

What is Venture Capital?

Venture Capital › Interview Preparation



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Venture capital is a form of capital provided to early-stage and high-growth companies, also known as "startups". The key characteristic of venture capital is the high level of risk associated with the investments. Venture capital firms are a very important source of funding for new businesses, because small businesses usually do not have access to capital markets (too small) or bank debt (too risky).

Where does the money come from?

Independent venture capital firms are essentially pools of money coming from institutions and wealthy individuals. These individuals are often successful entrepreneurs who have cashed out of a business and would like to reinvest their cash in sectors they know well. The money is typically managed by a team (ex-entrepreneurs, consultants, bankers, or industry experts) who will spend time looking for the next Google or Facebook. There are also corporate venture capital arms, most often owned by large technology or healthcare companies. The money comes from the parent company; for example, a large healthcare company would frequently invest in startups that have new ideas for medical devices or new drugs.

How do they make money?

Venture capitalists invest money in startups with the hope of selling them in a few years' time at a substantial profit (reaping many times the initial investment), either to another VC fund, to another company, or via an IPO. Venture capitalists add value to the companies they buy not only by giving them access to cash, but also by providing them with specific expertise and giving them access to their large networks and contacts in the industry.

How is Venture Capital different from Private Equity?

Private equity firms invest in stable companies using a lot of debt, and typically want a majority or controlling stake. The private equity firm aims at a two to three times' return on their initial investment. Venture capital firms invest in high-growth companies using no debt and are usually happy with a minority stake. Venture capital aims for a five to ten-plus times return on their initial investment.

What kind of companies do they buy?

Venture capitalists invest in companies across all sectors, but most commonly in the high-growth areas of technology, Internet, or healthcare.

Required feature: Very strong growth. Think about how companies such as Google, Twitter, and Facebook took on the world within a few years. Therefore, venture capitalists are looking for the next big idea; they want to see (at minimum) a double-digit revenue growth, and ideally over 30%+ growth per annum in large markets. Some companies may be growing fast but if they are in a small niche, they will quickly mature and be less attractive investments. The best companies for venture capitalists are those that can address many products in many regions, and target many people.

Scalability. Companies that can easily expand and reach very large audiences at a low cost, such as Google and Facebook, are attractive. The same applies to software companies, or even medical companies; once the product is created, it is cheap to sell globally.

Great management teams. Venture capitalists will always look for smart and very ambitious management that will be able to work very hard to make the company succeed.

What about job prospects and salaries?

Venture Capital firms are usually quite small, so there are few jobs available and this makes the industry extremely competitive. Salaries tend to be lower than those found in private equity groups or investment banking, because the funds managed are smaller, so most of the remuneration comes from a share of the returns on the investments. This share of investments, if the fund performs well, can be very substantial. The kind of people who work in Venture Capital funds tend to hire people with scientific backgrounds (technology, biology, healthcare, etc.) and also often hire entrepreneurs and people who have experience working in startups. However, there is a large number of ex-bankers and ex-management consultants at the larger firms who were focused on technology, media or healthcare sectors.

Can you give me a list of VC funds in Europe?

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