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Why raise Venture Capital?

In 2002 UK private equity (or Venture Capital) firms invested over £5.4bn in more than 1,450 companies, continuing a trend which has seen £55bn invested in nearly 25,000 companies since 1983. [Source British Venture Capital Association (BVCA) – 2002 Report on Investment Activity]. In addition, in a recent BVCA survey, private equity backed companies recorded average sales growth of 30% pa, and 83% of such businesses could not have existed or grown as fast without private equity investment.

As a successful business owner you may consider raising Venture Capital to expand your scale of operation, to buy another business or to realise part of your business value. As an experienced management team you may be seeking Venture Capital to fund a Management Buy Out (MBO) or a Management Buy In (MBI). In each case you will be confident of your business strategy which will deliver significant benefits to all shareholders but probably be outside the conventional lending criteria of the high street banks.

What is a Venture Capital fund looking for?
Venture Capital fund managers are looking to back successful businesses with a Management Team they believe in, a business model they can understand, operating in an attractive market sector and critically offering good growth prospects. The Venture Capital fund will seek substantial capital growth on their investment over a typical investment period of between 3 and 5 years. The Venture Capital fund may also seek an annual management or non-exec director fee.

What are the likely exits available to the Venture Capital (VC) funds?
Any owner or management team seeking Venture Capital must always consider how the fund will achieve its own exit from the investment, and in the current market this is likely to be a significant factor in the initial investment decision by the VC. The management team should carefully consider all potential exit routes, ranging from a trade sale through to a public floatation, and in any presentation to VCs will need to demonstrate that all these options have been carefully considered.

What is the VC investment process?
The VC investment process usually takes between 3 and 6 months and typically involves the following stages:

- Preparation – presentation and financial business plan
- Roadshow presentations to potential VC backers
- Shortlist of Venture Capital funds
- Negotiation of Heads of Terms agreement – for investment contract including Valuation
- Professional advisor scrutiny (due diligence)
- Completion of investment contract
- Receipt of funds

How do you choose the right VC funder?
The choice of a VC funding partner is not just about receiving a cash injection into the business. The VC provider will typically require Board representation and specific rights in certain given scenarios to protect their position. The VC will look to be involved in all strategic decisions as well as inputting to the annual business plan and to receive the monthly management accounts and information. The VC will become very ‘hands on’ if the business does not achieve its forecasts, and where problems do arise the personal chemistry between the business owner and VC fund manager will be critical. ***There are 162 Venture Capital funds*** listed by the British Venture Capital Association, each with their own investment criteria in respect of market sector, funding stage, investment size and geographical location. Even private equity firms which may appear to be suitable may not have funds available. Each VC fund will typically receive about 40 funding applications a week and complete between 3 and 6 investments each year, making the ***chance of success as low as 1 in 700***. These odds will be significantly shortened by careful preparation and by using the experience and extensive VC contacts of **vfdnet**.

How does a VC value a business?
Each VC will have their own valuation technique, however it is likely that the initial investment value will be driven by the projected capital return on their investment. The VC will arrive at its own view of the likely increase in value of the business, based on their scrutiny of the strategy and the financial business plan (3 – 5 years out), involving best, worst and middle case scenarios.

What are the typical costs involved and how can these be controlled?
The costs of the VC investment include the professional advisors (Lawyer and Accountants) reviewing the business, as well as Legal fees for both the VC funder and the Company and the VC arrangement fee. Total costs are therefore between 6% and 10% for a £2m plus investment, with these being incurred from the due diligence stage onwards. The risk of these costs will normally be born by the Company, hence it is critical that there is a ‘meeting of minds’ and comprehensive Heads of Agreement. Clearly the risk of substantial abortive costs can be minimised by the use of an experienced Finance Director such as provided by **vfdnet**. In addition the investment costs can be managed by the informed control of the due diligence scope and interaction between professional advisors. Anecdotal evidence suggests that ***“The lack of an experienced Finance Director will halve the chance of doing a deal, and even if the deal comes off the costs and time frame are likely to double.”***

How can the risk of an 11th hour deal breaker be avoided?
The risks of last minute problems in the investment process need to be reduced as much as possible through careful preparation prior to opening discussions with a potential VC backer. **vfdnet** is experienced in

understanding the typical requirements of VC providers, enabling the business to present its strengths and weaknesses at an early stage, hence helping to avoid unpleasant last minute surprises. In addition the business must ensure that throughout the investment period (3 to 6 months) that it continues to meet or exceed its performance targets or forecasts. This is best achieved by the investment process being project managed by **vfdnet** allowing the business owner or manager to focus on driving and developing the business.

Disclaimer

This factsheet has been prepared by **vfdnet** based on extensive experience. However every deal is different and no reliance should be placed on this advice. **vfdnet** does not accept any liability to readers of this factsheet. Owners or management teams wishing to attract Venture Capital must seek professional advice such as that offered by **vfdnet** Ltd.