# SMOOTH RIDE TO VENTURE CAPITAL

## *How to Get VC Funding for Your Business*

PANKAJ SAHAI

VISION BOOKS

SMOOTH RIDE TO VENTURE CAPITAL | PANKAJ SAHAI

VISION BOOKS

# *How to Get VC Funding for Your Business*

Have you got a great business idea but not enough money to translate into a reality? Have you got a small ongoing venture that can grow truly big if only you had the money? Is your venture at too early a stage such that banks won't fund you? In all such cases, you can grow your venture, create immense wealth and realise all your entrepreneurial dreams by using venture capital to fund your business.

This is the first comprehensive handbook of venture capital funding for Indian entrepreneurs. It deals with the whole gamut of issues related to the complex, multi-dimensional subject of venture capital in a simple and engaging manner. Using first person narrative, it explains lucidly all the concepts and intricacies of the venture capital raising process and guides the entrepreneur step-by-step, revealing the secrets of success at every stage of the process:

- *How is venture capital different from other sources of financing?*
- *How does the VC make money by investing in my business?*
- *How should I create my business plan to present to the VC?*
- *How will the VC value my business?*
- *How should I negotiate with the VC?*
- *How can I protect my interests once a VC funds my business?*
- *What legal agreements will I have to sign with the VC?*
- *How and when will the VC exit from my business? Would I have to pay him to do so?*

This authoritative handbook is a must for ambitious entrepreneurs, business managers, management consultants, business advisers and finance professionals alike.

**PANKAJ SAHAI** is a New Delhi based management consultant, entrepreneur coach, mentor and adviser. He is the founder of VentureAhead.com, an entrepreneur support and coaching portal, an enabling marketplace for ventures in need of strategic capital and partners. Previously, he worked, in responsible positions in India and overseas, with multinationals like Price Waterhouse, Ernst & Young, Schlumberger and Citibank, before becoming part of the core entrepreneurial team of shareholder-directors at IIS Infotech Ltd, a software services start-up, which was subsequently sold to FI Group Plc. (now Steria–Xansa). *Pankaj Sahai* is a Chartered Accountant (India) and a Chartered Management Accountant (United Kingdom).

**Rs. 495**

www.visionbooksindia.com

VISION BOOKS INVESTMENT

ISBN 81-7094-748-0

9 788170 947486

SMOOTH RIDE TO VENTURE CAPITAL | PANKAJ SAHAI

VISION BOOKS

PANKAJ SAHAI is a management consultant, entrepreneur coach, mentor and adviser. He is an entrepreneurial management professional possessing the repertoire of skills to start, grow and exit business ventures. He works through a network of professional relationships, and uses his hands-on entrepreneurial experience of start-ups, financial and legal expertise, abiding interest in HR and psychology, knowledge of venture mechanics and understanding of the sweat and tears of entrepreneurship, to provide professional advisory services to ventures at various stages of growth.

Previously, he worked in responsible positions, in India and overseas with multinationals like Price Waterhouse, Ernst & Young, Schlumberger and Citibank before moving into the entrepreneurship domain by joining the core management team of shareholder-directors at IIS Infotech Ltd., a software services start-up which was subsequently sold to FI Group Plc (now Steria-Xansa). After exiting, he founded VentureAhead.com, an entrepreneur support and coach portal, an enabling marketplace for ventures in need of strategic capital and partners. He is also the founder of VentureFeedback.com, an online surveys and tests portal which enables small businesses and others to conduct market and HR surveys and tests conveniently and economically.

He is a Chartered Accountant (India) and a Chartered Management Accountant (United Kingdom). Before earning his professional qualifications, he did his schooling from St. Columba's High School and then studied at Shri Ram College of Commerce and obtained the Bachelor of Commerce (Hon's.) degree from Delhi University. He lives in New Delhi. He may be contacted at pankajsahai@gmail.com or +91 98110 21090.

www.visionbooksindia.com

**Disclaimer**

This book contains the author's subjective opinion and views about the subject matter under consideration. It is not intended to be a substitute for professional advice. The readers are advised to seek definitive professional advice suitable for their specific needs before acting on the views expressed in this book. The author and publisher cannot be held responsible for any loss incurred as a result of specific investment or planning or other decisions made by the reader as a result of reliance placed on the views and opinions expressed in this book.

