TEXAS BUSINESS REVIEW

Bureau of Business Research • College and Graduate School of Business • The University of Texas at Austin
April 1999

Two Views of Venture Capital:

The Entrepreneur

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Imagine you are an entrepreneur. You have started a rapidly-growing venture, or at least you have devised a realistic plan for one. After carefully assembling an operating plan, including a detailed budget, you determine that you will need $960,000 to build and run the company for the next year. Where will you find almost a million dollars?

The Entrepreneur's Options

The answer: outside equity, an investor. Two of the most widely sought sources of equity capital are "angels" and venture capitalists. Angels are individuals with a large net worth who typically invest their own money in amounts ranging from $50,000 to $500,000 per deal. Angels can be anyone, from a successful entrepreneur who now has the means and desire to invest in others' entrepreneurial ventures to upper management in large public companies to partners in law and accounting firms to individuals with inherited wealth. Venture capitalists, in contrast, are professional investors who manage a pool of money raised from institutional funds (e.g., pension funds). These financiers typically invest from $500,000 to $5 million per deal.

The industries of interest as well as the amount of capital and effort that angels and venture capitalists invest varies greatly. The best ones bring more than money to their ventures: they offer business know-how, industry expertise, and contacts. This means that, when raising money for a venture, the entrepreneur must think strategically and seek the partner who can bring both financial and knowledge capital to the enterprise.

The Entrepreneur's Mandate

Angels and venture capitalists are in business to make significant returns on entrepreneurial investments: a minimum of three to five times their money in three to seven years. If successful, they realize a minimum of 30?40 percent annualized return on their investments. They garner these kinds of returns by owning a piece of a venture that shows significant growth in value over three to seven years and then selling their shares of the company, either through an initial public offering (IPO)—which renders their shares liquid—or, more likely, through the sale or merger of the company. Therefore, investors are looking for companies that are growing very fast, or show potential for rapid growth, and significantly increasing in valuation.

In their search for such investment opportunities, angels and venture capitalists are interested, first and foremost, in the people involved in the venture. Investors want to be convinced that the entrepreneur can implement the business plan. They want to see the drive, determination, commitment, and relevant experience necessary to build the venture. Investors understand that early-stage companies often lack a complete team. (Many entrepreneurs are great technologists but possess little in the way of marketing, finance, or business management skills.) Good investors offer access to quality management talent to help fill out the entrepreneur's team.

An entrepreneur must be clear in his/her vision of the company and able to articulate this image to potential investors. The two parties must share the same basic goals regarding the direction of the venture and maintain frequent and open communication to realize those goals.

The All-Important Plan

How much is it going to cost to secure the investment? How much of the venture are the investors buying for their capital? It's all about "valuation," the current value of the venture. For the founders of young, growing companies, valuation is part art, part science. It boils down to what the entrepreneur and investor agree is the current value of the future value of the venture.

A good business plan helps determine the future value. While there is no one single format for a good business plan, every complete, investor-oriented plan exhibits the same, generally accepted sections. A good business plan does not assure funding, but having no plan practically guarantees failure in the effort to raise money from outside investors.

The executive summary—a one-to-three page synopsis of the plan—is the most important part of the document. It makes the "first impression": most investors will read the summary first, looking for compelling reasons why the venture is a good investment opportunity and why the investor should read the rest of the plan and want to visit with the entrepreneur to learn more.

Several other sections complete the plan. The industry overview section describes the market, detailing the problems or needs of the market and its size, trends, and buying habits and identifying current and future competitors. The product or services section outlines the solution: how the venture addresses the problems or needs of the market. The management section introduces the people who will execute the plan and lists their relevant experience and abilities for accomplishing their jobs. How the company will offer its solutions to the market, how it will position itself, how it will sell its offering, how it will compete in a long-term competitive way—all this is explained in the marketing portion of the plan. The financial section distills the plan down to cash flow statements and balance sheets, showing a three-to-five year income statement and balance sheet resulting from the successful implementation of the plan.

After reviewing the business plan, interested investors will want a presentation from the entrepreneur and then, if still interested, they will begin detailed due diligence to make certain they understand the opportunity. Only then do the negotiations start. It is easily a two-to-six month process from introduction to investment.

Imagine again that you are that entrepreneur in search of $960,000 for your new business. You would be wise to seek more than money. Look for investors with expertise and contacts, who share your vision for the venture. Finding such a partner can mean the difference between success and failure.

Venture Capital Investment by Industry, in Texas 1998

Industry	Investment ($ millions)
Computer software and services	262.68
Communications	135.67
Industrial/energy	133.43
Medical/health	69.99
Consumer-related	53.08
Biotechnology	49.11
Semiconductor/other electronics	27.8
Computer hardware	18.3
Other products	91.59
Total	**841.61**

Source: Data from Venture Economics and the National Venture Capital Association.

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