VENTURE CAPITAL 2

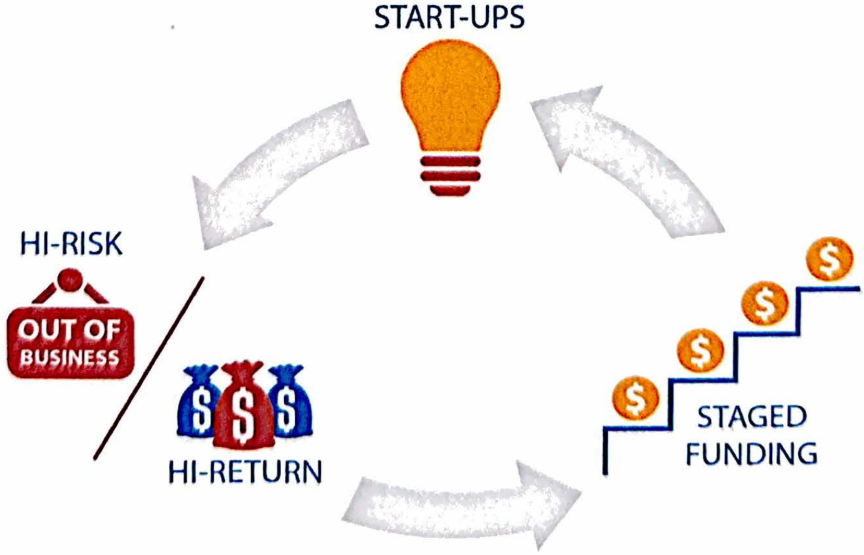
From iconic brands, such as Google, Facebook, Uber and Alibaba to blockbuster biotech or renewable energy companies, venture capital (VC) has funded and nurtured some of the most influential companies in today's global economy. Along with these runaway successes, however, VC has also been center-stage for some of the more spectacular flameouts in modern finance, from the bursting of the tech-bubble at the turn of the millennium to the storybook valuations of numerous billion-dollar "unicorns"[1] a decade and a half later. This "hit-or-miss," "all-or-nothing" character of venture investing drives both the mystique of the industry and on-the-ground decision-making bias of VC investors.

This chapter explores the dynamics of the VC industry, starting with the defining characteristics of VC investing and the unique elements differentiating it from growth equity and buyouts.[2] We then turn to the other side of the table and briefly touch on fundraising for early-stage firms and start-ups; first-time entrepreneurs preparing to raise funds will find this chapter useful to understand the dynamics inside a VC firm before entering into discussions with one of its partners.

VENTURE CAPITAL DEFINED

VC funds are minority investors betting on the future growth of early-stage companies—defined as pre-profit, often pre-revenue and at times even pre-product start-ups. Despite the lack of a controlling stake, VCs are among the most active investors in the PE industry and use their capital, experience, knowledge and personal networks to nurture and grow young companies. VCs may invest in specific verticals, technologies, and geographies, and often specialize in a distinct substage of investment, referred to as early-stage, mid-stage or late-stage VC funding. While every VC firm is unique, a few defining attributes apply to most, as detailed in Exhibit 2.1.

Exhibit 2.1 Defining Characteristics of Venture Capital



1. "Unicorns" is an industry term for private companies with valuations above US$1 billion.
2. Please refer to Chapter 3 Growth Equity and Chapter 4 Buyouts for in-depth discussions.

START-UP COMPANIES: VC funds invest in start-ups and guide them through their early years of development, as they seek to establish defensible market positions in rapidly expanding industries by disrupting existing products and services through innovation. A start-up can range from an early-stage company with a limited operating history—i.e., an entrepreneur, an idea, and a PowerPoint presentation—to a late-stage company with a fast-growing business. As a result, the capital requirements of start-ups vary widely, from a few thousand dollars to facilitate the development of an early prototype to significant injections in the tens or sometimes hundreds of millions of dollars to drive revenue growth at companies with billion dollar valuations.

