

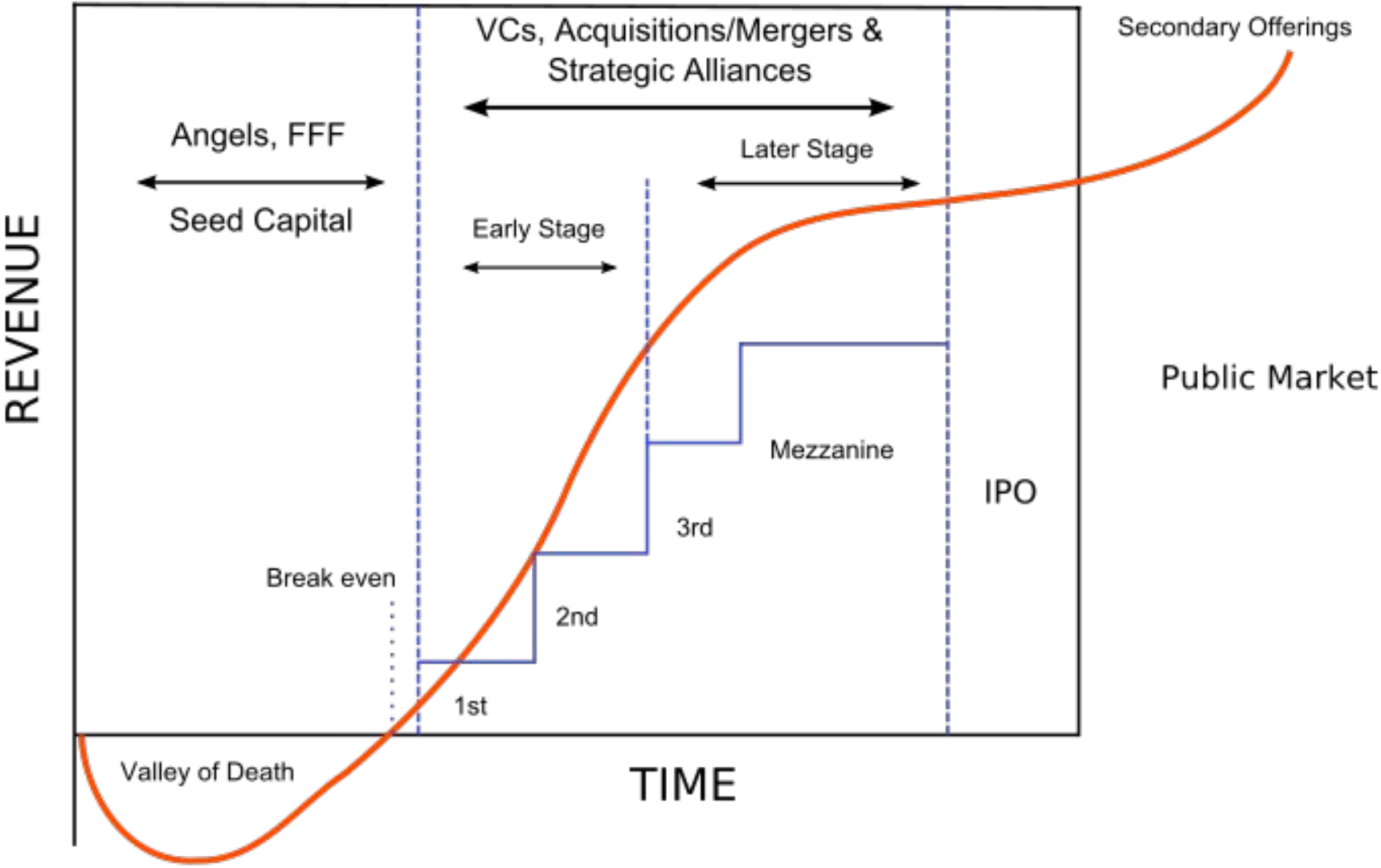


# VENTURE CAPITAL

[Wikipedia](#)

<http://www.go4funding.com/articles/angel-investors/types-of-angel-investors.aspx>

# Startup Financing Cycle



## WIKI: What is venture capital

**Venture capital (VC)** is financial capital provided to early-stage, high-potential, high risk, growth startup companies. The venture capital fund makes money by owning equity in the companies it invests in, which usually have a novel technology or business model in high technology industries, such as biotechnology, IT and software. The typical venture capital investment occurs after the seed funding round as growth

## VC: fantasies and expectations

- **Q: What rate of return would a venture capitalist generally expect?**

*Answered by Phil Verity, Mazars, 2007*

The initial rate of return most VCs would expect is **25 per cent (annualised)**. A VC will be looking to achieve this - at least - and exit a business in four to five years.

