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Venture Capital Financing Today

Innovation and Entrepreneurship Panel
University of Massachusetts at Amherst
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This Too Has Passed: Historical Overview 1965-2000 Golden Age

- 1960s: small number of (under ten) funds
- 2000: 1500+ funds
- Top fifty funds return majority of profits
- 60% internal rate of return (the compound annual return), 10X cash on cash returns
- A few companies in any fund return the bulk of profits
- Best performing financial asset class of ANY
- Fund size limited to $200M-$300M roughly, 4 managers, 4 principals/associates

The Reality of Today
Venture Capital 2000-present

- Funds are ranked by returns to invested, typically in quarters (top, upper, lower, bottom) quartile: Top quartile funds return 1X+ cash on cash
- Ten year lock up, illiquid, risky
- Secondary market for liquidity: big discounts
- Far too many funds chasing far too few truly innovative investments with a sustainable edge
- Worst performing financial asset class of any that a financial investor might pick

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Venture Funding in the Current Environment

- Early stage companies that require relatively small amounts of capital to reach positive cash flow, with low valuations GET FUNDING
- Later stage companies that require relatively large amounts of capital but early stage (low) valuations GET FUNDING
- Short time to liquidity/exit
- All other categories are NOT getting funded

Risk Management

- Take as few perceived risks as possible
  - » People, products, markets
  - » Hard science/leap of faith ventures are difficult/impossible to fund
  - » Cram down financings: invest in businesses with potentially significant products, markets, grow customer base, building on sunk costs of others
- Diversify investments across multiple firms and multiple (uncorrelated) market segments
- Limit the size of the investment early on
- As time passes, do triage on those not progressing, double down on winners

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Funding Implications

- What types of businesses will get funded?
  - » Early stage with **significant intellectual property** that can be licensed for multiple fields of use and/or some **sustainable market/business model edge**
  - » Late stage companies with early stage valuations
- Early stage businesses need to reach positive cash flow as quickly as possible
  - » Small amounts of capital
  - » If large amounts of capital is needed, it will be small amounts of **EQUITY** and large amounts of **DEBT** typically for service businesses with predictable cash flows
  - » **DEBT** is secured by either hard assets or cash flows