Start-ups all face one common challenge: reaching the next stage of development and raising fresh capital before running out of cash. A negative monthly cash flow and high burn rates are the order of the day at a start-up, and regular injections of capital are needed to maintain and expand operations. This requires a management team that can carefully balance aggressive growth targets with the reality of a company at the pre-revenue stage. As such, venture capitalists carefully assess the founding team as much as the business concept of a start-up and prefer backing experienced entrepreneurs. A VC firm's knowledge in a given vertical and its ability to add value through mentorship and active engagement can be critical elements of success for the start-up; for entrepreneurs, this expertise is a differentiating factor when choosing from a group of potential investors.

HIGH RETURNS AND HIGH RISKS: Research shows that on average two-thirds of the investments made by a VC fund lose money and one-third of VC-backed companies eventually fail. For VC funds to achieve their fund-level target return,[3] low-performing and failed investments must be offset by at least one or two highly successful—and highly visible—investee companies that generate a return of 10 times (10×), 100 times (100×) or more on the VC's invested capital. These "home runs" often return 100% or more of a single fund's committed capital and determine the success of an entire fund. This tail-heavy, feast-or-famine return profile underscores both the riskiness of VC investing and the significant risk appetite required from limited partners (LPs) to include VC funds in their private equity (PE) programs.[4]

The high risk of VC investments has a distinct impact on venture capitalists' investment decisions and their portfolio management style. Reflecting on the risk of failure, VCs require high deal-level target returns when exploring the next investment: a 40–80% target internal rate of return is not unusual and feeds directly into the valuation and equity stake underpinning the investment.[5] VC funds typically invest in more companies per fund than growth or buyout funds to increase the chances of a "home run" and to diversify their risk. The larger number of portfolio companies and the high rate of failure require VCs to make tough decisions and (potentially) write off underperforming investments quickly to focus their time and resources on the most promising companies. Entrepreneurs are well advised to be aware of these dynamics before presenting their business plans to a VC fund.

The risk–return dynamics of VC investing are a concern for its investors. While limited partners remain intrigued by the industry's well-publicized winners and

3. Chapter 19 Performance Reporting explains the dynamics of fund-level returns in greater detail.

4. Chapter 18 LP Portfolio Management discusses the decision-making process when allocating to PE in detail.

5. Please refer to Chapter 7 Target Valuation for a worked-out example on VC valuation.

its fabled returns, a landmark report by the Kauffman Foundation published in 2012[6] raised doubts on the return contributions from venture to an institutional portfolio, implying that the risks may outweigh the strategy's return and that LPs make decisions based on "seductive narratives like vintage year and quartile performance." It suggested that the LP investment process may be broken, and that LPs have themselves "created the conditions for the chronic misallocation of capital."

FUNDING IN STAGES: VC funding is raised via discrete rounds of investments. Each round will fund a start-up's operations for a specific period of time and enable the company to reach a predefined operating milestone.

Deploying funding in stages allows a VC fund to assess the progress of the company against milestones and allocate follow-on capital to the best performing companies in its portfolio. By spreading its capital out, the fund can invest in more companies thereby "buying an option" in more potential blockbusters. It also enables individual VC firms to specialize in a specific phase of company development, from early stage to late stage, and offer stage-appropriate expertise.

Successful VC-backed companies are typically funded through progressively larger rounds of preferred equity.[7] Each subsequent VC investor will look for positive momentum (as proof of the company's value proposition) and for signs of successful execution. The preferred shareholding structure establishes a hierarchy of claims on future proceeds in the event of an exit...or liquidation.

In each financing round, entrepreneurs and existing investors give up a share of their equity in exchange for additional capital, with the percentage largely depending on the amount to be raised and the new investor's return expectations, which take into account the company's riskiness and its forecasted value at exit.

In the case of a successful start-up, raising capital step by step allows an entrepreneur to benefit from progressively higher valuations and give up less equity per dollar raised as the business matures.

START-UP DEVELOPMENT
VENTURE CAPITAL TARGETS

A start-up will navigate several stages of development before reaching profitability and a steady state of operation. Along the way, the company draws capital and expertise from different types of investors in the VC ecosystem. While each start-up follows a unique path, three distinct stages of development can be defined: proof-of-concept, commercialization, and scaling up. It should be noted that the vast majority of start-ups will never reach this final phase of accelerated growth.