*Phil Verity is a partner at Mazars, the international accounting and business advisory firm, and head of the mid corporate market business line*

## Sad glimpse of reality

<i>Period Ending</i>	<i>1 Qtr</i>	<i>1 Year</i>	<i>10 Year</i>
<b>9/30/2012</b>	<b>0.6%</b>	<b>7.7%</b>	<b>6.1%</b>
<b>12/31/2011</b>	<b>1.4%</b>	<b>13.2%</b>	<b>3.3%</b>
<b>Early stage funds</b>	<b>1.1%</b>	<b>6.2%</b>	<b>3.9%</b>
<b>Later and Expansion stage</b>	<b>(1.2%)</b>	<b>6.1%</b>	<b>9.3%</b>
<b>Multi-Stage Focus</b>	<b>0.5%</b>	<b>5.6%</b>	<b>6.5%</b>
<b>DJIA</b>	<b>5.0%</b>	<b>26.5%</b>	<b>8.6%</b>
<b>NASDAQ Composite</b>	<b>6.2%</b>	<b>29.0%</b>	<b>10.3%</b>
<b>S&amp;P 500</b>	<b>6.4%</b>	<b>30.2%</b>	<b>8.0%</b>

# How many projects succeed?



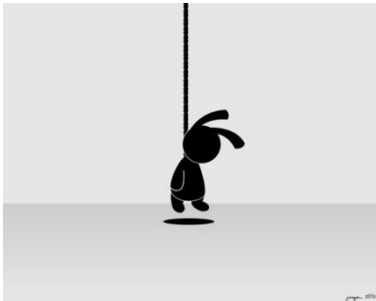
10 enthusiasts



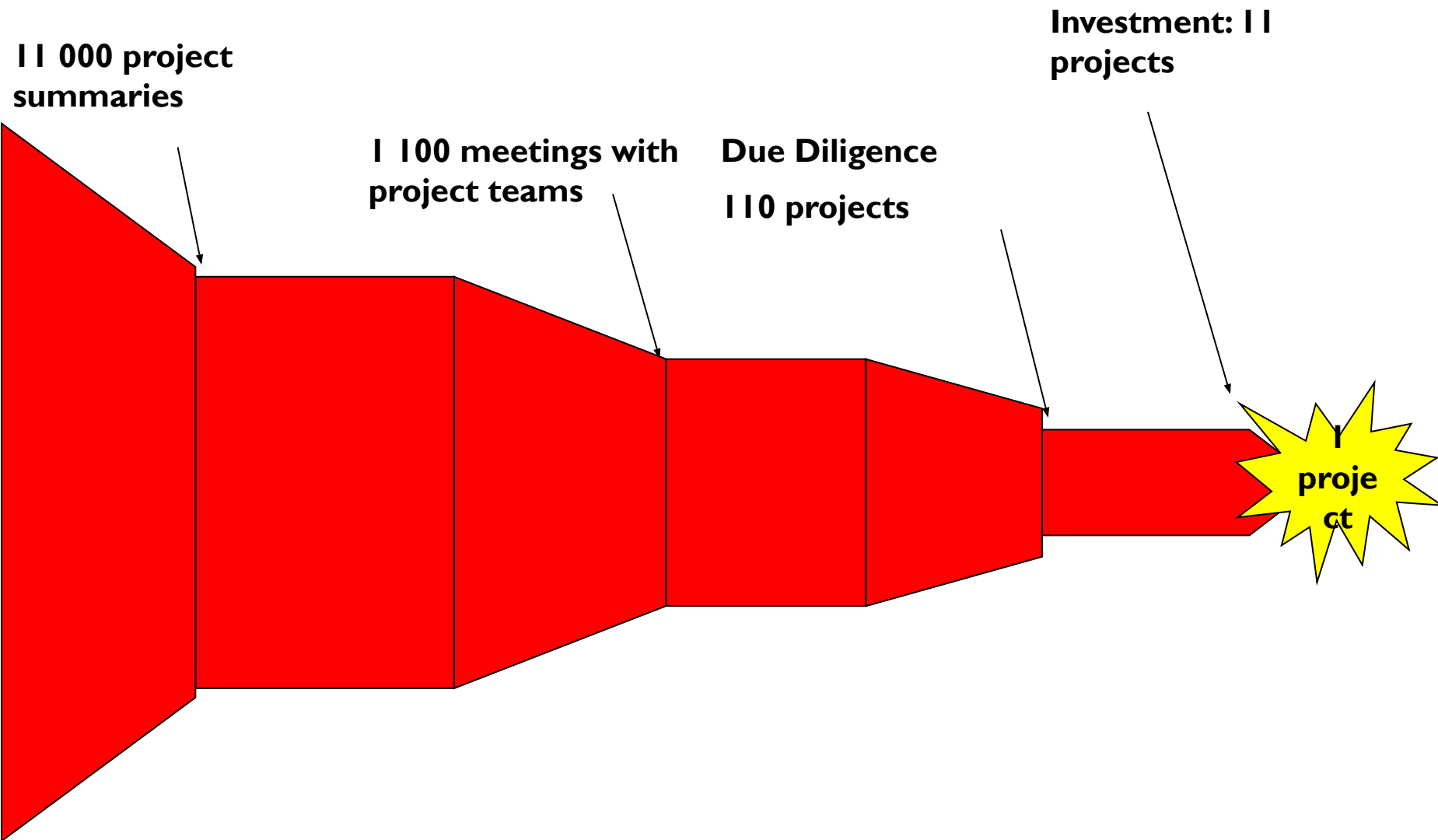
3 dead

3 living dead

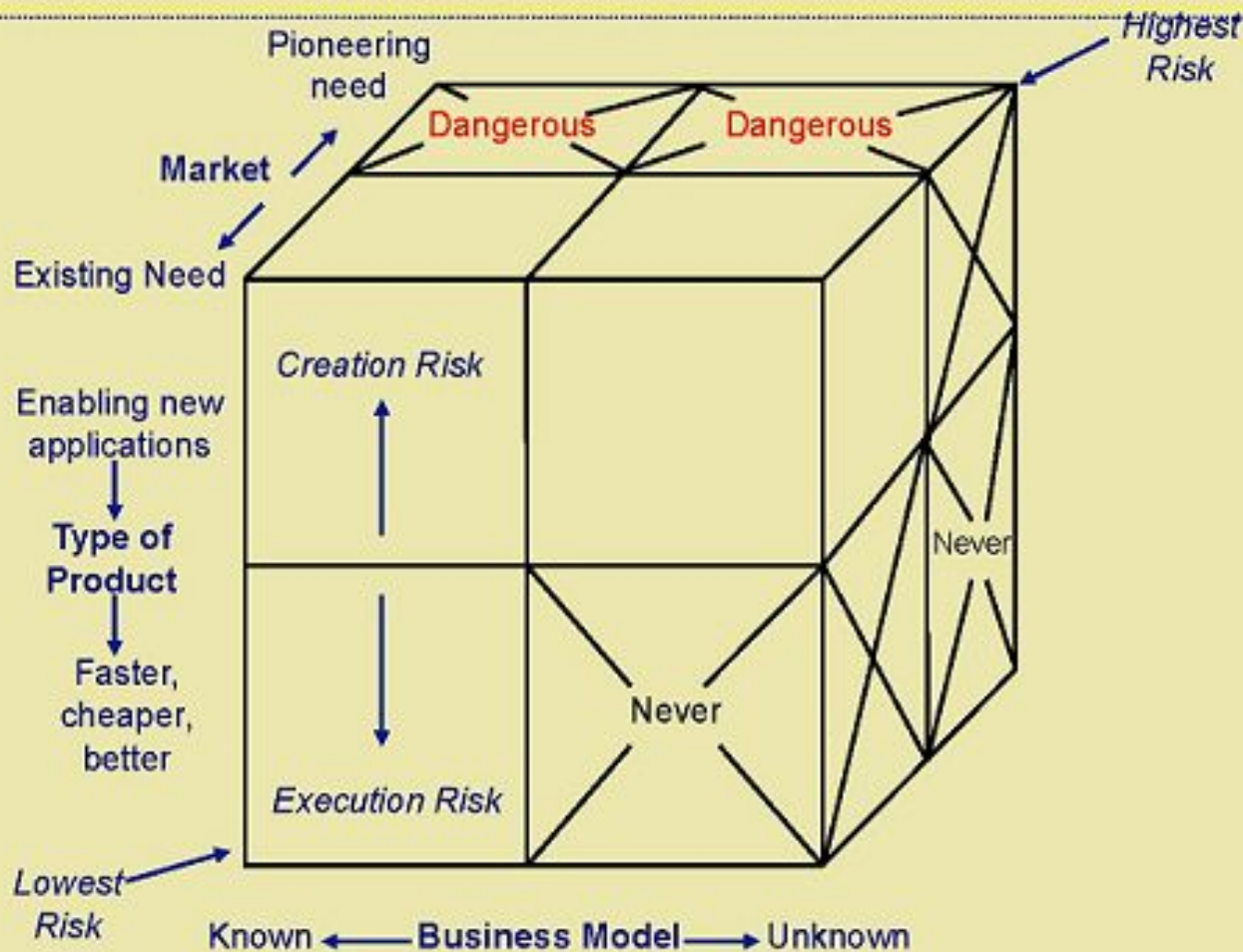
3 so-so



