



Capital flow

Sources, risks and returns

<http://www.venturecapital.or.th>

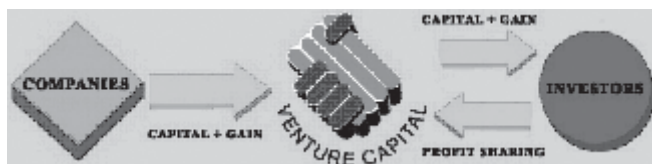
Thai Venture Capital Association, Thailand

Investment



- Fund managers will sign a management agreement, in which the investment policy is set (e.g. funds cannot invest in residential real estate, casinos or gambling companies, etc.) and the management fees laid out.
- Fund managers are usually paid annual management fees of 2-3% of the invested funds and also share around 20% of the total net profit of the funds, so long as minimum return hurdles are cleared.

Divestment



Risks vs return

VC investment is very high risk in nature. For example, if a VC invests in a start-up company, then probability of success is in fact less than 4%. Investors always expect risk-adjusted return, i.e. high risk=>high return. Normally investors in a VC fund expect a net return of at least 20% per annum, which means that the whole fund will have to get at least 25-30% return before any expenses or carried interest (profit sharing to the fund manager). In order to achieve the 25-30% target, the fund manager will have to target 35-40% in order to compensate for the failed investment in the fund.

Source of funds

Funds and fund managers

- There are many types of investors in VC funds, such as pension funds, insurance companies, banks, wealthy individuals and corporations.
- In the USA, funds are formed as limited partnerships; however, in Asia, most funds are formed as limited liability companies.
- Funds usually have 7-10 year lives, although some funds are evergreen funds.

In the above table, If a VC fund invests in a start-up company and we assume that each risk, i.e. start-up risk (S), management risk (M), technology risk (T), production risk (P) and marketing risk (K), has a 50% chance of success and failure, then the probability that a particular start-up company will do everything right and become successful is:

$$S \times M \times T \times P \times K = 50\% \times 50\% \times 50\% \times 50\% \times 50\% = 3.2\%!!! \square$$

Expected return		Perceived risk			
Investors	20%	Start-up risk	50%	Management risk	50%
VC fund	25-30%	Technology	50%	Production	50%
Each investment	35-40%	Marketing	50%		
		Implied success probability			3.2%

Business in Development Network

BiD Network is an online community of thousands of entrepreneurs, experts and investors from all over the world. The BiD Network makes high growth potential business plans of SME's visible and links finance and expertise to business opportunities. Through BiD Network Investor Matchmaking, quality business and their entrepreneurs are rendered access to the worldwide equity market consisting of experienced Angel Investors and SME funds. The Network is a meeting place for SME entrepreneurs, investors, experts and organizations. They can ask for advice or financial support, compete in the BiD Challenge or coach a participating entrepreneur and share information, business plans, news and discussions.

For more information, contact:
 Business in Development Network
 E-mail: info@bidnetwork.org; Web: <http://www.bidnetwork.org>



So you want to raise a VC fund?

<http://www.ventureintelligence.in>

In recent months, I've had the benefit of listening and talking to several Limited Partners, General Partners and Placement Agents, and learning how difficult it is to raise a venture capital fund in the current environment - especially, if it is a first-time fund (Hat's off Helion!). Here are some of my notes from these interactions.

- The venture capital business requires LPs to put relatively small amounts of money to work - compared to investing large chunks in buyout and late-stage PE funds. To put a reasonable amount of their portfolios in the VC category, they need to deploy in several funds (including newer funds from existing portfolio firms). This is hard work - especially given that returns from the VC category (on an average) hasn't been too great in recent years.
- Unless your existing fund is top quartile in terms of returns, fund raising is very tough. Creating outsized returns in your current fund is the best way to raise a second fund.
- Proven teams can close a new fund in six weeks. First-time funds can take up between 1-2 years to close.
- A lot of LPs are busy re-investing in their existing portfolio of funds (i.e., "topping up") rather than searching for new managers. It is therefore important that your fund is differentiated from their existing portfolios.
- Best time to raise a fund is when you don't need it - i.e., make sure to keep in active touch with LPs while you are investing your current fund. Just stop and say hello when you are in town. These kind of relationship building efforts pay off big time when you are actually in the market to fund raise.
- Stay close to existing LPs. Have an investor relations focus as early as possible. The new LPs you approach will want to know whether the current LPs are "re-upping" or not.
- According to one European GP, their firm did a survey of the investors and portfolio companies of their existing fund. Based on the results, the firm decided to add more partners before raising a new fund.
- He also recommended that GPs view fund-raising like any sales job. You have to qualify your prospects. There is no point in whining that "buyouts are sucking out the capital from the system," etc.
- Do your homework. If you are talking to a strategic investor, focus on the added value. Do not pitch to them the same way you would pitch to a purely financial investor. Also do homework on the geographical and cultural context of specific LPs.

Arun Natarajan, Venture Intelligence, India

- Several pension funds in the US invest directly. Europe however is full of gatekeepers and fund-of-funds.
- The key elements LPs evaluate are the team, fund size and performance.
- LPs evaluate whether the team members have the energy and passion to make a serious go for it.
- LPs like to see continuity of teams across cycles. Plus, they would like to know how the carry is being shared. (Is one partner going to take most of the carry?)
- The first impression is very important. LPs want to be comfortable with the team members at a personal level versus just look at the PPMs and other quantitative stuff. Some placement agents therefore recommend the first meeting be a simple "get to know each other" chat rather than a detailed presentation.
- What should be your fund size? Do the math based on the number of GPs in the fund; how much each can deploy, etc.
- While it sometimes might be frustrating, GPs should respect the decision making processes involved at LP firms.
- Pick your placement agent carefully. Not every player in this space is high quality.

Sponsored funds

- Fund sponsors would like to see the managers have their "skin in the game" by risking a significant part of their net worth in the fund.
- Sponsors might provide "walking around money" to fund managers (so that they can pay themselves a salary and cover expenses during the fund raising period).

First-time funds

- The universe of LPs who will back first-time managers is limited. Some of the larger LPs have a clear policy which says "No first-time funds, period".
- Do not use a placement agent. "It's a battle. Handle it yourself."
- Don't go institutional straightaway. Raise some friends and family money. Do a few deals to demonstrate traction and then go to institutions.
- University endowments and family offices are a better bet than the larger financial institutions.
- Make track records attributable. "Can't have multiple fingers pointing to the same deals." □