ISBN 10: 81-7094-748-0
ISBN 13: 978-81-7094- 748-6



First Published in 2010 by
Vision Books Pvt. Ltd.
(Incorporating Orient Paperbacks and CARING Imprints)
24 Feroze Gandhi Road, Lajpat Nagar-III
New Delhi-110024, India.
***Phone:*** (+91-11) 2983 6470
***Fax:*** (+91-11) 2983 6490
***e-mail:*** visionbk@vsnl.com

Cover Design by hutchdesign.org
Cover @ Vision Book Pvt. Ltd.

Printed at
Rashtra Rachna Printers
C-88, Ganesh Nagar, Pandav Nagar Complex
Delhi 110092, India.

# SMOOTH RIDE TO VENTURE CAPITAL

*How to Get VC Funding for Your Business*

PANKAJ SAHAI

VISION BOOKS

This book is dedicated to my parents,

Late B. M. Sahai, “the wise one”
and
Shakuntla Sahai, “the super mom”

For teaching me by example to how to
navigate life happily,
carrying family and friends alongside.

# Contents

# Preface

## Contextual Background

The *raison d'etre* of venture capital is that it supports, nurtures and facilitates innovation and entrepreneurship. It is a unique form of risk capital that encompasses many subjects. Its practitioners need to have an understanding of the innovation processes, entrepreneurs and entrepreneurship, strategy development and implementation, management of business, corporate finance, financial management and law, apart from the domain knowledge of the industry sectors in which they specialise.

Venture capital (VC) in its present form, with special mechanisms and laws to facilitate its growth, is an American creation and came into existence around 1940. In India, the entry of global VC funds in a big way happened only around the turn of this century. This was preceded by rationalisation of laws and the enactment of special regulations from mid-1990s onwards to facilitate and support the flow and investment of overseas VC funds into India. As a result, VC investments into the country grew from a mere USD 100 million in the early 1990s, to about USD 1.1 billion by 2000, and then further to about USD 14 billion by 2008.

With so much VC funding available for investment, Indian business ventures need to be capable, ready and willing to attract this money. Although the need for money exists, I have found that there is a woeful lack of knowledge among entrepreneurs about this form of capital and the process of acquiring it. Even finance consultants tend to treat the exercise of raising venture capital in a manner similar to raising bank loans or project finance, and are thus unable to properly guide entrepreneurs. This book aims to fill this gap and to strengthen the demand side of India's venture capital industry.

## Why This Book

I have written this book to provide entrepreneurs the necessary skills, tools and practical knowledge to enable them to successfully traverse the minefield that the VC raising process is. Although written primarily for entrepreneurs, the book would also be helpful for professionals engaged in facilitating venture capital into deserving businesses.

I work as an entrepreneur coach, mentor and advisor. I have been fascinated by the creativity, energy, enthusiasm, drive, and the fleet-footedness of entrepreneurs. I have always enjoyed interacting with them. I find that a lot of their attributes start to rub off on me and energise me immensely.

In 1999-2000, in the heyday of the dot-com frenzy, I founded VentureAhead.com, a portal to provide entrepreneurs a virtual marketplace to both raise venture capital and find strategic partners. I also personally developed online guides on entrepreneurship, venture capital, writing business plans, etc. in order to educate entrepreneurs. VentureAhead.com also pioneered the first-ever survey of investing preferences of the VCs investing in India. The survey was also unique in the sense that it was done completely online, a rarity in those days. I was so impressed with the usefulness, economy and speed of gathering online feedback that I felt a strong need to make this capability available to all fledgling ventures / entrepreneurs for their human resource and marketing research functions. This led me into launching VentureFeedack.com, a "fully-loaded", very comprehensive online tool which enables users to create, deploy and analyse online surveys and tests.

I mention all this because the first seeds of this book were sown in that period. It became evident over the years that entrepreneurs did not fully understand the concept of venture capital. I found myself spending an inordinate amount of time trying to explain to entrepreneurs the practical facets of raising venture capital and managing VC expectations. Many of them felt cheated when I told them that their dream venture would not meet a VC's requirements and they would thus not get venture funding. Some of them, after taking considerable amount of my time in understanding the process, felt they could do without any professional help. Needless to add, most of this lot went back to their jobs when their ventures failed due to paucity of funds. Most of them also felt extremely insecure about limits on their decision making after the arrival of a VC in their venture. All of them, without exception, fretted about their shareholding being reduced over time to, maybe, a minority. I have used this experience and the resultant insights to address in this book such concerns and mental blocks of entrepreneurs which inhibit them from getting venture funding.

