

Selecting a Venture Capital Manager

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By Peter T Gow

This article is about selecting a Venture Capital (VC) Manager with the right chemistry and experience.

Main Points in this article:

- 1 Raising capital from a VC Fund relies very heavily on the people factor and the trust that is established upfront.**
- 2 Very high failure rates (over 60 percent) occur in collaborative ventures.**
- 3 The key to maintaining successful relationships is to recognise that the will continually be in a state of flux.**
- 4 Understand clearly what VC Managers bring to the table in terms of skills, experience and networks.**
- 5 Professional reputation and the way a VC Manager does business are the key ingredients in determining the success of an investment relationship.**

Selecting the right Venture Capital (VC) Manager can have a very positive impact on the performance of your company.

Selecting the wrong manager, on the other hand, may result in delays in the attainment of your strategic objectives.

Inviting a VC Manager to join your board and share register can be like the story of the spider and the fly. The “come into my parlour” approach may have some serious longer term consequences if it is not approached correctly.

Like all commercial activities, raising capital from a VC Fund relies very heavily on the people factor and the trust that is established upfront. It also requires building on this trust during the term of the investment relationship.

Capital investment involves a 5 to 7 year relationship, supported by an agreement that outlines the terms and conditions and the business milestones to be achieved.

Apart from the people factor, otherwise known as “chemistry”, it is also important to understand the way VC Managers work. You need to understand their investment appraisal processes, their investment criteria, their particular areas of specialisation and the types of investments completed to date.

Chemistry and Critical Skills

One of the key ingredients for any

successful relationship, whether contractual or not, is the chemistry between the people.

It is not unusual to have very high failure rates (over 60 percent) in collaborative ventures, alliances or partnerships. Managing these types of relationships is very difficult over longer periods of time. Most relationships will fail within the first 5 years.

The key to maintaining successful relationships is to recognise that they will be continually in a state of flux.

Over time, events may occur which change the dynamics of the relationship. For example, shifts in the competitive environment or regulatory changes may either inhibit or create significant opportunities.

As these changes occur, it may be necessary to re-visit or re-negotiate the terms of the relationship.

Unless the parties are aligned and focused on the same objectives, the outcome may be financially, as well as personally, damaging.

The financial fallout may mean a significant decline in the value of the company and your investment, and it may also result in a dilution of your shareholding, particularly if further capital is required to change direction.

The personal result may be the loss of a key role or position in the company.

CEO's, and sometimes the founders, are asked to step aside to facilitate the change in direction.

This may be personally difficult, but the potential future value of the company needs to be considered.

New Capital to Support Business Objectives

In broad terms, VC Managers provide:

- Access to a wide range of business expertise
- Expertise in speciality areas eg technology development or commercialisation
- Access to key networks, alliances or associations
- Expertise at Board level, especially in regard to compliance, risk management and strategy
- IPO or Trade Sale negotiation experience.

Before approaching VC Managers, several key questions need to be considered:

- What are your business objectives and will these be achieved with outside capital?
- Where should the capital come from?
- What are the benefits of introducing a VC Manager?
- How do you select the right VC Manager?

The *first* question is a broad strategic one. It is discussed in further detail in the **Determining your Capital Requirements** article at this Website.

The answer to the *second* question will depend on the amount of capital you require.

If the capital requirements are over \$500,000, it will be necessary to consider the VC Funds or a Strategic Investor.

The Strategic Investor approach may be preferred where the technology or products are complimentary or where access to distribution is required.

The *third* question focuses on the value added benefits of VC Managers, if the chemistry is right. What will VC managers bring to the table?

The *last* question, relating to the selection of the right VC Manager, needs to be carefully considered. It needs good research and planning, as well as detailed reference checking.

The capital injection may involve an investment period of 5 years or more, so it is important to select the right manager to work with.

Background research on the VC manager and its key investment staff needs to be performed to understand:

- **Size of the VC Fund.** How big is the fund and what is the maximum size of the investments? How many investments are completed each year?
- **Investment Focus.** What investment stage is preferred? What are their investment criteria?
- **Investment Processes.** How does the process work and how long will it take?
- **Areas of Specialisation.** What key areas of expertise does the VC Manager have?
- **Investments Completed.** What sort of companies has the Manager funded and why? Are any of these companies in your industry sector? This is a key question as the Manager may already be aware of your company and its prospects.

- **Co-investment with Other VC Managers.** Has the Manager invested with other Managers? This is important when larger capital raisings are being considered. Most funds have limits on the maximum contributions that can be made.

- **Investment Instruments.** How the funding was advanced? Shares (preferred or ordinary) or debt securities, or a combination of both, may have been used.

- **Team Experience and Stability.** What sort of experience (general management, board and investment) does the VC Manager Team have? How long have the Team worked together? When was the last departure from the Team and why? What additional services can the team provide?

An evaluation of the VC Team's skills and experience is important. There should be a range, as well as depth, of skills, and as a minimum, there should be at least 3 active managers involved in the VC Fund.

Team Reputation

Professional reputation and the way a VC Manager does business are key ingredients that will determine the success or failure of the investment relationship.

It is therefore important to spend a fair amount of time evaluating the qualities of the Manager. This evaluation needs to cover both the direct dealings, as well as third party reference checks.

The list of parties to be contacted should include:

- CEO's and Non Executive Directors of companies that have raised capital.

- ❑ Other VC Managers where co-investments have been made.
- ❑ Corporate Advisers that have assisted the Manager with capital raisings, takeovers or disposals.
- ❑ Broker's that have raised capital through IPO's or private placements.
- ❑ Other Professional Advisers like lawyers or accountants.

The process of checking references may be very time consuming, but it needs to be done. It may reinforce your "gut feeling" about the people or it may highlight potential relationship problems.

The reference checking process needs to be handled carefully, with due respect for the confidentiality of the information and the reputation of the parties involved.

Discovering any major problems after the funding has been provided may give rise to serious longer term conflict.

Selecting the right VC Manager will definitely assist with the achievement of your company's objectives.

With the right VC Manager relationship in place, the chance of successfully exploiting new commercial opportunities dramatically improves.

The primary decision in selecting a VC Manager is in respect of fit, with a strong focus on chemistry and experience.

strategic planning, cash flow management and market research and analysis. Peter has over 12 years of experience in working with growth companies and has been involved in the completion of over 30 financings in the software, manufacturing and medical areas. His expertise covers company evaluation, strategy and market analysis, capital raising, transaction structuring, documentation and completion. Peter has also set up several venture capital funds for a major financial institution and appraised a range of venture capital managers.

Creative Capital Pty Limited
Peter T Gow
61 412 235 455
petergow@creativecapital.com.au

Peter T Gow is the Managing Director of Creative Capital Pty Limited. He founded Creative Capital to accelerate the learning skills of entrepreneurial CEO's and develop their expertise in capital management, business and