6. Kauffman Foundation; 'We have met the enemy – and he is us'; (2012).
7. Please refer to Chapter 9 Deal Structuring and to the Glossary in the back of the book for more details on the different share classes used in VC.

Exhibit 2.2 Start-up Development and Funding

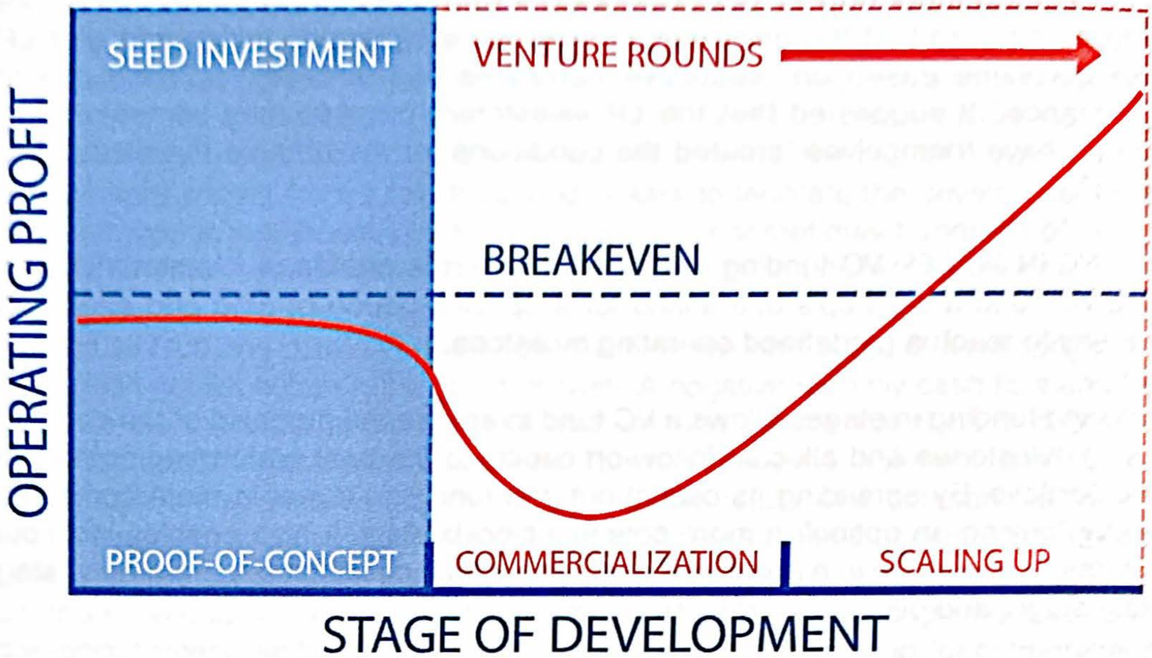


Exhibit 2.2 highlights the type of investment required at the respective stage to successfully grow and scale a business.

PROOF-OF-CONCEPT: Companies at this stage have little or no track record and only a concept of a product, technology or service. Small amounts of funding are required to conduct product feasibility studies, define relevant markets, formulate a business plan, and develop a prototype. Once the product or service is developed, engaging with and securing a user base to show that the idea has the potential to translate into a successful long-term business is a critical step to achieving proof-of-concept and attracting further funding; it also shows that the founding team has the ability to execute. During the proof-of-concept stage, company development is funded by seed investment often provided by the entrepreneur, friends and family, business angels or seed-stage VC investors.

COMMERCIALIZATION: After a company's value proposition has been validated by a group of core customers the focus shifts to translating the idea into an operating business and growing the top line. Companies at this stage of development focus on refining the product or service offering, expanding the sales and marketing functions, filling out missing capabilities in the core management team, and targeting large-scale customer acquisitions. They start to generate revenue but are far from cash flow positive; building up operations naturally increases operating cost, which combined with the initial working capital and capital expenditure needed in a growing business results in a high burn rate. In many cases, funding raised from VCs to drive commercialization are the first injections of institutional capital.