## Thanks Are Due to . . .

Authoring a book has three distinct levels. The first is the inspirational level. Why some people seek to write books while others don't has to do with the inner dynamics of an individual, his or her psychological make-up, background and experiences. There is bit of a teacher and a counsellor in every author. There also has to be the overpowering need to express oneself and communicate one's thoughts, feelings and conclusions from one's experiences. Even if one possesses these basic ingredients, one would still need someone or something to propel one into writing a book. That inspiration for me has been my late father who was an economic journalist, editor of a national daily, and co-author of a spiritual book. I am sure he would have been very happy to see me as an author. Somewhere deep down I am aware that I have written a book just to get his approval! I thank him for providing me the inspiration to become an author.

The second level is that of implementation. This is the stage of actually researching and writing the book. This stage is the graveyard of innumerable books which remain as concepts and never see the light of day. The experience of writing this book was similar to the roller-coaster ride that entrepreneurs I advise usually go through. With time required for work, family, friends, social obligations and self-renewal competing with this "theoretical" exercise of authoring, it was difficult not to feel dejected, de-motivated and frustrated at the slow pace of work. It took me three-and-a-half years to complete the final manuscript of this book. In the process, I gained quite a few insights into self-management and personal effectiveness which, I dare say, may form the basis of another book in due course! I thank all my friends and all members of my family for bearing with my erratic hours and providing their silent support and encouragement without which this book would never have been concluded. I would especially like to thank my brother, Amitab Sahai, who is blessed with a large heart and exceptional organizational capabilities apart from a natural affinity with technology. His pro-active management of day-to-day work and home issues kept things moving smoothly, making time for me to concentrate on writing this book. I would also like to thank Deepak Sahai, my other brother, and Anupam Jaiswal both of whom worked with me to design and develop VentureAhead.com and VentureFeedback.com, which continue to provide me a platform to interact with entrepreneurs and learn from their experiences.

The final stage is the rollout phase in which the actual publishing of a book takes place. In this phase one has to find a publisher who then takes on the work of editing, designing, printing, distributing and marketing the book. I was fortunate that I wrote the book after signing an agreement with Vision Books. I am grateful to Kapil Malhotra of Vision Books for his cheerful acceptance of the delay in the submission of the final manuscript. Kapil signed me on to write this book after only a half-hour meeting. By doing so he behaved like a true venture capitalist — he met the entrepreneur (me), heard his pitch about the concept (this book), and took the decision to invest his time and money in the project. I hope for his sake (as well as mine, I guess) that his investment gives him multi-bagger returns.

## Your Feedback

I would love to receive feedback from all entrepreneurs and others who read this book.

PANKAJ SAHAI

A-48, Gulmohar Park
New Delhi 110049, India.
Email: pankajsahai@gmail.com
Mobile: +91 98110 21090
Work: 91 (11) 2651 7234 / 2652 6319 (Direct)

GROUND ZERO

# Venture Capital Raising Plan

*"If I had 24 hours to cut a tree, I would sharpen my saw for 23 hours"*
Anonymous Wise Man

~

*"Money is plentiful for those who understand the simple laws which govern its acquisition."*
George S. Clason

The term venture capital is used to describe investments made by professional investors in exchange for owning a part of the business. The investment is made through equity or quasi-equity securities making the venture capitalist (VC) a financial partner and a part owner in the business in which he invests. Typically, the businesses in which the VCs invest are those that are able to demonstrate their potential to grow rapidly. The VCs use the term "scalable growth business" to describe such potentially investible ventures. The VC not only provides money but also "adds value" in the investee businesses by mentoring the entrepreneurs and filling in their gaps in experience, market knowledge, and networking. The VC's investment and his support and facilitation enable the business to grow to a size or stage that substantially increases its overall value. As the VC's money is inextricably linked to his mentoring of the investee business, it is also aptly referred to as "smart money". After the business grows and is established, it is then either sold, or listed on the stock exchanges, thus providing the VC, as well the entrepreneur, a substantial return on their respective investments of time and money.

From an entrepreneur's perspective, the key point to note is that venture capital is a unique form of risk capital which targets specific businesses and requires quite a lot of time to raise. Therefore, it is important to have a good understanding of how VCs operate and have a definitive plan for raising venture capital.

A time bound plan which facilitates raising of venture capital greatly improves your chances of success. The Venture Capital Raising Plan on pages 14-15 provides you such a blueprint.

