How do venture capital funds evaluate an investment proposal?

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Investment Committee is VCs internal group, which comprises of their limited and general partners and they provide their feedback on the investment opportunity. IC raises a number of issues about the investment and if after their discussion, venture capital fund is still positive about the investment then they call the promoters of the company for a presentation to some/all members of the investment committee.

The meeting with the partners is an important step in fund-raising process. The promoters should try to reach this step as quickly as possible by pushing their contact person in the VC fund. If the VC is being reluctant in setting up the meeting even after 10 weeks of first meeting, then promoters should realize that VC is not very interested in their proposal and it is most likely to result in a negative response.

Step 4: Detailed validation (due diligence) and shareholders’ agreement

If everything goes well during the IC meeting, VCs generally issue a term sheet mentioning their key terms and conditions of investment. Once there is an agreement on all the terms and conditions mentioned in the term sheet, VCs perform a detailed due diligence on the company. Since there is hardly any financial information to verify in case of a start-up company, the due-diligence process for start-ups is restricted to VCs trying to get into details of fund requirements, detailed usage of funds, month-by-month milestones etc.

Generally, VCs end up adding a lot of additional terms and conditions after the due diligence process under the section “conditions precedent” in the shareholders’ agreement. Once the promoters take care of all the issues identified during the due diligence process, VCs and promoters sign the shareholders’ agreement and money is transferred to the company’s account.

Source: http://wowfinance.wordpress.com
The venture capital investment process

 IMO Communications Pvt Ltd., India

Deal structuring

Once the venture has been evaluated as viable, the venture capitalist and the investment company negotiate the terms of the deal, i.e., the amount, form and price of the investment. This process is termed as deal structuring. The agreement also includes the protective covenants and earn-out arrangements. Covenants include the venture capitalists right to control the investee company and to change its management if needed, buy back arrangements, acquisition, making initial public offerings (IPOs) etc, Earn-out arrangements specify the entrepreneur's equity share and the objectives to be achieved.

Venture capitalists generally negotiate deals to ensure protection of their interests. They would like a deal to provide for:

- A return commensurate with the risk
- Influence over the firm through board membership
- Minimizing taxes
- Assuring investment liquidity
- The right to replace management in case of consistent poor managerial performance.

The investee companies would like the deal to be structured in such a way that their interests are protected. They would like to earn reasonable return, minimize taxes, have enough liquidity to operate their business and remain in commanding position of their business.

Post-investment activities and exit

Once the deal has been structured and agreement finalized, the venture capitalist generally assumes the role of a partner and collaborator. He also gets involved in shaping of the direction of the venture. This may be done via a formal representation of the board of directors, or informal influence in improving the quality of marketing, finance and other managerial functions. The degree of the venture capitalists involvement depends on his policy. It may not, however, be desirable for a venture capitalist to get involved in the day-to-day operation of the venture. If a financial or managerial crisis occurs, the venture capitalist may intervene, and even install a new management team.