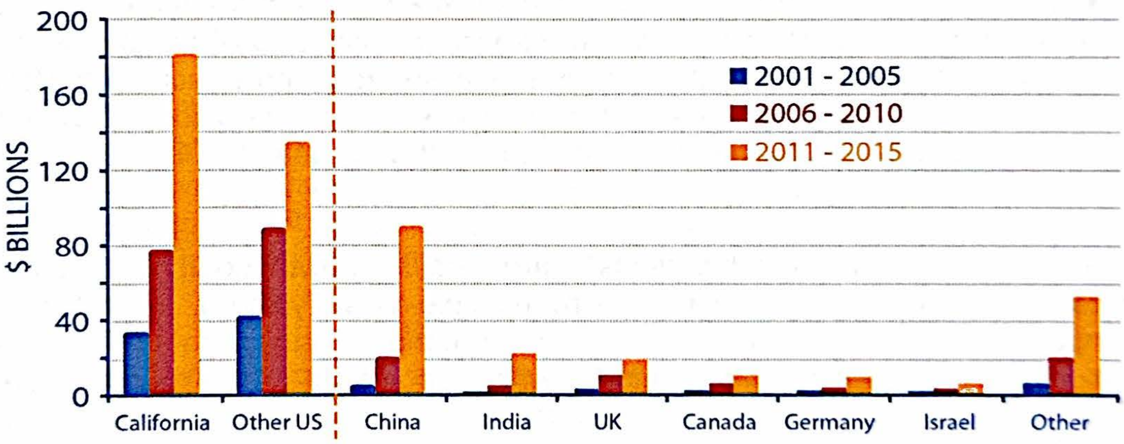
SCALING UP: This stage is all about expansion and market penetration. By now, companies are typically growing exponentially and are on their way to profit or even operating cash flow breakeven. However, profits generated from operations are reinvested in the company and may need to be supplemented by additional VC funding to meet market demand. In addition to rapidly growing a start-up's core offering, funding is needed to expand product and service offerings to differentiate the company from competitors and to balance product-specific sales fluctuations. Mid- and late-stage VC investors, along with growth equity funds, are the main investors at this stage.

Box 2.1

VENTURE CAPITAL REMAINS US FOCUSED

Geographic location is crucial for VC as an asset class, given the importance of networks when growing early-stage companies. The deepest, most "developed" VC ecosystems can be found in the United States—Silicon Valley in particular—but other geographies such as China, India, Europe and Israel have seen active clusters emerging. Successful VC communities not only have complementary funding vehicles that support early-stage growth with angel investors, crowdfunding platforms, corporate venture capital, and government funding vehicles, but provide ready access to follow-on rounds and serve as magnets to attract the talent needed to scale quickly. Exhibit 2.3 shows the total amount of venture capital invested by geography over three consecutive five-year periods starting in 2001.

Exhibit 2.3 Global VC Investment by Geography



Source: Preqin

THE VENTURE CAPITAL INVESTMENT PROCESS
UNIQUE ELEMENTS

The immaturity of companies targeted by VC funds introduces a range of unique elements into the VC investment process. Identifying future unicorns is an art, while structuring an investment to mitigate the investment risk involved is rather a science. We explore these elements in the section that follows.

DEAL SOURCING: Deal sourcing in venture is closely related to the reputation of the VC firm and the partners involved; established and well-known firms will have a regular stream of calls, pitch books and ideas flowing their way. Partners will also attend the various demo days of accelerators or industry conferences to scout for potential targets. When screening investment opportunities, VC investors' gut-feel about a start-up and its team is a crucial component and often drives the decision to pursue a specific deal. Nevertheless, questions revolving around the entrepreneur, the team's experience and motivation and the uniqueness, defensibility and scalability of the business model tend to feature prominently in those early discussions.

VALUATION: Determining the valuation of an early-stage investment is a highly subjective process.[8] While a company's current operations and future cash flow forecasts are a key component in establishing its value, so too are the robustness of its team, the strength of the business model and the size of the addressable market. As early-stage companies are typically unprofitable, investors employ multiples of revenue and other key performance indicators to arrive at a "post-money valuation,"[9] which also determines the equity split following an investment round. The expected number of future fundraising rounds will also impact valuation, as they will lead to dilution of the equity stakes for both entrepreneurs and past VC investors.