- **Part I** empowers you with the knowledge and concepts of venture capital and the working of the venture capital industry.
- **Part II** provides you with the tools and knowledge to assess whether you and your business are ready for the VC money. Some of you may realize at this stage that you are either not ready for the VC or not attractive enough for the VC to invest in your business. If that is indeed the case, you may decide not to go any further.
- **Part III** helps you to prepare all the documents that you require before starting the process. A lot of preparation has to be done before you start the process of searching and meeting VCs and soliciting their money. Also, you become "VC ready" by reviewing your business, validating its systems and processes, and obtaining an understanding of key VC concepts such as dilution, rounds of financing, etc.
- **Part IV** then prepares you to select, meet and present your case to the VC. You also learn how to negotiate the Term Sheet and manage the due diligence. Finally, you are ready to sign the legal documents that precede the infusion of VC money into your business.
- **Part V** details what happens after a VC invests in your business. For a period of 3 to 5 years, or more, you would have to work along with the VC. This section tells you what to expect and how to manage your relationship with the VC. Finally, the several exit strategies are explained for you to monetize the investment that you and the VC have made in the business over the years.

Most VCs in India raise a substantial portion of their funds from the US. Accordingly, they usually measure their investment and returns in the US dollars. I have, therefore, used USD, and not Indian rupees, to explain the concepts in this book. For those of you who would like to think in Indian rupees, I suggest that, as a thumb rule; use Rs. 1 crore (that is, Rs. 10 million) as a proxy equivalent of USD 1 million.

## How Long Does the Process Take?

The time taken to raise venture capital depends on how well prepared you are before you start the process. On an average, you would take between 6 to 12 months to get VC money into your business.

The Venture Capital Raising Plan on pages 14-15 illustrates this process. The entire process is summarised below:

| | |
|---|---|
| 1. Understanding the VC Industry | 15 days or less |
| 2. Assessing your readiness and that of your business | 15 days or less |
| 3. Preparation before meeting the VC | 2 to 4 months |
| 4. Negotiating, structuring and closing the deal | 3 to 6 months |
| Total time for raising venture capital | 6 to 12 months |

The detail of activities under each category of the process is the subject matter of this book.

## Venture Capital Raising Plan

| | | Months | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Activity* | *1* | *2* | *3* | *4* | *5* | *6* | *7* | *8* | *9* | *10* | *11* | *12* |
| *Part I* | *How the Venture Capital Industry Works* | | | | | | | | | | | | |
| Ch. 1 | What is Venture Capital? | | | | | | | | | | | | |
| Ch. 2 | How the Venture Capital Industry Operates | | | | | | | | | | | | |
| Ch. 3 | How VCs Make Money | | | | | | | | | | | | |
| Ch. 4 | Are All VCs the Same? | | | | | | | | | | | | |
| Ch. 5 | The VC Investment Process | | | | | | | | | | | | |
| *Part II* | *Assessing Your Readiness for Venture Capital* | | | | | | | | | | | | |
| Ch. 6 | Do I Need Venture Capital? | | | | | | | | | | | | |
| Ch. 7 | Getting Over the Fear of the VC | | | | | | | | | | | | |
| Ch. 8 | To What Kind of Business do VCs Provide Money? | | | | | | | | | | | | |
| Ch. 9 | The Process of Raising Venture Capital | | | | | | | | | | | | |
| *Part III* | *Preparing for the VC* | | | | | | | | | | | | |
| Ch.10 | Hiring Advisers | | | | | | | | | | | | |
| Ch.11 | Doing an Internal Review of Your Business | | | | | | | | | | | | |
| Ch.12 | Doing a Growth Audit | | | | | | | | | | | | |
| Ch.13 | Determining the Strategic Direction of Your Business | | | | | | | | | | | | |
| Ch.14 | Building Your Board of Directors and Advisory Board | | | | | | | | | | | | |

