Venture Capitals

Small and medium-sized enterprises that have an idea for an innovative investment and are looking for funds for its implementation should consider using venture capital. Microsoft, Google and Youtube received venture capital investments in their early days, and now they set an example for new businesses. Would you like to know how to attract venture capitalists?

Check this module to find out what venture capital is and how it works, how venture capitalists evaluate potential venture opportunities and the benefits of venture capital funds.

Venture capital - what is that?

Venture capital is defined as capital investments that are happening outside the stock exchange. On behalf of the investors the specialized investment funds are performing them. VC investment funds collect money from investors and then invest them in young and innovative businesses. Both individual investors as well as corporations and institutions have their share in the project. The fund's investment strategy assumes a financial contribution to many entities in order to minimize the risk related to the possible failure of any of the additional investments.

The investment is made for the shorter and longer term (2-5 years). The capital is invested in non-public enterprises with high growth potential. Funds are mainly used to finance:

- new products;
- technologies that are innovative;
- expansion into new markets;
- production so that it is possible to increase their power;
- expansion of distribution channels;
- increasing production capacity.

VC is a big chance for you if your business is young and innovative, this way you can get financing. It combines the goals and benefits of both parties of the transaction – you as an entrepreneur are looking for possible funds to boost your business and the investor is providing capital.

Thanks to VC, your young business has a chance to appear on the market and develop, and your investor can achieve above-average profits. VC functions by buying shares of your business and by then reselling them at a high profit (or sometimes possibly - at a loss). The more you as an entrepreneur can boast of some success already, the bigger chances you have to get money for your startup/business.

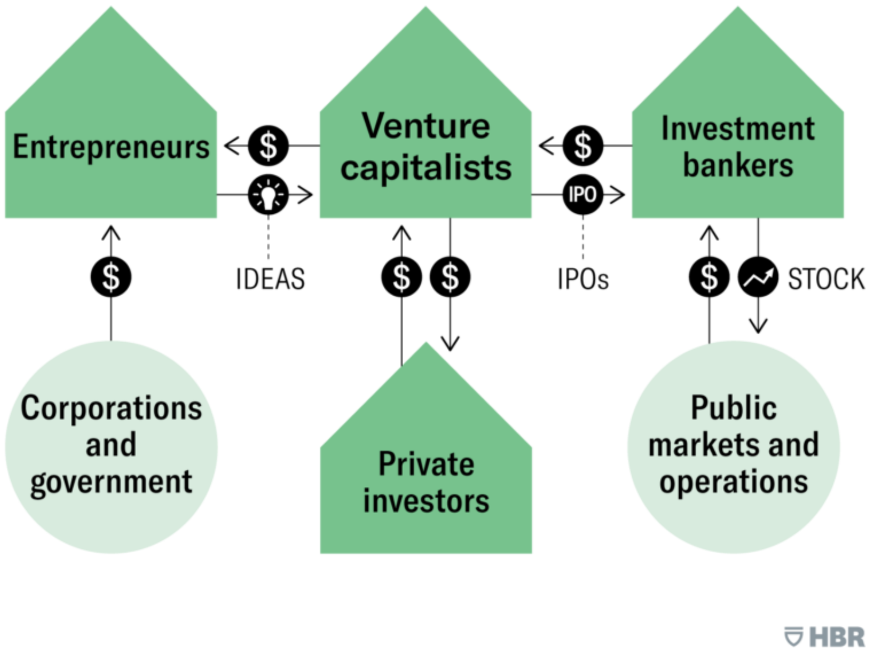
Venture capital funds provide entrepreneurs not only with the capital necessary for development and current operations. They are also a source of additional support in the form of:

- professional help from experienced investors;
- access to knowledge;
- access to the contact network of investors. [1]

[1] Fundusze venture capital – definicja, cel, korzyści | Magazyn Przedsiębiorcy

How The Venture Capital Industry Works

The venture capital industry has four main players: entrepreneurs who need funding; investors who want high returns; investment bankers who need companies to sell; and the venture capitalists who make money for themselves by making a market for the other three.



Still in doubt what exactly venture capital is? Watch these short videos:

[Venture Capital Explained]

[If You Know Nothing About Venture Capital, Watch This First | Forbes]

Pros and cons of VC

VC is a form of financing very desirable by young and innovative entrepreneurs. Its acquisition is associated with a number of advantages, such as:

- obtaining capital without the need to provide additional security;
- access to investors' knowledge and experience;

- increasing the group of potential key contractors;
- gaining access to multiple business contacts;
- having serious investors in the shareholding creates a positive image of the company in the eyes of customers, contractors, partners and other investors;
- no financial obligations - the contributed capital increases the goodwill;
- participation in investment risk;
- a renowned venture capital fund in the shareholding structure increases the credibility of the new enterprise.

