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Raising Venture Capital – A Working Guide for Entrepreneurs

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Many ambitious entrepreneurs seek venture capital to fuel the rapid development of their businesses. The good news is that the amount of funds raised for venture capital investment is growing at a rapid rate. In 2000, external institutions and private individuals committed £8,995 million to UK managed private equity funds for future investment. This constituted an increase of 55 per cent on the 1999 figure of £5,813 million. This substantial increase was principally due to increased commitments from overseas insurance companies.

In 2000, £1,885 million was invested in 341 companies. The distribution of this investment is shown in Table 3.3.1.

This guide focuses on advice to entrepreneurs seeking funding for early-stage or expansion projects, which received 75 per cent of the funds invested in 2000. The comments do not apply to start-up ventures, which are generally difficult to fund.

With the end of the Internet investment bubble in the first quarter of 2001 and the continuing volatility in the TMT (technology, media and telecommunications) sector, the investment criteria of venture capital companies has changed substantially. They are now focused

Table 3.3.1 Distribution of investment, 2000

Financing stage	Number of companies			% of companies			Amount invested (£ million)			% of amount invested		
	2000	1999	1998	2000	1999	1998	2000	1999	1998	2000	1999	1998
Start-up	153	101	115	13	9	10	175	128	111	3	2	3
Other early stage	256	159	126	22	14	11	528	219	177	8	4	5
Total early stage	409	260	241	35	23	21	703	347	288	11	6	8
Expansion	498	481	484	42	43	43	2,012	980	688	32	16	18
Secondary purchase	44	51	72	4	5	6	99	137	131	1	2	4
Refinancing bank debt	6	7	5	-	1	-	11	39	3	-	1	-
Total expansion	548	539	561	46	49	50	2,122	1,156	822	33	19	22
MBO	190	255	218	16	23	20	3,297	4,282	2,129	52	69	56
MBI	35	55	102	3	5	9	249	384	536	4	6	14
Total MBO/MBI	225	310	320	19	28	29	3,546	4,666	2,665	56	75	70
Total	1,182	1,109	1,122	100	100	100	6,371	6,169	3,775	100	100	100

Source: BVCA report on investment activity 2000

on businesses with revenues, profits and cash flow following a period where these attributes were not deemed essential to receiving funding. It is therefore critically important to gain early input from an experienced adviser on the merits of your proposals and the venture capital investors most likely to respond positively to your proposals.

In the film *Clockwise*, John Cleese said, 'Lord I can cope with the despair, but it's the hope which I can't cope with'. It is far better to obtain some clear advice on the prospects of success at the outset of your efforts to raise venture capital finance than to work very hard in vain for months. Your response to this could be to point to many successful entrepreneurs who raised equity finance for their businesses against the odds and today enjoy the fruits of their labour based on fulfilment of their dreams. The well-known golf professional Gary Player responded to the comment that he was lucky by saying that the more he practised the luckier he got. Success in raising the finance you need to succeed in your business will be created in great part by your determination to succeed. That said, it is always useful to weigh up the odds at the outset through discussion with experienced advisers and then use their experience to the maximum to improve the probability of success.

What sort of businesses are venture capital companies attracted to? This is an important question to which it is difficult to give a specific answer. A few general guidelines are set out below:

- established, with track record and a proven business model;
- good management team;
- profitable;
- good visibility of future revenue;
- excellent growth prospects;
- credible exit potential;
- limited exposure to changes in external factors such as markets, customers or suppliers.

Thus, what are the key points to remember in raising equity finance?

- getting started;
- creating the business plan and the investment proposal;
- dealing with investors;
- the small print.

Getting started

First of all, you must define what you want to achieve as proprietor of the business through raising the finance and implementing the business plan with the involvement of your investment partner. You need to confirm that the changes resulting from the investment process are acceptable in view of the potential gains from successfully building your business and realising your goodwill through a trade sale or flotation at a future date.

Carry out some initial research by attending seminars and other relevant events that deal with the topic. Speak to other entrepreneurs who have 'been there and got the T-shirt'. Gather documentation on the subject and draft a brief summary of your proposals.