HANDS-ON SUPPORT: Many successful entrepreneurs join VC firms to become early-stage investors themselves. The best VC funds will therefore draw on a strong bench of partners, who not only have an intimate understanding of the challenges faced by their portfolio companies, but also come with their own hard-earned experience to give credible advice. Venture partners mentor management teams, help develop the marketability of a start-up's product or service, identify and fill holes in its team, and facilitate the development of business processes required to scale up. Venture capitalists are also a key resource for start-ups when raising new rounds of capital, both in shaping the fundraising message and identifying potential investors in their network.

SYNDICATED DEALS: While "club deals"[10] are rare in growth equity and buyouts, venture rounds are quite often funded by multiple VCs. Typically, a lead investor will engage with the entrepreneur and founder, conduct due diligence, arrive at a valuation, negotiate terms and commit to funding a portion of the round. Once the lead investor establishes the commercial terms, a group of "followers" will join the round.[11] The lead investor will typically invest the largest amount of capital in a round, and will be the one to engage with the start-up post-investment. This type of club investment allows VC funds to diversify their risk and gain access to a wider range of investment opportunities.

8. See Chapter 7 Target Valuation for further details on VC valuation techniques and a worked example.
9. Subtracting invested capital from a post-money valuation establishes the "pre-money" valuation.
10. Club deals are PE investments made by two or three PE funds; they were particularly fashionable for large buyouts during the years leading up to the global financial crisis in 2008.
11. Existing investors often participate in subsequent rounds to maintain their ownership percentage in the business and to signal both their continued support and overall health of the business.

Box 2.2

VENTURE CAPITAL TERM SHEETS

Term sheets serve as the main negotiation tool in VC fundraising and, once agreed upon, set out the rights and obligations of investors in a round's newly created preferred share class. The provisions of the term sheet are then formalized in a share subscription agreement, and in an amended or redrafted shareholders' agreement plus articles of association of the target company.[12]

First-time entrepreneurs are well advised to carefully review the terms under negotiation before signing a term sheet, especially as earlier investment rounds set the ground rules for future fundraising, potentially complicating that process. Guidance from an experienced entrepreneur or a friendly venture partner can help overcome the knowledge gap between start-up founders and seasoned VC investors.

The provisions in a term sheet can be divided into economic terms and control terms.

Economic Terms

Economic terms set out the price of shares, the investment amount and the rights and obligations of the newly created preferred share class.

SHARE PRICE AND VALUATION: The first part of the term sheet defines the offer made by the VC in a given round, including the valuation of the company (pre-money), amount of invested capital, number of shares to be issued and price per share. The type of securities to be issued for this round, for example "series B preferred stock," is clearly defined.

LIQUIDATION PREFERENCE: This clause gives preferred shareholders preference over any distributions received in case of a defined liquidity event, be it an acquisition by a strategic buyer, a merger, an initial public offering (IPO) or the liquidation of the company. Preferred shareholders receive their invested capital back first (and at times a multiple thereof) before any distributions are made to common shareholders. In the case of "participating preferred shares," preferred shareholders will share the balance of the exit proceeds after the liquidation preference has been satisfied pro rata with common shareholders, on an as-converted basis.

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP): An ESOP sets aside a percentage of shares in the start-up that can be granted to non-founding employees in the form of stock options to attract, reward and retain first-rate talent. A term sheet will stipulate a vesting schedule for these options—a clearly defined timeline for the options to convert into shares—it will also allow the board to force a forfeit of these options under certain circumstances. In addition, the term sheet will

12. More information on deal documentation can be found in Chapter 10.

clearly define the number of shares reserved for the ESOP, and the strike price, timing and expiration date of the options. Given that ESOPs are a source of dilution for all existing shareholders, both the size and timing of an ESOP need to be carefully considered when planning to raise external funding. Many VCs will require an ESOP of 20% of the outstanding shares before closing a round.

