VENTURE CAPITAL

Venture Capitalists and Angel Accredited Investors (a group to which, by definition only, I reluctantly find myself included) are considered to be the most critical readers of a business plan. This is because we not only generally invest in riskier situations but also have limited background knowledge of your company. On an average, most Venture Capital firms approve a whopping 2% out of every 100 applications they receive.

What exactly do Venture Capitalists want to see? What would make your project stand apart from 98 other applications? In other words, “how much” and “what for”.

1. A substantial return: This is usually between 25% and 60% per annum compound, depending on the risk of a project. In other words, taking a 35% return requirement, the venture capitalists would want to earn approximately four and a half times their original investment, before inflation, over a five year period.
2. “Exit Route Required”: How do we get our money back and when. (Listing on Stock Exchange, acquisition by a larger Company or a Management buy-back. A typical period for an exit will be between three and seven years.

Assessment Of Risk Exposure: (see Chart)

Accordingly, the venture capitalists wish to see that the company satisfies its needs of both the market and the investors. Most Venture Capitalists firmly believe that they invest in people, not projects. This notion is underscored by the fact that the three most often issues in any investment is: “Management…Management…Management!”

The Structure of a Venture Capital Investment

A typical venture capital investment is structured so that the venture capitalist gets convertible preferred stock in your company. This stock gives the venture capitalist a preference over the common shareholders in the event of a liquidation or merger.

The preferred stock is convertible into common stock at the option of the holder -- and may be automatically triggered by certain events. For example, the preferred stock would convert to common stock in the event of an initial public offering (IPO) of the company to simplify the capital structure of the company and to facilitate the IPO.

Venture capital investments are also sometimes "staged." A certain amount of money is invested right away and additional money is invested later, as certain milestones are reached. From the company's perspective, it's important that these milestones are clearly defined and reasonably obtainable.

Venture Capitalists' Rights
Venture capitalists also typically expect to receive the following rights with an investment:

- The right to elect one or more directors to the company's board of directors
- The right to receive various reports, financial statements and related information
- The right to have its stock registered for sale in a public offering at the company's cost
- The right to maintain its percentage share ownership in the company by participating in future stock offerings

O U T L I N I N G T H E P L A N

You should organize your business plan in clearly defined sections covering the different aspects of the company. Putting together an outline forces executives to come to some early decisions about what will be where in the business plan. For example, carelessly organized plans often describe the market for a product in the same section as the product description, or describe the product in the market section. Outlining also requires the executives to understand the necessary level of detail that should be included in the plan.

D E T E R M I N I N G T H E K I N D O F P L A N

People writing a business plan for the first time frequently ask, "How long and how detailed should it be?" There are no fixed rules. Your plan's length will depend to a great extent on what you want it to accomplish and how sophisticated and complex your company's operations will be.

Broadly speaking, there are three kinds of business plans:

Summary Plan A summary plan of 10-to-15 pages works best for companies without an extensive history — a company in the early stages of development. There is not a lot of history to report, and existing operations are small. A summary plan can also be used by a more established company interested in testing the investment waters; if found to be inviting, a more complete business plan can be assembled.

A summary plan may also be appropriate for entrepreneurs with a history of success. If you are a seasoned manager with a good track record, a venture capitalist may not require as much information from you in the early stages as from an inexperienced manager.
The summary business plan should include enough information to convince potential backers that you have done your homework and understand the market — in as short a form as possible.

Full Business Plan The more traditional business plan of 20-to-40 pages — typically for financing purposes — spells out a company's operations and projections in much detail. This type of plan becomes more desirable as the amount of money being sought increases. For instance, if you want $5 million to start a high-technology manufacturing company or are seeking new commercial lending relationships, you will probably need a highly detailed plan that contains an in-depth market analysis, five-year cost and sales forecasts, detailed research and development information, and financial data to back up your assumptions and forecasts.

Operational Busine**ss Plan**

For established companies, a business plan can be an important source of guidance to top managers. It serves as a blueprint for company operations. It also ensures that all managers understand the company's direction and their respective roles in achieving company goals.
Almost of necessity, an operational business plan must be lengthy — typically well in excess of 40 pages and sometimes as long as 100. The greater the detail, the more likely that individual managers will understand their roles and achieve their goals.

T H E F U N D A M E N T A L Q U E S T I O N S

➢ Have you committed enough time and resources to gather and thoroughly analyze the right information?
➢ Are the key members of management committed to researching, writing and/or providing feedback on the plan?
➢ Have you identified the likely readers of the plan and chosen the appropriate type of plan to meet their needs?

The most significant single section of the business plan intended for outsiders is the Executive Summary. Venture capital and private equity investors, bankers, and corporate investment officials typically receive many business plans each week — more than could possibly be read from beginning to end. To help determine if the plans are worthy of further review, financiers invariably begin by reading the Executive Summary. If the Executive Summary suggests a promising business for investment or loan funds, then the experts will read further. If not, then they quickly reject the plan. Essential information that is buried in a later section has no value if the reader never gets that far. The primary objective of the Executive Summary is to entice investors to delve further.

K E Y S T O A N E F F E C T I V E S U M M A R Y

What makes for an enticing Executive Summary? First, it is important to remember that it is not a preface to or abstract of the business plan. Rather, it is the business plan in the most concise form possible.
An effective Executive Summary describes all of the key elements of a business plan in two to three pages. It must include the following essential information:
➢ A synopsis of the company's strategy for succeeding
➢ A concise account of the management team's qualifications that make the company successful (be sure to include a description of your team's contribution to previous successful business ventures)
➢ A brief description of the market (along with the ingredients for success that make your company unique in that market)
➢ A brief description of the product or service
➢ Key historical and forecasted financial data, such as annual revenue and net income, for five years
➢ An estimate of the amount of the funds you need, a statement of how you will use the money and how lenders or investors will get their money back.

This is a lot to explain clearly in two or three pages. In fact, composing an effective Executive Summary is one of the most difficult writing tasks any executive will face.