# Draper's Rocket Pipeline

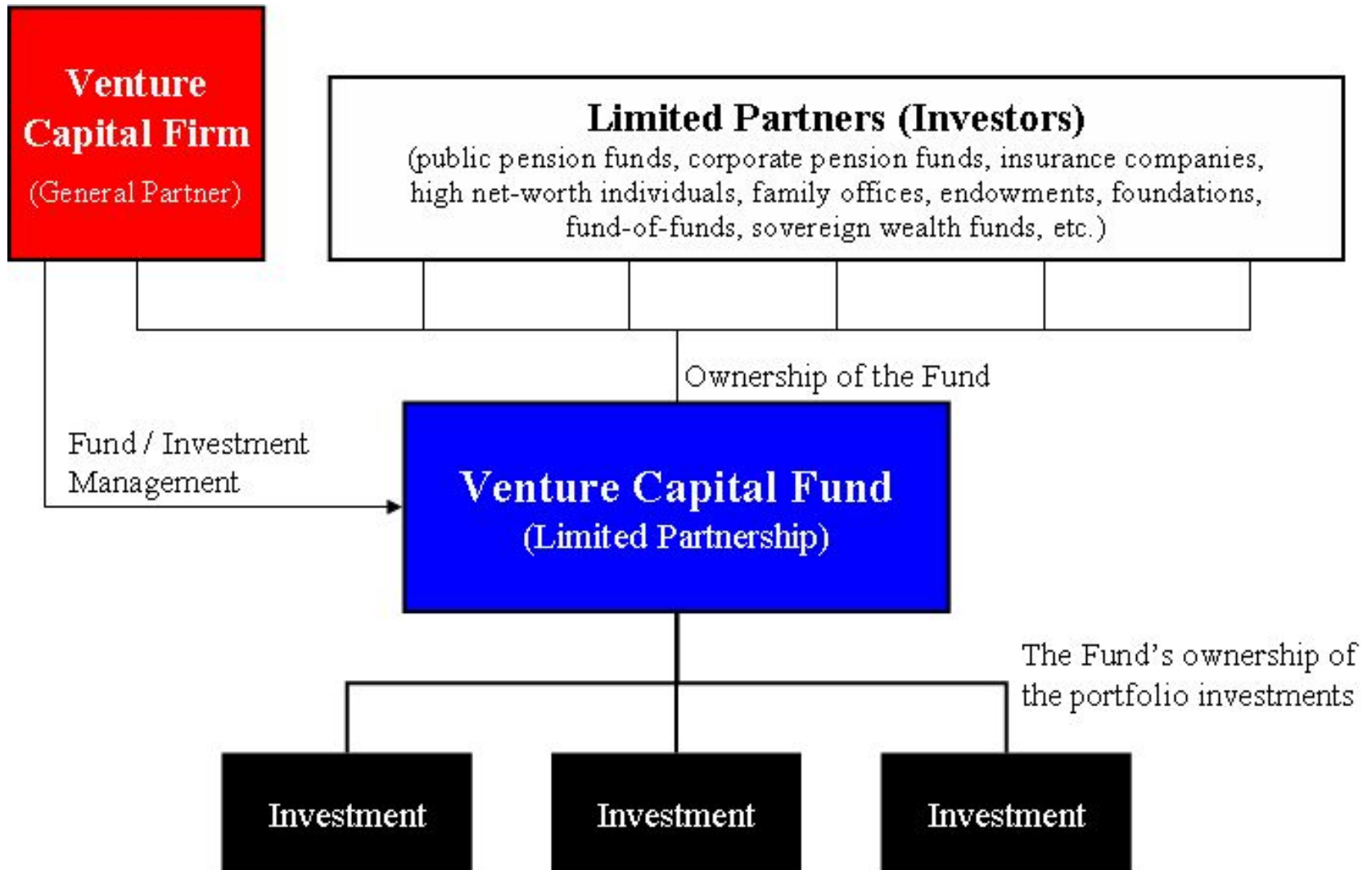


# Investment Framework





# What is venture capital



## WIKI: Venture round

**Venture round** is a type of funding round used for venture capital financing, by which startup companies obtain investment, generally from venture capitalists and other institutional investors. The availability of venture funding is among the primary stimuli for the development of new companies and technologies.