ANTI-DILUTION: This provision protects earlier investors in the event of a "down-round" (i.e., a round of funding raised at a lower valuation than the previous round). With anti-dilution provision in place, the conversion price of the preferred share class will be adjusted downwards to the level of the new valuation; as a result, shareholders who invested at a higher valuation in earlier rounds will receive additional shares to maintain their ownership stake in the start-up and avoid dilution.

Common shareholders do not have such protective provisions and will be diluted. Anti-dilution clauses come in various degrees of severity, and founders are well advised to be aware of their impact.

CONVERSION RIGHTS: Preferred shareholders may convert at any time to common stock at their sole discretion; the conversion rate—at the outset usually 1:1 of preferred to common—is clearly defined in this clause. Investors will generally be converted from preferred to common shareholders at clearly defined trigger events, typically just prior to a sale or merger. In the event of an IPO, conversion of the preferred stock is usually automatic.

Control Terms

Despite being minority shareholders, venture investors typically request certain control rights to monitor the development of the start-up and influence important decisions.

BOARD REPRESENTATION: VCs will expect to be represented on the board of directors of the investee company. Whether it is one or two board seats with the respective votes or merely an "observer right" depends very much on the dynamics during negotiations. (An in-demand company courted by several venture investors may be able to negotiate lesser representation as a condition of investment.) Founders are well advised to have a clear board plan—defining the number of seats available to venture investors and those assigned to independent directors—before raising their first external round.

PROTECTIVE PROVISIONS: Venture investors usually receive voting rights on an "as-converted" basis equal to that of common shareholders. In addition certain actions may require the consent of the VC or approval of at least 50% of the preferred shareholders. These actions may include alterations of the certificate of incorporation, which would adversely change the rights, privileges and powers of the preferred shareholder, or approval of any sale of assets or mergers, or any changes to the number of preferred shares issued. Veto rights may apply with regards to specific events such as an IPO, new equity financing or increase in the ESOP and can extend to governance matters such as the right to approve the appointment of senior executives.

DRAG-ALONG/TAG-ALONG PROVISIONS: A drag-along provision gives the majority shareholder the right to force other shareholders to sell their shares in a third-party transaction. This provision enables the majority shareholder to sell out and achieve a clean break at exit. A tag-along provision provides minority shareholders with the right to sell their shares in conjunction with the majority shareholder in a third-party transaction, participating in any liquidity event pro rata.

TRANSFER RIGHTS AND NEW ISSUE RESTRICTIONS: The term sheet typically includes preemptive rights for share transfers and new issues, stating that the existing shareholders shall be offered any shares first in the case of an existing shareholder wanting to sell out.

INFORMATION RIGHTS: This provision clearly states which operational and financial information must be provided to preferred shareholders and when; the requested information usually includes at a minimum unaudited monthly and annual financial statements.

FOR THE FIRST-TIME ENTREPRENEUR
RAISING MONEY FROM VCs

First-time entrepreneurs often think that all VCs invest in great ideas and innovative companies across industries and at any time in their lifecycle. This is far from the truth; every venture firm has a very specific focus on verticals, technologies, geographies, and most important investment amounts or funding rounds. They are likely to pass on a great idea if it doesn't fit their focus or sweet spot; thus, entrepreneurs should carefully select those funds worthwhile approaching. Due diligence is crucial for both parties, and entrepreneurs should ask for references from past investee companies before selecting a VC fund. Speaking with those founders will give them a clear idea of the day-to-day reality of working with and accepting funding from the respective VC.

Beyond focusing on how to fund their start-up, founders also need to decide on the timing and size of the various rounds. Entrepreneurs must balance the need for raising capital from external investors with the requirement of giving up equity in the process.

Consider the hypothetical financing of a start-up shown in Exhibit 2.4 in which an entrepreneur raises four rounds of external funding, at progressively higher valuations, over a three-and-a-half-year period.

