

7.5: Tips in Your Entrepreneurial Walkabout Toolkit

Dealing with Venture Capitalists

Young companies around the world now eagerly—and sometimes successfully—reach out to VCs in other countries. If you are a budding entrepreneur thinking about going the VC route to fund your business, it's important to learn more about the industry and community. At the end of the day, money is what matters—it's business for VCs. This is a harsh point of view for entrepreneurs, who are often quite emotional about their product or service. It can be hard to know just how to evaluate VCs. Here are some tips to follow no matter where in the world the entrepreneur or VCs are located. Sanjyot P. Dunung, *Starting Your Business* (New York: Business Expert Press, 2010).

1. **Understand the nature of a VC.** They are basically fund managers looking for high returns for their investors. Understand the VC's portfolio's mission and goals. Most have multiple funds in their portfolio each with different investment parameters based in part on the various investors. VC is an industry, and the VCs are your "customer." You need to understand how the industry operates, how to get your "product" (i.e., your company) noticed, and how to close the sale (i.e., get your funding). While there are certainly nuances, treat it like a sales process from start to finish. Remember that VCs run a business, one that they are held accountable to by their investors. More often than not, the people you meet at a VC firm are not the actual investors (although the senior principals may have some of their own money in the fund); they just work for the VC firm.

VCS focus on market trends, whether it's green technology, social networking websites, or the current perceived "hot" industry. While it's still possible to get funding if you are not in a current trend, it's certainly harder. VCs typically look at groups of investments and generally like to have funds with three or four companies out of ten providing exceptional returns. They expect the rest of the businesses in the portfolio to either be weak performers or to fail. Sounds harsh, perhaps, but this is purely statistical to the VC industry. It's important to ask VCs about their expected returns. When VCs market their funds to potential global institutional and wealthy investors, they have to indicate a vision, strategy, and target range for returns to these potential "buyers"—that is, investors. If you're beginning to think that a VC sounds suspiciously like an entrepreneur, you're correct. You need to realize that in the same way you're raising money from a VC, the VC is raising money from someone else.

2. **Control the interview.** Ask the VC about their mission and goals. Additionally, learn about the VC's investment style. Do they prefer to be heavily involved? Or are they hands-off? Is their investment style consistent with both your operating style and stage of business? Experienced and well-connected VCs can be very useful for an early-stage company. If the VC is a strategic investor, understand the motivations for their interest in your product, service, or market.
3. **Act the part.** Be prepared. Conduct yourself professionally at all times. Dress and act like you're going to a job interview—it's quite similar. Don't drop names or promise too much. Don't make claims about your product or service that can't be substantiated.

Again, your credibility will suffer even if you actually have a solid product or service. Go to any VC meeting with a clear presentation and detailed business plan. If you can't answer a specific question, say so and promise to get back to them within a specified time frame with further information. Even if you don't have an answer, be sure to get back to them later with a follow-up that indicates you are still researching the answer. Don't act like you're entitled to funding for any reason. You may think your idea is great, but VCs see many "great" ideas. Support your request for funding with clear business rationale and facts. Lose any attitude.

4. **Examine the VCs network/expertise.** What is the VC's network? Is the VC or their network in your industry? Does the VC know both clients and partners, and at what decision-making level are these contacts? Is the VC willing to actively assist you with global networking? Look at the companies in the VC's portfolio to see if there's a synergy across the portfolio. It's helpful if the VC is willing to facilitate interaction with key strategic investors in the fund as well as other complementary portfolio companies.
5. **Does the VC have an ability to guide the company to a suitable exit strategy?** An important issue for most investors and VCs is the exit strategy. It's great if a company does well, but the VC wants to know how and when they're going to get their money out. Experienced VCs usually have a time horizon of three to seven years. The entire life of their fund may be only ten to thirteen years, after which time their investors expect to receive their original investments back with all the returns. While an initial public offering (IPO) is certainly a sexy exit strategy, it's not for every company. If you do business with the companies that are likely to buy your firm, then be sure to highlight this early on. Many VCs also like to see a list of possible strategic

acquirers. As noted earlier in this section, access to global markets benefits many global VCs and entrepreneurs, both of whom now have more options to find investors or companies to invest in as well as more exit strategies.