*Contd. . .*

| | | Months | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Activity* | *1* | *2* | *3* | *4* | *5* | *6* | *7* | *8* | *9* | *10* | *11* | *12* |
| Ch.15 | Understanding Ownership, Dilution and Rounds of Financing | | | | | | | | | | | | |
| Ch.16 | Determining the Valuation of Your Business for VC Funding | | | | | | | | | | | | |
| Ch.17 | Creating Your Funding Plan | | | | | | | | | | | | |
| Ch.18 | Creating Your Business Plan | | | | | | | | | | | | |
| Ch.19 | Creating the Elevator Pitch and the VC Presentation | | | | | | | | | | | | |
| ***Part IV*** | ***Negotiating and Structuring the Deal*** | | | | | | | | | | | | |
| Ch. 20 | Selecting and Meeting the VC | | | | | | | | | | | | |
| Ch. 21 | Preparing to Negotiate with the VC | | | | | | | | | | | | |
| Ch. 22 | Negotiating the Term Sheet | | | | | | | | | | | | |
| Ch. 23 | Managing the Due Diligence | | | | | | | | | | | | |
| Ch. 24 | Closing the Deal | | | | | | | | | | | | |
| ***Part V*** | ***Managing the VC Relationship*** | | | | | | | | | | | | |
| Ch. 25 | Getting Along with the VC | **Maybe for 3 to 5 years after VC Investment** | | | | | | | | | | | |
| Ch. 26 | Exiting Profitably | **After 3 t0 5 years post -VC Investment** | | | | | | | | | | | |

*"Begin with the End in Mind"* Stephen Covey's Habit # 2

~

*"Far and away the best prize that life offers is the chance to work hard at work worth doing"* Theodore Roosevelt

~

*"Many of us spend half our time wishing for things we could have if we didn't spend half our time wishing."*

Alexander Woollcott

PART I

# How the Venture Capital Industry Works



This part contains the basic concepts of venture capital. It starts off with the various definitions in use. It goes on to explain the need for venture capital and how it is different from, and cannot be substituted with, bank loans and other forms of capital. A brief explanation of funding needs of a venture during its lifecycle provides you with the stages at which venture capital is required by businesses and provided by the VC industry.

Further, it explains how VC funds are structured and how they operate, their life cycle and the objectives during each phase of their existence, how they make money and what returns they target, and the typical process that is involved in making VC investments.

*"Venture capitalists only have two emotions: fear and greed. All their decisions are reached by balancing one against the other."*
M. Henos, Venture Capitalist

~

*"I never invest in someone who says they're going to do something; I invest in people who say they're already doing something and just want funding."* John Doerr, Venture Capitalist

~

*"Most investors prefer learn-it-alls to know-it-alls."*
Bob Kagle, Venture Capitalist

~

*"We divide business plans into three categories: candy, vitamins, and painkillers. We throw away the candy. We look at vitamins. We really like painkillers. We especially like addictive painkillers!"* K. Fong, Venture Capitalist

CHAPTER 1

# What is Venture Capital?

*"Be you in what line of life you may, it will be amongst your misfortunes if you have not time properly to attend to pecuniary [monetary] matters. Want of attention to these matters has impeded the progress of science and of genius itself."*
William Cobbett

## What is a Venture?

In common parlance, the term venture refers to a business undertaking. The dictionary definition is more specific. The word "venture" is *defined* as follows[*]:

> ***"venture*** (vĕn'chər)
> n.
> 1. An undertaking that is dangerous, daring, or of uncertain outcome.
> 2. A business enterprise involving some risk in expectation of gain.
> 3. Something, such as money or cargo, at hazard in a risky enterprise."

As you may note, there is a lot of emphasis on the words "risk" and

[*] *The American Heritage® Dictionary of the English Language*, Fourth Edition. Houghton Mifflin Company, 2004. 31 August, 2008. <Dictionary.com http://dictionary.reference.com / browse / venture>"

"uncertain" in the definition of a venture. It is also interesting to note the evolution of this word:

> ***"venture (v.)***
> c.1436, "to risk the loss" (of something), shortened form of *adventure,* itself a form of adventure. General sense of "to dare, to presume" is recorded from 1559. Noun sense of "risky undertaking" first recorded 1566; meaning "enterprise of a business nature" is recorded from 1584. Venture capital is attested from 1943" *

Clearly, the term venture is the shortened form of "aventure", which itself is the abridged version of "adventure". In short, the origin of the word is associated with adventure, risk and uncertainty of outcome. In terms of its usage to refer to a risky undertaking, the word is almost 400 years old.

But the term "venture capital" is much more recent and came into general usage only about 1950.

It is evident from the definition and history of the term venture that the term venture capital is associated with the undertaking of risk and uncertainty in expectation of gain from a business enterprise.

