

Smooth Ride to Venture Capital - Pankaj Sahai

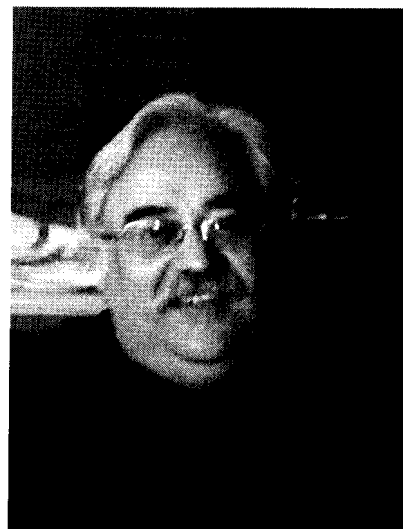
“Smooth Ride To Venture Capital – How to Get VC Funding for Your Business” for the entrepreneurs

I felt that there was lot of VC & PE money available to be invested on the one hand while there were many investible ventures which were unable to access to venture capital on the other due to their lack of familiarity with this mode of risk funding..In my interactions with entrepreneurs over the years, I found that there was a woeful lack of knowledge among entrepreneurs regarding what venture capital was all about, whether they did really need venture capital for funding their business , whether they qualify for it , and if they did, then what was the process of acquiring this form of capital. Even finance consultants tend to treat the exercise of raising venture capital in a manner similar to raising bank loans or project finance, and are thus unable to properly guide entrepreneurs. This book aims to fill this gap and to strengthen the demand side of India's venture capital industry.

Most entrepreneurs are fascinated by the idea of taking money from

globalised world, is the same - moderated only marginally to accommodate the requirements of the respective legal systems and precedents.

Operationally, the VC business in India and the US are run in the same manner. Only the investment themes and returns expectations vary. For example, in the US a lot of VC money gets invested in early stage ventures doing pure R&D in sectors like nanotechnology, biotechnology, “cleantech” (R&D relating to environmental friendly products) semiconductor industry etc; while in India the emphasis is on the sectors like IT services, financial services, infrastructure , education which have growing markets offering opportunities of high returns to VC money. Also, in India VC money seems to prefer established business models of later stage ventures rather than the classic early stage investing in the US. To that extent, I feel that VC money in India is definitely playing safer and



Mastering venture capital

accountable to the VC, who comes in as a financial partner in the business. Hence they resist VC money.

Thirdly, almost all entrepreneurs fear dilution of their ownership as well as a management control of their

someone who does not want it back from them personally, does not take personal guarantees or has their assets collateralised , and does not want interest on the capital that he invests in their business ! It sounds like a very good deal and all of them feel that they should participate in this “lottery”. The book has been written to clear such distorted understanding about venture capital.

What difference can you see in the attitude of VCs in USA and VCs in India

The VC industry as it exists globally, with special laws and regulations to support it, is a creation of the USA, a proud product of its revered capitalist ideals. As such, the attitude of the VCs world over, especially now in a

taking less risks than that in the US.

Why didn't the concept of VC become so popular in India as in the US Why do the majority of entrepreneurs still opt for conventional funding

There can be many reasons. Firstly, there is tendency in India to set up businesses as family enterprises which are in the nature of “self-employment” businesses, providing employment as well as independence and autonomy to its owners in perpetuity. Such businesses are not investible candidates for VC money. Secondly, there is general unwillingness amongst entrepreneurs to function as a management team

business due to the VC's requirements of taking equity in exchange for his money, management rights and having a definite exit plan to monetise his investments. So much so, existing business owners don't mind putting all their family assets as collateral for loans to avoid getting in a financial investor in exchange for equity in their business.

Lastly, it is just the sheer lack of information and knowledge about venture capital, its processes and requirements that keeps investible businesses from seeking VC funding.

How far have been venture capital activities in India been

impacted by the global financial crisis

There has been a general slowdown in the VC investments in India due to the global crises.

VC funds rely on high-net worth individuals and institutions like pension funds, insurance companies etc for money, which then is invested in targeted growth businesses. With so much money being wiped out as a result of the global financial collapse, the VC funds have found it difficult to raise more funds from its investors. In fact, quite a few investors who had made commitments to invest in VC funds just before the crises, found themselves unable to meet their commitments due to an erosion of their net-worth as a result of the slowdown. Moreover, with the stock markets crash, not only the VC funds could not exit the investments as per their plans, their entire portfolio of investments also became "underwater", that is, valued below their investment price at a loss.

The silver lining for the VC funds, however, has been that the valuations have become cheaper (due to the

decline in the stock prices) and investment amounts have become

willing to take more risk at a much lower turnover rather than trying to build up a business, which can impress a Venture Capitalist

Angels invest only at the seed stage in ventures which they can also support through their experiential learning. Angel funding is usually a "hands-on" investing activity in which investors fund ventures or venture ideas in their close geographical proximity in order to provide them with the much needed mentoring.

The amounts angels invest are very small, just enough to, for example, make a business plan or do a feasibility study or develop a barebones prototype. Once such activity is complete, the entrepreneur has to approach VCs for funds to get the venture to the next stage of development. Angel investment precedes that of a VC. Whom you approach depends upon the development "stage" of your venture.