6. **Check-writing ability.** Can the VC make an initial investment? What is their process for obtaining more funding? Venture capitalists fund companies from one of their portfolio funds. If monies in those funds run out, there's limited ability to find more funding. Most experienced VCs save a portion of each fund for follow-on funding for their portfolio companies (which are companies they have already invested in). Remember that VCs have an interest in your company's success, so long as the business parameters warrant it. They are not likely to keep funding a venture with minimal life left in it.
7. **Beware when a VC has no real management experience.** Find a VC with experience in running a company, not just banking. Venture capitalists still tend to come from the worlds of consulting and investment banking. Most have never worked for a company. As a result, their knowledge base of a corporation tends to be academic and theoretical and doesn't stem from any tangible experiences. They tend to be unfamiliar with corporate operating practices as well as general line management. Despite some efforts to hire entrepreneurs on their teams, most VCs still hire people who are just like themselves, a practice that drastically limits the range of experiences and perspectives of their team. Look at the individual backgrounds to assess any diversity of experience and perspective. If you are targeting key markets globally, make sure your VC has direct experience in those markets.
8. **Avoid unreasonable terms and demands.** Manage return expectations; ensure you and the VC are on the same page as far as expectations. Make sure that you and the VC are both motivated by a mutual win. Don't agree to terms that are potentially dangerous to the long-term health of your company. For example, the VC may try to extract personal terms from you, such as a deferred salary or personal guarantees. Even if you are independently wealthy, terms that may make your personal financial survival more difficult only distract you and make you less focused on the business, which should be your and the VC's priority. In such cases, the VC is less interested in your well-being: after all, everyone needs to pay their bills. These terms are never in anyone's best interest, let alone the company, and will undoubtedly come back to haunt both you and the VC. The entrepreneur should also be careful not to have unreasonably high compensation demands for themselves.
9. **Level of involvement and fit.** How involved do the VCs want to be? Are they helpful or intrusive? Are your professional and cultural styles compatible? If you're from different cultures, be sure that you understand effective ways to communicate and manage differences and expectations. Negotiating a VC's level of involvement can be really challenging, as expectations may change over time. Some VCs who take a hands-off approach in the beginning may increase their involvement at the first hint of difficulties or problems. Overall, most VCs oversee investments in multiple companies, so they don't always want to be heavily involved. Just be sure that the level of involvement meets the needs and expectations of both you and the VC.
10. **Look for mutual respect.** Sure, you need money, but the VC needs to also be aware that they need good companies with solid ideas in order to be successful and profitable.

Is there a mutual acknowledgment of respect and that you both need each other to succeed? Many VCs appear to operate as if this isn't the case. Just as you will likely turn to your VC for creative financing and exit strategies, the VC should respect your industry and management experiences. Success can only be achieved if there's mutual respect and a focus on creating a win for all involved.

11. **Watch for questionable integrity, greed, ego, and power trips.** Be wary of the VC who shows interest in doing your deal and suggests he or she receive a personal fee for doing so or wants to go on your payroll as an "advisor." Kickbacks are not legally standard in the VC world, although they occur in varied forms more often than not. The only persons who may be entitled to fees are those you have retained as investment bankers, advisors, or intermediaries. Additionally, a VC who operates this way is likely to have a pattern of doing so and is not likely to provide the kind of professional support needed during challenging periods. If your VC is from a country outside your base country, be sure to understand your VC's culture and his or her country's rules. It's not worth engaging in unscrupulous business practices. Even if in the short term it helps to fund your company, the long-term repercussions could be disastrous. Find another source. Above all, strive to keep your integrity in all your business dealings.

VCs who are undeservedly full of themselves may be more interested in satisfying their egos than partnering to grow strong companies. Some VCs will show such characteristics by playing mind games at early meetings. Others may try to intimidate you or be unconstructively condescending—for example, creating a hostile environment by aggressively and rudely demanding that you close your PowerPoint presentation and answer obtuse questions. You may find yourself the target of a barrage of foul language. While every industry has its share of egomaniacs, what you really need to focus on is how you can build a level of professional trust that will enable you and the VC to work together during challenging periods. Some VCs can forget that it's a partnership and that the entrepreneur is likely to have an equity interest in the company as well. The VC may seek to treat the entrepreneur as a

subordinate or an employee—and not a co-owner as well. Without a sense of cooperative teamwork, you may not have the VC and board support you need at critical junctures. Interestingly enough, the code of conduct that most professionals are expected to follow in the corporate world is not always standard in the VC world. Stay above any questionable behavior and stay professional. Despite the allure of money, you probably wouldn't want to do business with these types of people in any circumstance. Sanjyot P. Dunung, *Starting Your Business* (New York: Business Expert Press, 2010).

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