Home
Current Issue
Entrepreneurs
Technology
Business
Venture Capital
Interviews
Industry Review
Early Beginnings
Book Review
Out of the office
Successful Planning
Venture Blogs
VC Tools
Recent Articles
Latest News
VC Useful Resources

RSS 2.0 NEWS
RSS 2.0 BLOGS

Our Archive

Venture Capital: Dispelling The Urban Legends

By Jeffrey P. Blanchard

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Recently, I met with a small business representing itself as having developed a revolutionary, proprietary technology. Upon arriving, I explained that I was there representing a limited partner and did not discuss my venture capital company in any detail. When the discussion turned to the company's funding needs, they expressed a strong preference for obtaining all of the needed capital-- $10 million-- from individual and angel investors, based on their belief that venture capital investors would demand too much ownership of the company in connection with the needed investment and require control of the board of directors. They also expressed their fear that venture capital investors would micro-manage the company and would, at the first opportunity, replace the management team and force the premature sale of the company, reaping all of the rewards for themselves.


JP Blanchard

Unfortunately, many other firms needing capital to execute their operating plans share the concerns expressed by this small business, however erroneous. Indeed, ambivalence regarding venture capital firms is rampant among entrepreneurs in early- and expansion-stage companies. On the one hand, many entrepreneurs require the funding and business experience and judgment such entities can bring. Yet fears abound regarding what the venture capital firm will demand of—or take from--the entrepreneurs' company once the capital is invested.

In fact, my experience as the founder and partner of a longstanding venture capital firm, paired with continual interactions with entrepreneurs and reading in business publications, reveals that entrepreneurs' most prevalent concerns are these:

1. Investors will attempt to take control/ownership of the company.
2. Investors will micromanage the company, usurping the responsibilities of the management team.
3. Venture capital firms will eliminate the extant management team, using the firm's ownership and financial leverage to terminate the founding management team, replacing them with the venture capitalists' personal choices for successors.
4. Venture capitalists may force the premature sale of the company so that the firm can exit the investment.
5. Venture capitalists will disproportionately retain the financial rewards of the management team's hard work.

What is the source of these fears? How pervasive are the behaviors they imply? And what can you do to benefit from venture capital funds while avoiding being taken advantage of?

These questions will be addressed in a series of articles, beginning here (see sidebar). Covering the fears in turn, each piece will suggest what you can do to select the right venture capital partner, as well as how you can best manage the relationship from the initial negotiations and throughout the relationship.

It's reasonable to ask why these fears exist. Is it because they are founded on

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common venture capital (mal)practices? In my experience, no. As you will see in this series, the vast majority of venture capital firms cannot benefit from the abuses that so often characterize their industry. Doubtless, some venture capitalists deserve their reputation as ruthless, self-serving co-owners of businesses, but most professional investors have the primary objective of maximizing the return on their investments. If they serve of the boards of their portfolio companies, they also have a fiduciary duty to protect the interest of all of the shareholders of those firms and the responsibility for exercising good business judgment in building value for their portfolio companies, and hence for all of the shareholders of those companies, their investors, and themselves.

If venture capital practices aren't to blame for the widespread distrust, then what is? Cyclical media attention resulting from entrepreneurial disappointment seems to drive these fears. Though largely unfamiliar with venture capital practices, the media are well acquainted with emotional content that sells their publications; and concepts that repeatedly appear in print garner factual status among readers, just as the tabloids at the checkout stand of grocery stores hawk their goods with sensationalism.

Small business publications that cater to entrepreneurs may be particularly likely to denigrate venture capitalists due to anger many entrepreneurs may already harbor toward firms that have refused them funding. The fact is, there are far more deals proposed than made among companies in the early and expansion stages most in need of funding. My own firm examines over 1,000 deals each year, and on average, only five or six receive funding. This figure is comparable among other venture capital firms, and understandably, the entrepreneurs not selected may feel slighted.

In conclusion, if you seek investor funds, you require information regarding the myths and realities of working with a venture capital firm. Each article in this series is intended to meet these needs, enhancing your ability to collaborate with venture capitalists to build your company's value.

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