What are Venture Capitals?

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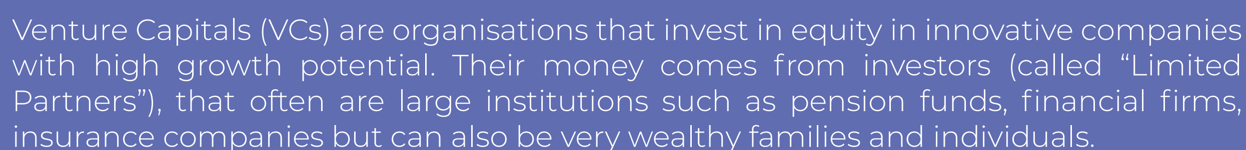

Venture Capitals (VCs) are organisations that invest in equity in innovative companies with high growth potential. Their money comes from investors (called "Limited Partners"), that often are large institutions such as pension funds, financial firms, insurance companies but can also be very wealthy families and individuals.

Equity means giving away a share of your company in return for funds. One advantage of this is that the investors share the risk; another advantage is that it can help align the incentives of stakeholders, so that everyone has a reason to want the company to succeed.
One big disadvantage is that it leads to 'dilution' (the company founder will own less of the company, hence receiving less of the up-side) and control over decision making may also have to be shared.

Venture capitals are often a top-of-mind source of investment for start-ups and innovative SMEs, even if their support is not easy to get.

Venture Capitals offer financial and non-financial support to help a business grow and eventually commercialise. Different VCs have different investment strategies and timing (from early-stage to exit). But one thing they all have in common is their search for unicorns with a very high return on investment that allow them to compensate for potential losses and offer a high profitability to their Limited Partners.
Indeed, Venture Capitals exist because of the structure and regulations that apply to capital markets and limit the interests banks can charge on loans, which often prevent bankers to invest in high risk companies without hard assets against which to secure the debt.

Because they search for a high return on investment, VCs usually focus their investment efforts in a specific industry sector, stage of development of the companies they fund (see below) or territory. This often translates in the funding of start-ups with an existing technology and market (and not in the funding of R&D, which is mostly funded through public expenditures and corporations), even for the so-called "early stage" financing. According to the Harvard Business Review, more than 80% of the money invested by venture capitalists indeed goes into building the infrastructure required to grow the business—in expense investments (manufacturing, marketing, and sales) and the balance sheet (providing fixed assets and working capital)[1].

[1] https://hbr.org/1998/11/how-venture-capital-works

Stages of development and associated VC's financing:

Venture Capitals invests from early stage to exit. The first rounds (seed and Series A) can be funded both by Venture Capitalists and Business Angels.

- **Seed funding** is typically used to finance **a startup's initial costs**, such as product development, market research, and business formation expenses. The amount of money raised in a seed round can range from a few thousand dollars to several million, depending on the startup's needs and the investors' appetite for risk.
- **Series A** funding is the next stage of venture capital financing. The amount of money raised in a Series A round can range from a few million dollars to tens of millions, depending on the startup's needs and the investors' appetite for risk. It is typically used to finance a startup's growth, such as hiring new employees, expanding into new markets, and increasing marketing spend.

Growth capital from Venture Capitals is used to scale the business. These are typically larger financing rounds with have higher valuations because the companies have started to prove traction and de-risk the investment.

- **Serie B**: Series B appears similar to Series A in terms of the processes and key players. Series B is often led by many of the same stakeholders as the earlier round, including a key anchor investor that helps to draw in other investors. The difference with Series B is the addition of a new wave of other venture capital firms that specialise in later-stage investing. However, Companies undergoing a Series B funding round are well-established, and their valuations tend to reflect that; most Series B companies have valuations between around $30 million and $60 million.
- **Later stage (Series C, D etc.)**: Businesses that raise a Series C funding are already quite successful. These companies look for additional funding in order to help them develop new products, expand into new markets, or even to acquire other companies. Series C funding is focused on scaling the company, growing as quickly and as successfully as possible.
- **Mezzanine financing**: At this stage, the company is in very good shape and is looking for financing before investors cash out during an IPO (see below)

The aim of a Venture Capital is to exit its investment in usually two to seven years once the company's balance sheet reaches a sufficient size and credibility, to ensure its return on investment. VCs can exit through secondary sale, an Initial Public Offering (IPO) or an acquisition. Early stage VCs may exit in later rounds when new investors (VCs or private-equity investors) buy the shares of existing investors. Sometimes a company very close to an IPO may allow some VCs to exit and instead new investors may come in hoping to profit from the IPO.

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