A company that uses venture capital financing must take into account the negative consequences of such a decision. First of all, the investor buys some of the company's shares, which in a way means losing operational autonomy. The profit generated will be shared between all co-owners. Power in the entrepreneurship will also be divided. It may turn out that you will have to take into account the opinion of your business partner, which will be different from the vision of the originators of the business.

How to exit?

The dissolution of the venture capital fund means selling some shares or the sale of an organized part of the business. The following forms of exit from VC investments are possible:

- sale of shares to another investor;
- purchase of shares from the investor by the company that has been supporting so far;
- sale of the entire company to an industry investor;
- listing of the company on the stock exchange;
- purchase of shares in the company by some of the existing shareholders.

What to keep in mind when thinking about having a deal with venture capitalists?

Venture capitalists are looking for good managers and good industry rather than good people and good ideas. What they want to see is that an entrepreneur's idea corresponds with the current focus of VC. To make their job easier and the returns higher, venture capitalists seek entrepreneurs whose equity participation and management skills can ensure both. It is vital for entrepreneurs to understand the needs of the funding source and to set the expectations properly - with that both sides, entrepreneur and VC, can take profits.[2]

Business Angel vs. VC

When you think of which way of finance you should choose, either to go with business angel or venture capital - the experienced entrepreneurs say that simply take money from where you can get them. If you need less amount of money - angel investor is for you. If we are talking about a big amount of money, let's say 1 million, VC is a solution for you. To find out more what differs a business angel from VC and how to identify which one and when specifically your startup needs - watch this video:

[Angel Investors VS. Venture Capitalists - Ask Jay]

Characteristics	Venture capital institutes	Business angels
Source of funds	Institutional investors that invest borrowed funds under the limited liability terms	Private actors that invest their own funds
Responsibility	Limited personal financial responsibility, but responsibility to management and owners	Full personal financial responsibility
Investment experience and possibilities	Solid investment experience and investment capability	Brief investment experience and limited investment capability
Investment stage	Predominantly late stages of SBE life cycle	Early stages of SBE life cycle
Entry strategy	Necessary	Unnecessary
Investment period duration	3-5 years	3-8 years

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How to attract venture capitalists?

Build a relationship. As simple as it might sound, in the world of business it is very often about the right people you meet and know. So, here you are going to pitch your idea, trying to convince the investors that your business has a potential, has a bright future, and you hear: “We will call you”.

In many cases, they never call back. What are the reasons? You didn’t build a relationship with them. The thing is that going to events where you can find investors requires doing a little bit of research and getting to know people, building relationships.

After all, it is not about getting money from random people, but from the right people. The investor has to be comfortable with giving you the capital to fund your business, and it is very obvious that getting comfortable with the idea of giving money to someone

[2] How Venture Capital Works

[3] Comparative table comes from “Business angels as an alternative to financial support at the early stages of small businesses’ life cycle”

is coming with getting to know this person and their ideas. Show to the investors that you are aware of an ever-changing market and that your business idea is able to change to adapt to the needs of the market.

Show them perspective and that your idea is not going to be just another idea, but that you will bring it on another level and after one idea for the business more ideas will follow. In many cases, something that you are starting with might not be the final company your business idea results in. It is simply an adaptation to a market – things pivot and adapt in time.

Do you know the beginnings of Twitter? Once it was Odeo, a podcast company. But the Odeo was not working as it was planned, the originators knew it, and the investors knew. And it transformed to something that doesn't resemble, but is one of the most recognizable mediums worldwide.

Let's sum it up – to succeed in this world, build connections and network and be prepared for changes and transformation. Go to as many networking events, startup events, conferences, business meetings as possible. Before you pitch your idea, get to know the investors first, tell them about yourself, and get their feedback. And as it was mentioned in the previous module, be prepared with your pitch deck!

Another tip to get money from VC is to already have co-founders. It is simply, because they might not believe that you are going to do that all alone. But if you have a co-founder, maybe two, it's a different story then and venture capitalists see that.

What you need to know about VC is that it invests money not in big things but in enormous things. They are looking for other ideas such as Uber, AirBNB or Ebay. You get that point, right? Dream big and reach high. Once your business brings profit, VC is in there to take their share in each round and they expect that in every next round it's going to be more and more money, that the business will reach a higher level and bring bigger profit every time.[4]

[4] How to Raise Venture Capital | Entice Investors to Fund Your Startup Idea