The above example brings up a number of issues for entrepreneurs to consider. First, as the valuation of the start-up increases, the entrepreneur is able to raise larger sums of capital in exchange for lower equity stakes in the company. The burn rate allows an entrepreneur to plan the amount of funding needed to achieve the next development milestone and to optimize the time between rounds. Finally, the entrepreneur's

Exhibit 2.4 Fundraising Considerations for Entrepreneurs

CHARACTERISTICS OF ROUNDS				CONSIDERATIONS FOR ENTREPRENEURS			
ROUND	POST-MONEY VALUATION (USD)	CAPITAL RAISED (USD)	EQUITY STAKE OF THE ROUND	BURN RATE (USD/MONTH)	FUNDING (MONTHS)	ENTREPRENEUR'S EQUITY STAKE	USD PER 1% EQUITY STAKE
SEED	2m	150k	7.5%	15k	10	92.5%	20k
SERIES A	12m	2m	16.7%	150k	13	77.1%	120k
SERIES B	25m	3m	12.0%	300k	10	67.8%	250k
SERIES C	75m	6m	8.0%	CASH FLOW POSITIVE	N/A	62.4%	750k

declining equity stake following each round of investment shows clearly the impact of dilution when raising external funding.[13]

Some founders question the merit of giving up substantial amounts of equity in return for venture funding. They often consider an alternative: growing the company organically without external funding by conservatively managing the early stage with their own capital and trying to quickly grow revenue. With the rise of the "lean start-up"[14] model (and the availability of low-cost funding sources, i.e., crowd funding), this alternative path has become a realistic option for certain business models.[15]

What Is a Venture Capitalist?

By Brad Feld, Managing Director, Foundry Group

One of the biggest mistakes entrepreneurs make is to assume that all VCs are the same. Over and over again I hear questions like "how do I raise venture capital?," or "how do I approach a VC?," or "what does a VC want to see in the first meeting?," or "now that I'm going to pitch a VC, what should I show them?" The answer—generically—is "I have no idea—WHO are you meeting with?" This usually gets the person's attention, at least a little.

There is no single archetype for a VC, or for a VC firm. Instead, each VC, and firm, is different. Consider the game Dungeons & Dragons (or, if you don't know D&D, contemplate one of the *Lord of the Rings* movies.) Some VCs are elves, some are orcs, others are wizards, or mages, or trolls. Each character has a different set of skills, weapons, money, and experience points, which change, increase, and evolve over time.

13. Note that not only the entrepreneur gets diluted by subsequent financing rounds but also previous investors.
14. Reis, E. (2008).
15. Wasserman, Nazeeri, and Anderson (2012).

There are dozens of archetypes of VCs. Each individual VC has a different set of skills. Their styles, beliefs, and personalities vary widely. Their approaches and ideas are influenced by the individual's historical experiences. Behavior—both in the moment and over time—varies widely.

A VC firm is a collection of individual VCs with differing archetypes. Firms vary widely in shapes and sizes. My firm, Foundry Group, consists of equal partners and no additional professionals. Other firms have many layers of investment professionals, including partners, principals, associates, analysts, entrepreneurs-in-residence, and operating partners. Some VC firms are small—there are even single partner firms—while others have dozens of investment partners. Some firms are operator heavy (partners with operating backgrounds), others are financial heavy (MBAs and bankers), while others are a mix.

The entry points of VC firms vary widely. Some VCs invest early. Others invest late. You have firms that label themselves as pre-seed, while others call themselves seed and early-stage investors. Other firms wait until a company is in the market with a product that is starting to scale. Other VCs, often called growth investors, prefer to engage when a company is clearly succeeding and is now scaling. Still others like to be the last round investor prior to an IPO and are consequently called late-stage investors. And yes, there are firms that cut across multiples of these categories.

The categories that firms invest in, and how they describe them, also vary widely. Foundry Group uses a thematic approach that we pioneered in 2007. Other firms use a sector approach, which has been around for many years. Some firms invest only in software and Internet-related companies, while others invest in clean tech or life sciences. Once again, the configuration of the approaches can be combined in many different, and occasionally unique, ways within a VC firm.

Once you realize you are dealing with many different archetypes of individual VCs with widely varying skills and experience levels, and the configuration of these archetypes into a firm is similar to how characters combine and interact in a battle in D&D, you realize that there is no generic VC or VC firm.

As an entrepreneur, you should do your research on the person and firm you are approaching or talking to. It's easy to do today using the web and the power of all the network connections between people. If you understand who you are talking to, what motivates them, and what they care about, you can both target them better as well as have a much more effective conversation with them.