## What Then is Venture Capital?

Venture capital is money invested in businesses that are small; or exist only on paper as a concept, but have the potential to grow and become immense. The people who invest this money are called venture capitalists or, simply, VCs. The businesses VCs choose to invest in are; typically, privately owned, their shares are not listed on the stock exchange and also carry restrictions regarding their transfers. The venture capital investment is made when a VC buys shares of such a company and becomes a financial partner in the business.

As the VC investment is made in a company's equity, it is also referred to as risk capital, denoting that, unlike loans that are secured by lenders through charges made against the assets of the company, this

---

* Online Etymology Dictionary. Douglas Harper, Historian. 31 August 2008. <Dictionary.com http://dictionary.reference.Com / browse / venture>

investment is at risk of being completely wiped out if the business goes into bankruptcy. VC money is also sometimes referred to as "patient risk capital" as the investment is usually made for a medium to long-term period ranging from anywhere between 2 to 3 years to about 5 to 7 years, and in some rare cases as long as 10 years. Clearly, the objective of the VC is not to earn a regular income from his investment but to make a substantial gain, for example, 3 to 5 times the amount invested, by selling his shares either at the time of the listing of the company's shares on the stock exchange, or through the sale of the company to a strategic investor.

VCs who provide their own money to entrepreneurs for "seed capital" to research an idea, draw up a business plan and other initial business activities are referred to as "angels" and the money they invest is called "angel capital", which is one of the ways "informal venture capital" works. "formal venture capital", in contrast, refers to money collected by money managers and "pooled" in a company or trust which then is called a "VC Fund". This money collected from rich individuals (HNIs — high-net worth individuals), pension funds and other institutions is invested in businesses that meet the pre-defined criteria

"Private equity" is another term that you will come across in your search of venture capital. The meaning of this term is commonsensical. Private is something that is not public. So, private equity simply means shares of a company that are not listed on the stock exchange and hence are not available for the general public to invest in. Private equity investment means buying into the share capital of a privately owned company whose shares are not listed on a stock exchange.

For all practical purposes, private equity is the same as venture capital and the two terms are often used interchangeably, especially in India and Europe. But you must be alert to the fact that in USA, the birth place of the VC industry as it is known today, the term venture capital is used in a narrower and limited sense of investment only in nascent, rapidly growing, innovative and, often, technology-based firms. The term excludes buyout capital provided for mergers, acquisitions and reorganization among large existing companies, the data for which is collected and tracked separately by analysts. As this narrower the US definition of venture capital keeps the origins of this form of capital alive in memory, it is also often called classic venture capital.

The difference between private equity (PE) and venture capital (VC) is basically the stage of the lifecycle of the business at which each form of capital is directed. VC is regarded as a sub-set of PE, with both forms of capital being invested in privately owned business by buying shares of the company. PE investments are made in businesses in their expansion stage, when the businesses have established products, markets, etc., and have a history of steady cash flows. VC investments are, in contrast, made in the earlier stages of the lifecycle of a business when the credibility of its business model is still in the process of being established. As the VC investment comes in at an early stage of business, it remains invested in the business for a longer period, and is also a riskier form of investment than is PE. PE money usually seeks a 3-year investment horizon. As such, VC money seeks a higher return than PE money to account for the higher risk that it takes.

Some PE money also goes into companies which are already listed on the bourses. These are called PIPE investments. PIPE is an acronym for "Private Investments in Public Equity" which explains the nature of such investments. PIPE investments are less risky as they invest in companies which are already listed and hence have already to comply with all the disclosure and investor protection laws. This makes a lot of information available in the public domain, making PIPE investments decisions informed ones and hence less risky than other PE and VC investments.

You will also come across the term "Corporate Venture Capital" (CVC) in your quest for raising funds for your business. CVC refers to venture capital investments made by large corporations to further their strategic interest. CVC investments may be done through a dedicated pool of money organized as a formal VC fund, or as corporate direct investment in the investee companies. Big companies such as Intel, Dell, Microsoft, etc. make CVC investments which are mostly strategic in nature, that is, these investments are made with a view to enhancing their own financial or market position. However, these companies also make investments purely for superior financial returns. A more detailed explanation of CVC is attached in Appendix 3.

## What Venture Capital is Not

Venture capital is *not* money available at a rate of interest payable at regular intervals although VCs usually do take some regular payment as fees to provide support to the companies in which they invest. This form of investment should also not be confused with other financial services which are performed for a fee, such as management consulting, merchant and investment banking, or business intermediary services.

To put the definition of venture capital in sharper focus, let us review the contrast between debt capital, or simply, loans from banks, and venture capital.