# Parties in the play

- **Finders or stockbrokers.** *Introduce companies to investors.*
- **A lead investor**, typically the best known or most aggressive venture capital firm that is participating in the investment, or the one contributing the largest amount of cash. The lead investor typically oversees most of the negotiation, legal work, due diligence, and other formalities of the investment. It may also introduce the company to other investors, generally in an informal unpaid capacity.
- **Co-investors**, other major investors who contribute alongside the lead investor
- **Follow-on or piggyback investors.** Typically angel investors, rich individuals, institutions, and others who contribute money but take a passive role in the investment and company management
- **The company** being funded
- **Law firms and accountants** are typically retained by all parties to advise, negotiate, and document the transaction

# Stages in investment

- Introduction.
- Offering.
- Private placement memorandum.
- Negotiation of terms.
- Signed term sheet.
- Definitive transaction documents.
- Definitive documents
- Due diligence.
- Final agreement
- Closing

## Introduction

Investors and companies seek each other out through formal and informal business networks, personal connections, paid or unpaid finders, researchers and advisers, and the like. Because there are no public exchanges listing their securities, private companies meet venture capital firms and other private equity investors in several ways, including warm referrals from the investors' trusted sources and other business contacts; investor conferences and symposia; and summits where companies pitch directly to investor groups

# Offering and first informal agreements

- Offering. The company provides the investment firm a confidential business plan to secure initial interest
- Private placement memorandum. A PPM/prospectus is generally not used in the Silicon Valley model
- Negotiation of terms. Non-binding term sheets, letters of intent, and the like are exchanged back and forth as negotiation documents. Once the parties agree on terms they sign the term sheet as an expression of commitment.
- Signed term sheet. These are usually non-binding and commit the parties only to good faith attempts to complete the transaction on specified terms, but may also contain some procedural promises of limited (30-60 day) duration like confidentiality, exclusivity on the part of the company (i.e. the company will not seek funding from other sources), and stand-still provisions (e.g. the company will not undertake any major business changes or enter agreements that would make the transaction infeasible).

# Formal things

- Definitive transaction documents. A drawn-out (usually 2–4 weeks) process of negotiating and drafting a series of contracts and other legal papers used to implement the transaction. In theory, these simply follow the terms of the term sheet. In practice they contain many important details that are beyond the scope of the major deal terms.
- Definitive documents, the legal papers that document the final transaction. Generally includes:
  - Stock purchase agreements — the primary contract by which investors exchange money for newly minted shares of preferred stock
  - Buy-sell agreements, co-sale agreements, right of first refusal, etc. — agreements by which company founders and other owners of common stock agree to limit their individual ability to sell their shares in favor of the new investors

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## More formal things

- Investor rights agreements — covenants the company makes to the new investors, generally include promises with respect to board seats, negative covenants not to obtain additional financing, sell the company, or make other specified business and financial decisions without the investors' approval, and positive covenants such as inspection rights and promises to provide ongoing financial disclosures
- Amended and restated articles of incorporation — formalize issues like authorization and classes of shares and certain investor protections



# Next stages

- **Due diligence.** Simultaneously with negotiating the definitive agreements, the investors examine the financial statements and books and records of the company, and all aspects of its operations. They may require that certain matters be corrected before agreeing to the transaction, e.g. new employment contracts or stock vesting schedules for key executives. At the end of the process the company offers representations and warranties to the investors concerning the accuracy and sufficiency of the company's disclosures, as well as the existence of certain conditions (subject to enumerated exceptions), as part of the stock purchase agreement.
- **Final agreement** occurs when the parties execute all of the transaction documents. This is generally when the funding is announced and the deal considered complete, although there are often rumors and leaks.

## The end ...

- Closing occurs when the investors provide the funding and the company provides stock certificates to the investors. Ideally this would be simultaneous, and contemporaneous with the final agreement. However, conventions in the venture community are fairly lax with respect to timing and formality of closing, and generally depend on the goodwill of the parties and their attorneys. To reduce cost and speed up transactions, formalities common in other industries such as escrow of funds, signed original documents, and notarization, are rarely required. This creates some opportunity for incomplete and erroneous paperwork. However, disputes are rare and few if any deals unravel between final agreement and closing. Some transactions have "rolling closings" or multiple closing dates for different investors. Others are "tranching," meaning the investors only give part of the funds at a time, with the remainder disbursed over time subject to the company meeting specified milestones.

## ... and after

- **Post-closing.** After the closing a few things may occur
  - Conversion of convertible notes. If there are outstanding notes they may convert at or after closing.
  - securities filing with relevant state and/or federal regulators
  - Filing of amended Articles of Incorporation
  - Preparation of closing binder — contains documentation of entire transaction