Box 2.3

BEYOND VENTURE CAPITAL

ALTERNATIVE PATHS TO FUNDING

VC funds are not the only source of capital for start-ups. A variety of players provide capital and expertise to these businesses, each with a different set of value propositions. Early-stage companies may work with several of these players and VC investors to get their business off to a successful start.

BUSINESS ANGELS: Angel investors are affluent individuals who invest their personal funds at a very early or "idea" stage of development. They are often experienced professionals from the industry in which the start-up operates and may be closely involved in shaping and developing the company's first business plan.[16]

START-UP INCUBATORS AND ACCELERATORS: These vehicles help start-ups develop and grow their businesses.[17] Particularly first-time entrepreneurs may find the structure, support and mentorship offered by these programs attractive. Admittance into the best programs is highly competitive, with some accepting no more than 10 candidates per 1,000 applicants. Incubators and accelerators are often mentioned in the same vein—but there are differences:

- Incubators: Incubators guide entrepreneurs through the first steps of idea generation and help them develop a business model on the basis of that idea. These programs have no set duration and typically provide office or co-working space, administrative support and networking opportunities to entrepreneurs in exchange for rent or—in some instances—an equity stake in the start-up. Incubators are often sponsored by a government entity or university and generally do not provide capital.
- Accelerators: Accelerators offer short, intense courses and access to industry mentors for entrepreneurs that have a proven concept and are ready to consider raising VC financing. Accelerators admit start-ups in cohorts and each program culminates in a "demo day" when participants pitch their investment idea to a group of potential investors. Most accelerators are privately owned and often provide a small amount of seed funding in exchange for an equity stake in a participating company.

CORPORATE VENTURE CAPITAL: Corporations have emerged as a fast-growing source of funding for start-ups and compete head-on with independent VC funds. Corporate venture capital (CVC) is created by business entities not usually engaged in financing and investing; INTEL Capital, Unilever Ventures and Google Ventures are among the most prominent. These investors often

16. Please refer to the links and references at the end of this chapter for additional material on angel investors.
17. Readers will find a list of incubators and accelerators on our website (www.masteringprivateequity.com).

leverage the expertise of their parent organizations and invest in industries where the parent is active. The main incentive to start a CVC program is to gain early access to disruptive innovations that may help (or hinder) the strategic goals of the parent company, with financial returns often a secondary consideration.

CLOSING

Fast-growing companies, incubated around a creative idea on how to solve a problem or explore an opportunity, are not a coincidence. Big successes require a meeting of minds between a skilled founding team and investors providing funding and mentorship to offer advice if and when needed. This chapter offered perspectives from both sides of the table, considering investors and entrepreneurs alike. The magic in the form of big disruptions and extraordinary returns happens when talented entrepreneurs meet the best-suited venture partners.

KEY LEARNING POINTS

- **VC funds invest minority stakes in start-ups seeking to develop defensible, fast-growing businesses by disrupting existing products and services through innovation.**
- **VC investing is characterized by tail-end returns, with one or two home runs typically offsetting the failed investments in a successful fund.**
- **VC funds invest in specific industry verticals and stages of company development, from seed to early to late stage.**
- **Entrepreneurs must be aware of the trade-offs between accepting external funding and giving up equity when raising capital from VC funds.**
- **Understanding the future impact of the terms negotiated during fundraising is key, especially for first-time entrepreneurs.**

RELEVANT CASE STUDIES

from *Private Equity in Action—Case Studies from Developed and Emerging Markets*

Case #5: Sula Vineyards: Indian Wine?—Ce n'est pas possible!

Case #6: Adara Venture Partners: Building a Venture Capital Firm

Case #7: Siraj Capital: Investing in SMEs in the Middle East

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For detailed discussion on term sheets please refer to:

Feld, Brad, Venture Deals and his related blog http://www.askthevc.com/ .

Further reading on angel investing, incubators and accelerators:

Accelerators vs. Incubators, http://www.techrepublic.com/article/accelerators-vs-incubators-what-startups-need-to-know/.

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