Venture Capital 101

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What is venture capital?

Venture capital (VC) is a form of private equity and a type of financing where investors invest in early-stage companies which they believe to have long-term, high-growth potential. Accredited investors, family offices, institutional investors and others invest in VC.

Venture capital is patient capital!

1. Conventional lenders cater to established companies, instead of companies in their ideation phase. VC funds bridge this gap by providing financing to companies that are not the right "fit" for other financing sources such as bank debt.
2. From 1995 to 2018, approximately 47.0% of companies (1,930 companies) that went public were venture-backed, reflecting the importance of early-stage investing.
3. Although VC has a higher risk profile due to the longer-term commitment of cash and potential failure rates, it also offers the potential for outsized returns. Many of the most successful companies of the past 25 years, such as Apple, Amazon, Facebook, and Microsoft, were venture-backed, taking years to grow from small startups into some of the world's most valuable companies. Historically, VC returns have been reported to fall within the 20-30% range on an annualized basis (although actual returns can vary significantly from one investment to the other and there are no guarantees).

How do VC Funds seek to de-risk investments? They do their diligence!

Sourcing	Application	Initial Review	Due Diligence	Investment Committee	Investment
1000s of connections	100s of applications	200 – 300 companies	40 – 60 companies	20 – 30 companies	10 – 15 investments

1. **Sourcing:** VC funds source deals many different ways, including through networking events, their personal networks, and industry research.
2. **Application:** Companies submit their pitch deck and certain information about their business to the fund.
3. **Initial Review:** The fund review the company's submission and may meet with the company's founders or management team.
4. **Due Diligence:** If a company passes the initial review, VCs complete additional diligence to assess the company's market opportunity, IP portfolio, management team, etc.
5. **Investment Committee Decision:** VC funds have general partners or investment committees who review their diligence and make a decision to invest or not.
6. **Investment:** If interested in investing, funds negotiate the terms of their investment and invest in the company.

What types of due diligence do VC funds do?

Due diligence is the process by which VC funds assess the potential risks and returns of an investment. Types of due diligence include the following:

1. **Product:** Evaluating the company's technology, including its stage of development, recent data or customer feedback and early traction.
2. **Market:** Reviewing the company's market opportunity, the competitive landscape and the company's anticipated market share.
3. **Legal:** Reviewing the company's intellectual property (patents, licenses, etc.), contracts with third parties and organizational structure.
4. **Financial:** Assessing the company's historical and pro forma financial performance.
5. **Capitalization:** Evaluating the company's current capital resources, its investor base, and sources and uses of funds to meet targeted milestones.
6. **Execution:** Evaluating the company's management team, board or advisory board and third party relationships to determine execution risk.
7. **Return:** Determining the appropriate valuation on which to invest, based on the market and exit opportunities.

What types of protections do VC funds seek?

VC funds use a variety of contractual and operational tools to help support their portfolio companies and protect their investments. These may include:

1. **contractual rights**, such as preemptive rights, anti-dilution rights, consent rights and board appointment rights;
2. **investing in "stages"** by writing smaller checks in earlier rounds, and tracking the company's progress to determine participation in later rounds; and
3. **taking a board or observer seat** to help support the company's management team in making strategic decisions, and to provide ongoing mentorship and access to contacts to support execution.