The availability of angel funding depends upon the existence, and maturity, of the angel networks in the country. In the USA, angel funding is

. The amount of VC investment required

. The number of years the VC money will remain invested in your business
The assumptions regarding the market multiples being used to value the business at exit

. The IRR% that the VC has committed to his the investors in his Fund

. The existing state of the VC's other portfolio investments made by his Fund

. The existing state of the capital markets

. The existing inflation and interest rates

The entrepreneur should prepare his business plan on realistic forecasts based on which he should use his advisers to determine the value of his business. Then he should assess the market variables to estimate the IRR which the VC would find acceptable in the existing market situation (again, use the experience and knowledge of your advisers). After which he should use this VC IRR, investment amount and the Valuation of his business to arrive at the equity stake that would enable the VC to achieve his IRR on exit.

smaller (cost cutting by companies) making transactions more reasonable and doable. VCs are now more focussed on their "monitoring" role, ensuring that their existing investments are nurtured and keep alive for a handsome "harvest" when the financial markets recover.

From the entrepreneurs' perspective things have become tougher. There are less investible funds with the VCs, valuations are much lower than those before, scrutiny by the VCs more rigorous and demanding, follow-on funding more difficult to get and there is more blood in the boardrooms of VC investee companies.

Why would an entrepreneur not look for an angel investor, who is

very organised with specific regulations governing it. In India, although there has been a positive movement towards organising this activity, it is nowhere near its counterpart in the USA.

How can an entrepreneur minimise the equity stake that he has to part with to a VC

The short answer to this question is this: Prepare well before approaching a VC

The equity stake that a VC will take in a business that he invests will depend upon:

. The development stage of the business

. The projected growth rate of the business

Do all venture capitalists evaluate only business that has already been built up and needs financing or are they also willing to consider good early stage business ideas in need of capital

Venture Capital as a concept came into In general, all VCs do not have the same investment preferences. Each VC fund has its own investment style which is well articulated. VCs differ in their investment style based on:

. The industries to which they limit their investments

. The development stage of the business at which they invest

. The minimum and maximum amount of money they invest in each venture

. The minimum and maximum time

they wish their investment to remain in the venture

- . The geographical areas in which they confine their investments
- . The way they monitor their investments post-investment
- . The preferred mode of exit from the ventures in which they invest

So, the VCs differ with each other in more ways than one. The learning for the entrepreneur here is that while looking for venture capital, he should select and target only those VCs whose investment preferences the venture can satisfy. And not send emails/business plans to all and sundry.

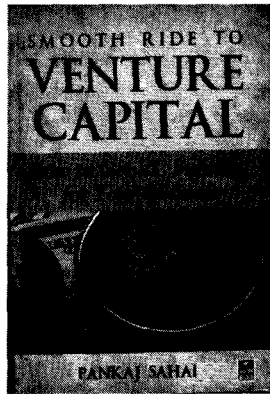
Is there any way can an entrepreneur assess his idea and the growth potential of his venture before signing an agreement with a VC Are there any consultants whose advice can be taken

It is the entrepreneur's job to be able to demonstrate to the VC, or any other potential investor, the growth potential of his business or idea. He should research his idea, use consultants for doing a feasibility study, network with his industry's trade association etc. to gather enough information and evidence to prove that his business is operating in a fast growing market and that he and his management team, have the passion, capability and experience to implement the business plan on the basis of which the investment case is being presented to the VC.

There are many consultants who can be of help to the entrepreneur. The entrepreneurs may contact their industry association, the VC industry association and the various chambers of commerce for mentoring in this regard.

If an entrepreneur already has an angel investor, is it advisable that he himself can make an effort to bring in a VC

Yes, angel investors can definitely help in introducing him to the future VC investors. But, the entrepreneur should



never be too dependent on existing investors to get follow-on investors. The entrepreneur should be leader of his business and should not let investors, angel, VC or any other, take a lead role in any matter. Yes, he should proactively seek advice and guidance, but should always reserve the final decision to himself, unless of course legal agreements specify otherwise or trigger situations in which the investor has the final say in who comes in as a follow-on investor.

The current VC funding is largely confined to high technology areas. How can other entrepreneurs get access to risk capital

In India, VC funding is not confined to high-technology areas. As the markets are being deregulated through government intervention, new growth markets are being created and funding is flowing into them. Examples of such sectors are infrastructure, financial services, education and real estate. There are in existence funds that are heavily investing in such sectors. The entrepreneurs have to just have focus and identify the funds providing money in their domains. Again, you may contact your industry association, the VC industry association, the various Chambers of commerce and various consultants providing these specialised services.

Is profit always shared on ownership percentage basis or can royalty be added to it too
In early stage transactions the sharing

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is only on ownership basis as there is no or insufficient cash for the venture to be burdened with cash outflow related to royalty or any other regular payment to the investor. However, in later stage ventures, with established cash flows, the investor may negotiate with the entrepreneur any other payment such as royalty. However, one must remember that IRR% is first negotiated and if there is a regular royalty being paid to the investor then his equity % will stand reduced to equate to the negotiated IRR%.

If an entrepreneur does not want to go public but to be acquired by an established corporation, how can he go about it

The formal process of looking for someone to buy you out is this :

- . Appoint advisers, usually a firm of investment bankers
- . Make a "Information Memorandum" with the help of your advisers. This document will detail information about your business, its management; its current status, its achievements and its growth potential etc
- . Make a list of potential buyers ; these could be your customers looking for backward integration or your peers and competitors looking to consolidate in the marketplace or companies with excess cash wishing to diversify into your markets or an international companies wishing to have a quick entry in the country etc.
- . The advisers then contact the potential buyers and negotiate, structure and conclude the deal for your over a given period of time.

- Lawz Bureau ■