



## Venture Capital

Every ambitious owner manager, keen to expand their business, will at some time consider venture capital as a source of additional funding to complement bank and other forms of finance

### When to seek venture capital

Although most commonly used to fund management buy-outs, venture capital can provide finance for:

- Expansion opportunities;
- Development of new products;
- Turnarounds;
- Sale of minority equity stakes by existing Shareholders;
- Start-ups

Venture capitalists are generally specialist organisations set up to invest in owner-managed businesses and usually provide a mix of share capital and loan stock. They take a flexible approach to structuring the funding package to ensure the business is soundly financed.

In addition to investing in a business, most venture capitalists take an ongoing role in the strategic development of the business. In order to assist with this, the venture capitalist may appoint an experienced non-executive director to the company's board.

### Investment Criteria

Whilst each venture capitalist has specific investment criteria, they all seek to invest in companies with the following attributes:

- A strong and committed management team with a blend of skills and a sound track record;
- A market position which is not unduly vulnerable to competitor pressure;
- An identification of risks with sensibly thought out strategies to mitigate them;
- The potential for continuing growth of profits;
- The ability of the business to secure adequate funding from banks and other sources of finance to complement the funds provided by the venture capitalist;
- Identifiable exit opportunities – generally flotation, trade sale or buy-back.

Venture capitalists will look for an opportunity to exit from an investment within three to seven years.

### Risk and Reward

The returns required by a venture capitalist are influenced by the level of risk. The greater the risk, the greater the reward. The reward will in part be generated from ongoing dividends and interest but will mainly arise from capital gain on exit. Typically, a buy-out or growing business investment would be expected to yield an annual compound return of at least 30% of the original investment. A turnaround or start-up would be expected to yield considerably more.



## Other Considerations

Each investment opportunity must be looked at on its own merits. However, other general considerations include:

- Venture capitalists frequently structure their investment with some form of performance “ratchet”. The ratchet is likely to dilute the venture capitalists’ share of the equity if certain performance criteria are achieved by the company in which they invest.

Most venture capitalists for economic reasons find it difficult to justify small investments (say under £1 million) because the time and associated costs of putting a deal together are disproportionately high compared to the sum invested. However, there are some equity providers willing to provide smaller sums;

- The Enterprise Investment Scheme provides an opportunity for a company to raise up to £1,000,000 a year with those investing given special tax incentives for an investment of up to £200,000 each in a tax year;
- Managers of a business should think carefully before entering into an arrangement with a venture capitalist if they do not really accept the idea of giving up part of the company’s equity. An arrangement with a venture capitalist is a long-term partnership, with the venture capitalist expecting to take a high return if performance is achieved.



## Improving Chances of Success

Raising venture capital is by no means easy. Venture capitalists receive many proposals, so they need to be approached with a well presented opportunity. The chance of success can be improved in the following ways:

- Demonstrating a sound knowledge of the product and market place. An entrepreneur is expected to know enough about the competition to support the anticipated market share;
- Looking closely for any weakness in the management team. There should be an action plan in place to strengthen any identified weaknesses;
- Consulting professional advisers with knowledge of venture capital organisations. Good contacts and working relationships are important;
- Matching the type of funding and the venture capitalist to the needs of the business.

## Business Plan and Presentation

Any proposal for finance, whether for venture capital or other funding, must be supported by a business plan. The business plan needs to convey the project with brevity, be factual in content and preferably punchy in style. The plan should also:

- Have a summary outlining the nature of the investment opportunity for the venture capitalists and the funding required;
- Identify the assumptions most critical to the success of the business and provide a sensitivity analysis setting out how the financial projections may be affected by the outcome of the assumptions.

Monahans can help a company with its capital requirement from the earliest stage. Monahans has a wealth of experience and

extensive contacts with the venture capital market and can assist in preparing a venture capital proposal and evaluating the terms offered.



## For further advice and assistance

Our specialist Corporate Finance Department will be pleased to help.

Please contact **Peter Lugg** on **01225 472800**

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