

The Basics of Venture Capital for Small Businesses

What Venture Capital really is and how to attract it.

You and a friend have a great idea for a product that you think you can sell. You work nights and weekends to develop a prototype for your product. You don't actually have it to the stage where you can sell it yet, but you can show it to experts in the field at trade shows to get their opinions. You go from trade show to trade show and most of the reviews your product gets are very positive. You're filled with hope that you can bring your product to market. There is one problem. You don't have any money. How do you get the money for a start-up company to develop and sell your product?

Your first idea may be to approach a bank and ask for a loan. You may soon find out that banks are not interested in a start-up company that is little more than an idea. Your search for money will very likely lead you to the [venture capital](#) market.

What is Venture Capital?

Simply put, venture capital is other people's money. It is financing for new, usually high-risk [start-up](#) businesses just like the new product that you want to bring to market. There are a lot of well-known firms whose names you would recognize that were financed, when they were start-ups, by [venture capital](#). One of them is [Netscape Communications](#).

[Venture capital](#) firms pool investment dollars from investment companies, pension funds, large [corporations](#), university endowment funds, and even wealthy private individuals and uses these funds to invest in high-risk start-up companies that they think will be profitable. These pooled funds are often called private equity.

What do Venture Capitalists want in return?

Venture capitalists are only interested in firms they think will turn into solid [investments](#). Since they take on so much risk when they make an investment in a start-up unknown firm and product, they look to earn a very high return. Venture capital firms pick and choose their investments carefully as they are investing other people's money. [They only take on those projects they think will earn the high return.](#) They usually become involved in the business by lending their expertise in the hope of helping the business succeed. Their ultimate goal is to take the business public someday. As a result, they

usually are not interested in a corner grocery store or Mom and Pop business. They look for small businesses with potential to grow larger.

Venture capital firms who make an investment in a small business take an equity or ownership stake in the company. They usually take preferred stock in the company and want one or more seats on the Board of Directors. They also want access to the financial information of the company. Small businesses who accept venture capital investments have to be willing to share decision-making power with the venture capitalists that have a stake in their firm.

How do you find a Venture Capital Firm for Your Business?

Venture capital firms get a large number of proposals from small business firms and it can be difficult to capture their attention. The best way to do so is to get a referral through a financial professional. You should talk with your banker, lawyer, CPA, or other financial professional. One of these experts will probably be able to make a referral for you. Some [venture capital](#) firms focus on one geographic area or one or two specific industries. Your financial professional will be able to sort that out for you.

You can also attend private equity conferences or industry events and find out how other professionals in your industry attracted venture capital.

Before you visit the venture capital firm, you must develop a [business plan](#) and a presentation for that business plan. That is the first thing the venture capital firm will ask for. The only way to get serious attention is to be professional, prepared, and organized.

The venture capital market is very much a networking and personal introductions market. It may take months to attract financing through venture capital. Persevere!