



Venture Capitalists –
Opportunities
for Entrepreneurs?

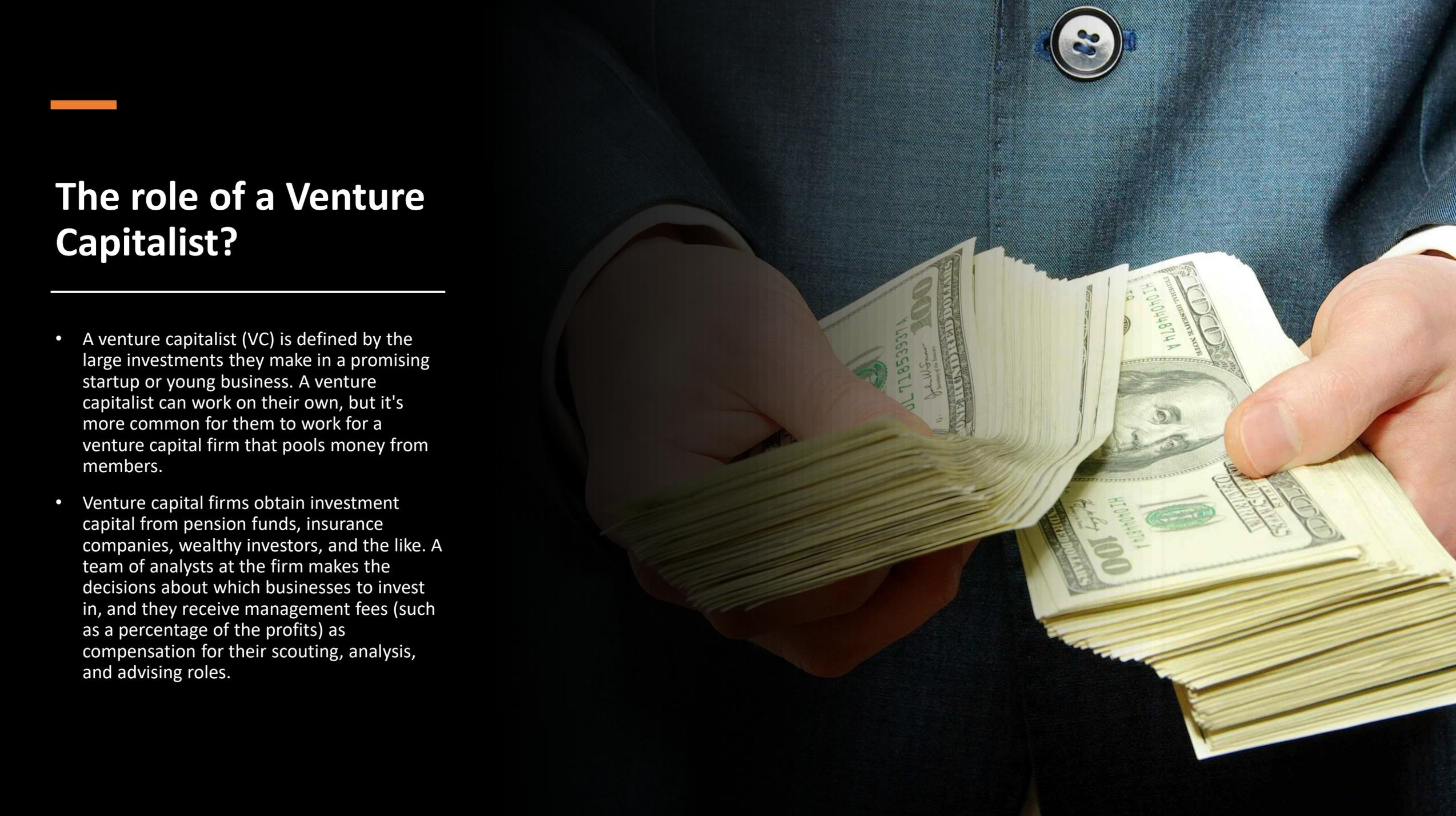
By Susan Ward



So, what/who is a venture capitalist?

- A venture capitalist is a person or company that invests in a business venture, providing capital for a startup or expansion.
- The majority of venture capital comes from professionally managed firms. These venture capital firms seek higher rates of return than they could earn through other investment vehicles, such as the stock market.





The role of a Venture Capitalist?

- A venture capitalist (VC) is defined by the large investments they make in a promising startup or young business. A venture capitalist can work on their own, but it's more common for them to work for a venture capital firm that pools money from members.
- Venture capital firms obtain investment capital from pension funds, insurance companies, wealthy investors, and the like. A team of analysts at the firm makes the decisions about which businesses to invest in, and they receive management fees (such as a percentage of the profits) as compensation for their scouting, analysis, and advising roles.

What are Venture Capitalist looking for?

- Venture capitalists aren't looking for stable, safe companies—they want to see a high potential for growth, which comes with extra risks. By one estimate, VC firms usually seek to multiply their investment by 10 within seven years.
- If venture capitalists were content with meager gains, they would stick with traditional investments like blue-chip stocks and index funds. By taking risks on new businesses, technologies, and industries, venture capitalists expose themselves to significant risks in hopes of enjoying exponential returns. Typical sectors for venture capitalists to invest in include IT, bio-pharmaceuticals, and clean technology.



How do Venture Capitalists Work?

VENTURE CAPITAL

- An investment from a venture capitalist is a form of equity financing. The VC investor supplies funding in exchange for taking an equity position in the company. Equity financing is normally used by non-established businesses that are unable to use debt financing, such as business loans from financial institutions.
- Insufficient cash flow, lack of collateral, and a high-risk profile are some of the reasons why businesses may be unable to use debt financing. Many new businesses have issues in these areas.
- Venture capitalists typically invest in businesses for the long-term. They'll stick with a young business for years until it matures to the point that its equity shares have value, and the company goes public or is bought out. VC investors usually exit the company at this point, enjoying massive profits since they invested in the now-public company when it was just a fledgling startup.



How to Get Venture Capitalist Funding?

Venture Capital

- The vast majority of businesses won't secure venture capital funding, so it may be a good idea to look for other funding options first. VC firms take risks, but they are very choosy about the businesses they take risks on.
- According to the business magazine Inc., just 0.62% of startups manage to secure VC funding.³ Your odds for VC funding may improve if you're past the startup stage, and you can demonstrate a viable product or service, but you still have a lot of room to grow.
- If you do decide that venture capital funding is right for you, you need to find a way to capture VC firms' attention. Recruit big names to your business, win an award, and do anything it takes to build momentum behind your business. With the right mix of momentum, promise, and story, you may be able to win over some venture capitalists.



Disadvantages to using Venture Capitalist.

- There are downsides to losing some of your ownership in your business, and VCs may be a poor choice for entrepreneurs who want to retain control of their businesses. In exchange for providing funding, VC firms may obtain majority voting rights or special veto rights (either through obtaining a majority of the shares or a preferred class of shares). VCs may also mandate priority rights for compensation in the case of a share sale.



DISADVANTAGE

Advantages to Using Venture Capitalist.

- However, there are some advantages to extending equity to venture capitalists, beyond the cash injection. Many VCs are veteran business experts. For those with an exciting idea, but not much business experience, it can be beneficial to add expertise to the company in the form of venture capital ownership.





Key Takeaways

- Venture capitalists are entities—usually firms—that invest in businesses during startup or early expansion phases.
- Venture capitalists differentiate themselves from other types of investors in that they invest large sums of money and seek massive returns.
- Venture capitalism is a form of equity financing, and venture capitalists usually acquire significant power in the company in exchange for their funding.

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