

Venture Capital Library

Definition

Venture Capital (VC), is risk capital invested in privately held companies by VC firms, through the underwriting of newly issued stock and/or convertible bonds

Characteristics of VC

- Interest for companies with high-growth potential Industry experience & networking
- Active management's support on strategic company decisions
- 3-5 years investment horizon;
- Capital gain as remuneration of the assumed investment risk
- Investment evaluation on prospective terms, rather than balance sheet criteria.

A typical Venture Capital operation

A VC operation is structured in different steps and requires the preparation of adequate documentation.

Housekeeping requirements (some could be irrelevant to Startups!).

- Year-end accounts and all other tax and regulatory obligations satisfied
- Financial resources to keep operations going for at least 6 months
- Agreement from the majority of shareholders on the VC round
- Absence of executive injunctions or bankruptcy proceedings
- Absence of legal disputes on business assets (patents, products, etc.)
- Total commitment from Management to execute the "Tools"

Tools necessary to complete a VC round:

- A **Business Plan** adequately addressing the information needs of VC A **company presentation** (slides or transparencies) also on paper
- A **media kit** (CD rom, web site, brochure etc.) containing information and press articles on the company, products, technologies, etc.
- Pro-forma **account statements** updated to the last 90 days.

Timing

A typical VC operation completes, from the moment the TOOLS are completed, in **3-6** months on average.

Phases

A VC operation follows a step-by-step procedure; the phases structure is described below:

- Complete Essential Requirements and Tools preparation
- Identification of VC companies to be contacted
- Pre-qualification and Initial telephone contact with identified VCs
- Secrecy Agreement and Executive Summary mailing
- Mailing of Business Plan + Media Kit to VCs wishing further information
- 1st meeting with interested VCs and action plan for due diligence
- Due Diligence period: a thorough analysis of all business documents and aspects: requires timely and adequate attention from Management
- Preliminary investment decision from seriously interested VCs

- Negotiations on the Terms of the Investment
- Completion and signing of contracts

Obstacles to Overcome

SMEs are plagued by chronic lack of VC in the startup and early development phase. This problem, more acutely felt in the high-tech sector, is intrinsic in the nature of SMEs. Therefore access to VC is very competitive and failure is common due to the following obstacles:

- Lack of knowledge about venture capital sources
- inexperience in the preparation of business plans
- limited knowledge of the fund raising process.

Self-Test

Do you have the right profile for VC funding? Try answering the following questions

- Is the Management team mature and experienced?
- How advanced is your business plan?
- Is your offer (product, technology, service or market concept), innovative?
- Any significant failure risks in the development phase of your offer?
- The market for your products exists, is young or needs to be created?
- If the market needs to be created, do you foresee extraordinary investments?
- And the risks connected with market adoption phase are of an ordinary or extraordinary nature?

And then match your answers with the Ideal financing profile for a VC round

- Mature and experienced management team
- (**startups**: ..., and has experience in managing startups)
- Our business plan is advanced and on track
- (**startups**:... it has been developed in all its strategic components)
- Our products (technology, service or market concept) are new and innovative and are protected (**startups**: ..., protectable) by patents, copyrights, etc., and we own exclusive world (European/national) rights;
- The market for the products in development (**startups**: to be developed) exists - a niche market which we can dominate, or it is a large market in which it is possible to compete - and it is not dominated by large corporate groups with which it is possible to enter into lucrative strategic alliances;
- Products in development have overcome the basic research phase (**startups**: a functioning prototype has been produced) and are being optimized;
- Our Products address specific market needs.

The overwhelming majority of small companies are positioned in the middle ground between the ideal profile and a totally negative situation. The closer to the ideal profile, the higher the chances of success. **Startups** (new or very young companies) tend to be positioned in a lower position. Their profile risk and chances of success are strongly correlated to the experience and stature of Management and to the market potential that their products/technology have.