CHAPTER 7

Getting Over the Fear of the VC

"Two roads diverged in a wood, and I took the one less travelled by, and that has made all the difference."
Robert Frost

Most entrepreneurs jump into the process of raising venture capital without adequate information and preparation. This leads to a tremendous waste of valuable time and money. Some entrepreneurs do the opposite. Even though they need venture capital, and would qualify for it, they avoid approaching VCs. They have an unfounded fear of VCs based on their distorted understanding of their motivations and expectations as co-owners of their business.

This fear is reflected in the following statements that one often hears from entrepreneurs who would like to raise VC money but are unclear what it entails.

Myth 1: "VC Will Take Over My Business"

This is completely baseless. The VC is not interested in taking over your business. He is only interested in getting timely and adequate information about your business in order to protect his investment in it.

VCs put their money into your business — but it remains your business. They are backing a package of products, services, equipment and

management, namely your team, your vision, your skills, your capability, to deliver returns on their investment in your business.

The VC invests in your business based on your representations that it is a growth business and that your management team and you have the capability to manage the business in a manner that his investment can multiply several times over the investment period of, say, about 3 to 5 years. In fact, one of the major criteria VCs use in making an investment is the existence of a complete, capable, creative, cohesive and experienced management team in the business. VCs invest in a business because they find that the management is capable and trustworthy.

VCs are not planning to take over your business when they invest in it. They do not want to run your business. It's not their job. And if it ever comes to that, then everything has gone horribly wrong and that hurts everyone, including the VC

VCs are also not in the business of managing companies. The VC's business is money management. They are financial managers interested in making a good return on their investment. VCs invest in about 5 to 10 companies per VC fund and are interested in ensuring that the businesses in which they invest, mature over time and provide them with a substantial return. All their actions after making the investment are geared towards two objectives, namely, protection of their investment, and harvesting their investment as soon as possible at a huge profit. Taking control of your business is not a part of their game plan. However, be aware that investment agreements that you sign for getting VC funds may sometimes provide for situations in which the VC would have the right to change the management team. And if you have signed such an agreement, then do ensure that the circumstances that can trigger the process of management change never occur as a result of your negligence or carelessness.

Myth 2: "VC is Looking to Control My Business"

VCs are not interested in having a say or a veto in day-to-day operational decisions. However, they seek to have a say in the strategic direction of your business and would therefore have a say in decisions which are strategic in nature. A VC investor would include in the investment agree-

ment the decisions in which his consent would be mandatory. Examples of such decisions are:

- Capital expenditure above certain limits.
- New product development.
- Opening new offices within the country and / or overseas.
- Appointment of key personnel, like CEO, CFO, COO, etc.
- Appointment of auditors and internal auditors.
- Appointment of legal counsel.
- Loans beyond certain limits.
- Sale of key assets or business segments.
- Formation of strategic alliance and joint ventures.
- Any decision that either creates or has the potential for creating major legal and financial risks for the business.

Control on the key decisions which impact the strategic direction of the business is exercised through the VC's representation on the company's board of directors (BOD). The investment agreement would provide for the number of VC directors on the BOD of the company and would also list the decisions which can only be taken with the consent of the VC directors. Typically, the by-laws or articles of association of the company will be amended to incorporate the necessary changes and give the VC the right to have a say in certain critical decisions.

Most businesses in which VCs invest benefit by the discipline of external oversight at board level and from the broad commercial experience of the non-executive director representing the VC. VCs bring valuable experience and skills to the business and may sometimes even take on a semi-executive role, if so required. This arrangement provides the company with skills which it may otherwise may not be able to afford.

Myth 3: " I Will Have to Sell My Business to Enable the VC to Exit"

Most entrepreneurs find it difficult to accept the fact that the VCs "financial" approach, in fact, maximises value for all parties, including the entrepreneurs. VCs do what they do in order to make money for the investors who have put their money in the VC's fund and, hence, will

not invest in propositions where they cannot see a clear path to realising their profit. This does not mean a sale is inevitable — listing your company on the stock exchange or refinancing may be effective alternatives that allow you to keep your stake and your management role. The best way to minimise the chances of a potential conflict is to ensure right from the start that both sides are working to the same timetable. This is part of the initial negotiation process. Moreover, even if sale is the agreed exit route, the overall "timetable" may be flexible. If there is need for the VC money to remain invested in the business longer than the agreed time frames to achieve an acquisition or open up a new market, most VCs will give the strategic case a fair and objective hearing. There is almost always a balance to be found between realising cash and making it work for a bit longer if the desired returns can be obtained.

Myth 4: "I Will Have to Change My Way of Working"

Yes, this is true to some extent.

Before a VC steps in, you, as the founder of the business, are responsible only to yourself for all the business decisions. Post VC investments you, as the CEO of the business, become accountable to the shareholders of the company, including the VC. The changes in your functioning that are likely post VC investment include the following:

- Greater transparency in your decision making.
- Greater emphasis on ensuring that the business is not overly dependent on the whims and fancies of its key personalities. The formulation of policies, procedures and processes will be encouraged to ensure that decision making is structured but without losing the business's entrepreneurial edge. In effect, the company will move from being dependent on personalities to being dependent on processes.
- Employees are likely to be more empowered and human resources best practices will find speedier implementation.
- The company will transform into a board managed company with the critical decisions being taken after deliberations by the board of directors.

- Decision making may become less "by the seat of the pants" and more structured requiring all stakeholders to be involved in the decision making process.
- Reporting requirements within the company will become more formal with pre-agreed formats and periodicity.
- Financial discipline will improve dramatically.
- Greater urgency in the organisation as the VC will hold the management accountable for commitments made in the business plan.
- Documentation, like board minutes, shareholder minutes, etc. will be maintained more formally and meticulously.

All these changes would make the business more structured and better organised, thereby giving the founder more time to focus on growing it.

Myth 5: "The VC Will Come to Know My Business Secrets and Use Them to My Detriment"

Once he has put his money in your business, the VC is not likely to jeopardise it by working against the company's interest. In fact, the VC will become your partner in growing your business after he invests in it. Any act that destroys value in your business harms the VC as much it harms you. Therefore, this fear of yours is unfounded. However, if required you may ask the VC to sign confidentiality or non-disclosure agreements to safeguard yourself and your business.

Myth 6: "The VC Demand for High Returns is Very Unreasonable"

The VC's return expectations are commensurate with the risks that he takes. Venture capital is a very risky business and the returns have to adequately compensate for the high level of risk that the activity entails. The "whys and wherefores" of the VC returns has been explained earlier in Chapter 3. As an entrepreneur, you may note that not only does the VC provide you with funds, he is also there by your side to add value to your business by his experienced counsel and networking reach. He

helps to expand the pie. He makes money and, in the process, you also make more money than you would have otherwise made if you had remained small and in the "lifestyle business" mode.

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I hope that your fears of the VC have now been allayed. Now, the question is this: is your business the type in which the VCs generally invest?