Through this initial research, identify advisers who can add value to the investment process. Contact these advisers, send them your summary and interview them to confirm how they can help you. Subject to your conclusions on adding value, appoint your financial adviser based on clearly agreed terms of engagement including fees.

If possible, organise the management of your business so that account is taken of your time commitment to the fundraising process. You will be spinning many plates during this period and the business needs to perform to plan to avoid problems in dealing with due diligence. Communicate your plans with key managers and consider providing them with share options so that they are fully committed to the future of the business.

Creating the business plan and investment proposal

As the entrepreneur you must own the business plan. You should work closely with your advisers to finalise the plan. This document is crucial in the fundraising process. It must provide a transparent understanding of the business and create the basis for a positive dialogue with potential investors. Key contents include:

- a punchy executive summary that can be detached from the main plan and presented as a summary of the plan;
- an analysis of the market supported by accredited research together with explanation of your competitive advantage, your main competitors, your marketing plans and your marketing channels;
- a definition of the customers you currently deal with together with

those you have targeted in implementing the plan and achieving your sales targets;

- an explanation of your operations and the way in which they will support the growth of the business;
- a description of the management team, including CVs;
- comprehensive financials.

The plan should be concise. Careful editing will make it more appealing to the investor who sees too many unappetising plans. Presentation of the plan is crucial.

The plan should also include a clear analysis of the finance required, the source of this finance including bank, asset finance and equity, and the use of it in implementing the plan.

With your advisers you should define the offer to the investor. Venture capital companies use a number of basic benchmarks for evaluating returns on their investments. By applying these to the finalised business plan you can define the offer which is likely to interest the investor. You should also take account of debt finance which can be raised in parallel with the equity to finance the plan. By raising debt finance you can reduce the equity exchanged for the investment provided by the venture capital company. The equity you retain as a result of raising debt finance will become increasingly valuable as the business plan is successfully implemented and the prospect of a trade sale or flotation becomes more likely.

Dealing with investors

The British Venture Capital Association has 130 venture capital companies as members. Each of these companies has different investment criteria and appetite for investment. They are bombarded with business plans and they tend to look in detail at only about 15 per cent of those they receive. Your financial adviser should know which investors to approach and have relationships with investment directors in those selected companies. As a result, you should get to meet the investors.

You should be well prepared for the initial meeting with the investors. A clear presentation of the business proposition by key members of the management team is crucial. As a result of this meeting you should expect further detailed questions and some indication of a draft term sheet setting out the structure of the investment and

the matters that need to be dealt with to finalise the term sheet. It is important to get a clear response from this initial meeting, be it positive or negative. Focus on the positive responses. Do not get involved with half-baked responses from investors, as these go nowhere.

Aim to get at least three positive responses. Keep the initiative with each of these by setting a timetable for the process. Your objective is to obtain a final term sheet from each investor. Negotiating with investors to secure the best deal at this stage is crucial. The conclusion of this stage is the decision on which investor gets exclusivity to finalise. A short exclusivity period of six weeks is realistic to allow the investor to conduct due diligence and deal with the legal documentation. You should keep the other investors warm during this exclusivity period.

Small print

Ensure that you have an experienced lawyer on board at an early stage. The amount of legal documentation needed will surprise you. Protecting your interests in entering into this sort of arrangement is very important. It is also important to keep the initiative in dealing with the documentation so that you meet the timetable agreed and drive the process during the exclusivity period.

Your corporate finance adviser should take centre stage in the final stages of the process. He needs to be a good negotiator to deal with the inevitable 'wobbles' that will occur in finalising the agreements.

The legal framework created as a result of the agreement with the investor will change your business behaviour substantially. You will have:

- non-executive directors;
- a service agreement;
- a new set of rules on your behaviour as a shareholder;
- rigorous financial targets to meet.

You will also have the opportunity to realise your business plans.

Summary

The comments above provide a short summary of the path to raising equity finance from venture capital companies. Each investment will have unique features which will need to be handled in the right way to achieve a successful conclusion.