Venture Capital Financing for Startups

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Abstract: ***Venture capital financings are not easy to get seize or close. Entrepreneurs will be superior prepared to gain venture capital financing if they appreciate the process, the expected deal terms, and the possible issues that will arise. In this case study, we present an outline of venture capital financings. Startups looking for financing frequently turn to venture capital (VC) firms. These firms can offer capital; strategic assistance; introductions to latent customers, partners, and employees; and much more. To understand the process of obtaining venture financing, it is important to know those venture capitalists usually focus their investment efforts using one or more of the following: 1) Specific industry sectors (software, digital media, semiconductor, mobile, SAAS, biotech, mobile devices, etc.) 2) Stage of a company (early-stage seed or Series A rounds, or later stage rounds with companies that have achieved meaningful revenues and traction).***

Keywords: Venture Capital, Finance

1. Case Study

Harvard Business School professor Georges Doriot is generally considered the "Father of Venture Capital". He started the American Research and Development Corporation (ARD) in 1946 and raised a $3.5 million finance to invest in companies that commercialized technologies developed during WWII.3 ARDC's first investment was in an exceptionally company that had ambitions to use x-ray technology for cancer treatment The $200, 000 that Doriot invested **was** $1.8 million when the firm went public in 1955. Venture capital is a subset of private equity (PE). While the roots of PE may be traced back to the 19th century, working capital only developed as an industry after the Second World War.

Venture capital (VC) is a kind of private equity and a sort of financing that investors provide to startup companies and little businesses that are believed to own long-term growth potential. Venture capital generally comes from well-off investors, investment banks, and other financial institutions. However, it doesn't always take a monetary form; it may be provided within the sort of technical or managerial expertise. Venture capital is typically allocated to small companies with exceptional growth potential, or to companies that have grown quickly and appeared graceful to continue to expand. Though it is often risky for investors who put up funds, the potential for above-average returns is a beautiful payoff. For new companies or ventures that have a limited operating history (under two years), risk capital funding is increasingly becoming a well-liked – even essential – source for raising capital, especially if they lack access to capital markets, bank loans, or other debt instruments.

Though it can be risky for investors who put up funds, the potential for above-average returns is an attractive payoff. For new companies or ventures that have a limited operating history (under two years), venture capital funding is increasingly becoming a popular – even essential – source for raising capital, especially if they lack access to capital markets, bank loans, or other debt instruments.

Venture capital financing is funding provided to companies and entrepreneurs. It can be provided at different stages of their evolution, although it often involves early and seed round funding.

Venture capital funds manage pooled investments in high-growth opportunities in startups and other early-stage firms and are typically only open to accredited investors.

It has evolved from a niche activity at the end of the Second World War into a sophisticated industry with multiple players that play an important role in spurring innovation.

In a venture capital deal, large ownership chunks of a company are created and sold to a few investors through independent limited partnerships that are established by venture capital firms. Sometimes these partnerships consist of a pool of several similar enterprises. One important difference between venture capital and other private equity deals, however, is that venture capital tends to focus on emerging companies seeking substantial funds for the first time, while private equity tends to fund larger, more established companies that are seeking an equity infusion or a chance for company founders to transfer some of their ownership stakes.

Venture capital is a fund sourced from wealthy people, big companies, and pension funds that are invested into various businesses so that they can grow and make a profit and provide returns in multiple terms of the initial investment. The aim of the investors here is to support the startups to grow, upscale, and reach a point of IPO offering, acquisition by bigger companies, or buying of smaller ones so that they can make a successful exit, cashing out a good amount of return from the VC money invested. The motto of the entrepreneur, on the other hand, is to sustain stable and fruitful growth, ensuring profits so that the investors don't make a quick exit.

There can be individual investors who can put their money into the business or a venture capital company that invests the total fund accumulated into a portfolio of several businesses. Startups have the highest probability to fail due to the inexperience of founders and the negligible track record of the startup ecosystem in India. Thus, often individual investors are not convinced and stay away from funding startups. Here, funding deals are mostly done by

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venture capital firms that balance losses from a startup's failure with returns from other deals in the investment portfolio.

Stages in Venture Capital Financing

There are five stages in venture capital financing, and they include:

1) **1 Seed Stage**
   At the seed stage, the company is only an idea for a product or service, and the entrepreneur must convince the venture capitalist that their idea is a viable investment opportunity. If the business shows growth potential, the investor will provide funding to finance early product or service development, market research, business plan development, and setting up a management team. Seed-stage venture capitalists participate in other investment rounds alongside other investors.
2) **2 Startup Stage**
   The startup stage requires a significant cash infusion to help in advertising and marketing new products or services to new customers. At this stage, the company has completed market research, has a business plan on site, and has a prototype of its products to indicate to investors. The company brings in other investors at this stage to provide with additional financing.
3) **3 First Stage**
   The company is now ready to go into actual manufacturing and sales, and this requires a higher amount of capital than in the previous stages. Most first-stage businesses are generally young and have a commercially-viable product or service.
4) **4 Expansion Stage**
   The business has already started selling its products or services and needs additional capital to support the demand. It requires this funding to support market expansion or start another line of business. The funding can also be used for product improvement and plant expansion.
5) **5 Bridge Stage**
   The bridge stage represents the transition to a public company. The business has reached maturity, and it requires financing to support acquisitions, mergers, and IPOs. The venture capitalist can exit the company at this stage, sell off his shares, and earn a huge return on his investments in the company. The exit of the venture capitalist allows other investors to come in, hoping to gain from the IPO.

Structure of a Venture Capital Firm

A venture capital firm is structured in the form of a partnership, where the venture capital firm serves as the general partners and the investors as the limited partners. The limited partners may include insurance companies, wealthy persons, pension funds, university endowment funds, and foundations. All the partners have an ownership stake in the venture firm fund, but the general managers serve as the managers and investment advisors to the companies invested.

The profits from the investment of the venture capital firm are split between the general partners and limited partners. The general partners, who are also the private equity fund managers, get 20% of the profits as a performance incentive. They also receive an annual management fee of up to 2% of the capital invested. The limited partners who invested in the fund share 80% with the general partners.

These days venture capital is a lot more stretchy than it was a few years ago. VC money is invested at all stages of startup growth, starting from seed and early-stage funding to growth-stage, and late-stage ventures. The good thing about the Indian startup ecosystem is that VC investors have not shied away from backing startups early.

Venture capital firms invest in startups, seeking good returns and in India, there's plenty of opportunity for the right service considering the untapped market. In exchange for the investment, they get equities or company shares from the startup, thus earning the right to be on the board of directors and participate in all the business decisions. While on the

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one hand, this gives investors a scope to secure potential returns, on the other hand, it takes away the entrepreneur's complete autonomy over their business. With investors on board, founders will feel some pressure to deliver the returns — but that largely depends on the investor itself.

This is an important thing to consider from the founder's point of view while deciding whether to raise VC funding for the business.

But, in a situation where the founder has got an exclusive idea that is first of its kind in the operating sector and is certainly going to succeed as a business. Here, instead of them approaching investors or VC firms, it might be the case that investors come to their door. Here the founder has the leverage and can get good funding for lower equity while in the case of a founder pitching their idea to many investors, this demand-supply dynamic is inverted.

Q1. When you evaluate a business plan, what is the most critical element you look for?

Q2. Would you like to invest in companies geographically near or far from your offices?

Q3. Which areas of investment do you find interesting?

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