Loans are available from banks at a fixed rate of interest. The bank assesses the ability of your business to pay regular interest, which means that your business has to be able to generate enough cash to meet the regular cash outflows on account of interest. The bank also likes to secure the principal amount, that is the amount it gives you as loan, by:

- Taking mortgage or pledge against the assets of the business;
- Taking mortgage or pledge against your personal assets as collateral security; and
- Taking personal guarantees from you for re-payment of the principal.

Banks are concerned with limiting their liability in case you default on the loan and hence are conservative in their dealing, seeking as much security as possible to cover for their loan to you. Now here comes the catch — if you and your business had enough assets, and the business generated enough cash to pay interest, then why would you need a loan? On the other hand, if your business has no assets but you have great ideas and the wherewithal to translate them into a viable business, where do you find the money to realize your dreams, as you would certainly not qualify for bank loans?

This is the gap that venture capital fills.

The VC, in contrast to a bank, evaluates the potential of a business to grow and become a very big business. Unlike a bank, a VC does not want regular payments, so the money that he invests in exchange for the shares of your company stays as capital in the business for a long time. He does not ask for any security and he puts in substantially more money that you as the entrepreneur have invested. To "de-risk", i.e. protect, himself, he likes to keep himself informed of the happenings in your business and, through the investment agreements, takes rights to have a say in major decisions of the business.

## Do VCs Provide Only Money?

VCs provide what is known in the industry as "smart money". This phrase means that VCs' contribution is not limited to money. They function as guides and mentors and help the entrepreneur in making the business succeed.

VCs are backers of ideas and potential. Apart from capital, they provide expertise to enable a start-up business to succeed and grow. They are experienced professionals who have had successful careers as entrepreneurs. They have "been there and done that". They are knowledgeable about the dynamics and the business landscape of fast growth ventures, the markets they cater to, and the key factors that are required for such ventures to succeed. They use this knowledge to evaluate the growth potential of businesses in which they invest.

VCs require a sharp nose to smell investment opportunities. They also have to be able to make judgements about the people running the businesses which they are evaluating as investment candidates. Besides, they also keep themselves updated with the different markets, business technology trends, etc. to arrive at the odds of a business's success. In other words, a VC is not only good with numbers but is also very adept at networking and judging people, opportunities and business dynamics.

The VCs can, and often do, make valuable contribution in areas such as long- and short-range business planning, recruitment of key personnel, development of key customer relationships and developing strategic alliances in their investee businesses.

Mostly, a VC's involvement in a business he has invested in tends to be need-based, and is most likely in businesses where he thinks he can "fill in the blanks", that is, provide skills in areas where they are lacking. In all the businesses in which VCs invest, they try to identify any gaps in the critical skills that are crucial for the venture's success. They then work to provide that expertise. For them, providing help and a leg-up to the management team is a risk control measure. It is one way of ensuring that their investment in the business is protected. Their support to the venture reduces the likelihood of the business failing due to any skills gap in the business.

Take, for example, the case of a company being run by a young "techie" with limited business experience. The VC in such a situation is more likely to provide his input on a regular basis. In the case, however, of a business run by an experienced business manager with a full management team in place, VCs are likely to limit their involvement to monthly reviews of the business and, perhaps, to introductions with the potential future constituents of the business, such as senior employees, strategic customers and vendors, joint venture partners, partners in overseas markets, etc.

Of course, you as the entrepreneur may view the VC's active involvement as interference in the running of the business. Such an approach is misplaced. VCs do not actually want to run a business which someone else has created. They are only interested in adding value to the businesses they invest in so that they can multiply their investment manifold. And they cannot do so without being aware of all aspects of the business.

If you are used to operating a "life-style" business on your own, or as part of a small founder group, then don't send an invitation to a VC to join the party. If you do invite him, then be ready and willing to rearrange the chairs at the table, if required.

### How Does This Help Me, the Entrepreneur?

The understanding of various terms helps you to focus your search for venture capital. Having come this far, you are unlikely to ask the VC, "How much interest will you charge on the money that you will invest in my business?" You will also be able to now distinguish between whether the money that you plan to raise for your business is PE or PIPE or VC or CVC money. While accessing various websites of investors you will be able to differentiate between their investment focus and dig deeper only those which complement your requirements. Lastly, as each of these types of capital is tracked and reported upon separately, you will be able to understand the industry reports with much greater clarity.