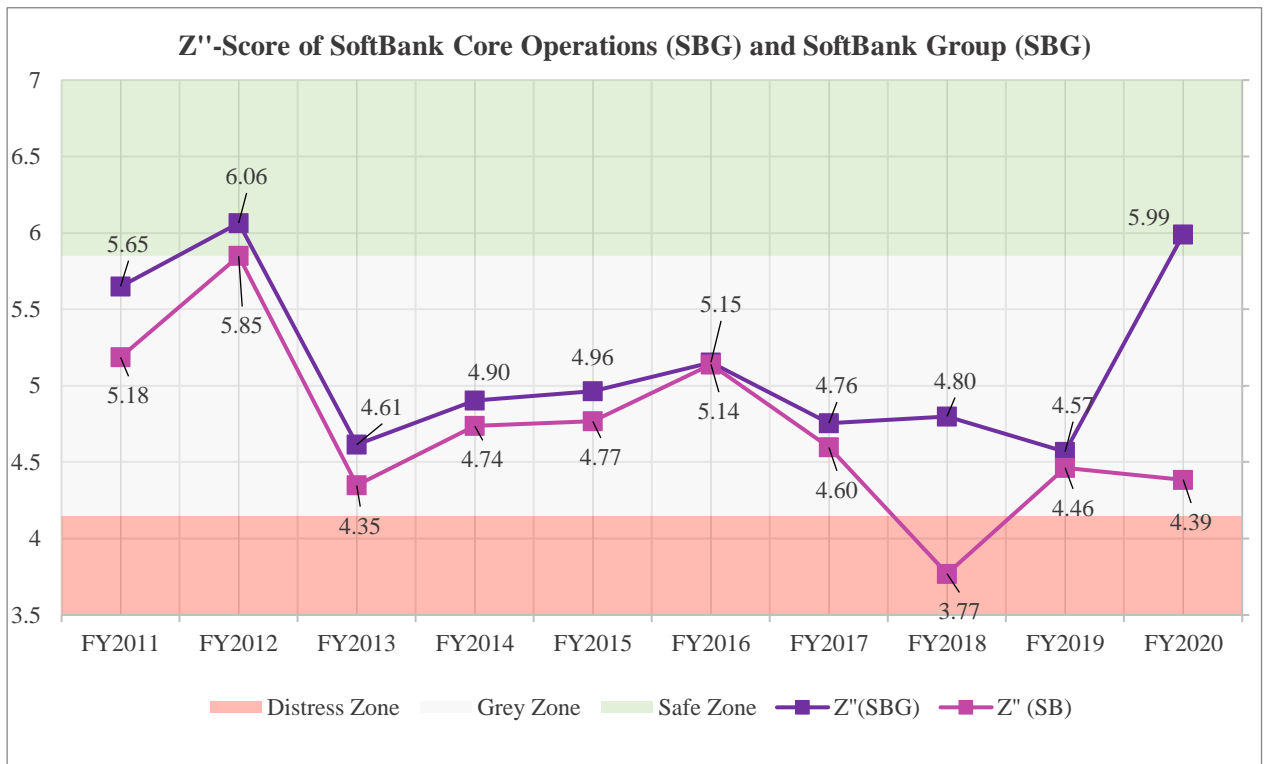
Graph 23: Return on Assets (ROA)



Graph 24: Return on Equity (ROE)



Graph 25: Z''- Score of SoftBank Core Operations (SBG) and SoftBank Group (SBG)



Graph 26: Implied and External Credit Ratings

