Venture Capital

Raising capital

Alex Rodriguez works for a venture capital company:

'As you know, new businesses, called **start-ups**, are all **private companies** that aren't allowed to sell stocks or shares to the general public. They have to find other ways of raising capital. Some very small companies are able to operate on money their **founders** – the people who start the company – have previously saved, but larger companies need to get capital from somewhere else. As everybody knows, banks are usually **risk-averse**. This means they are unwilling to **lend** to new companies where there's a danger that they won't get their money back. But there are firms like ours that specialize in finding **venture capital**: funds for new enterprises.

Some venture capital or risk capital companies use their own funds to lend money to companies, but most of them raise capital from other financial institutions. Some rich people, who banks call **high net worth individuals**, and who we call **angels** or **angel investors**, also invest in start-ups. Although new companies present a high level of risk, they also have the potential for rapid growth – and consequently high profits – if the new business is successful. Because of this profit potential, institutions like pension funds and insurance companies are increasingly investing in new companies, particularly hi-tech ones.'

Note: **Venture capital** is also called **risk capital** or **start-up capital**.

Return on capital

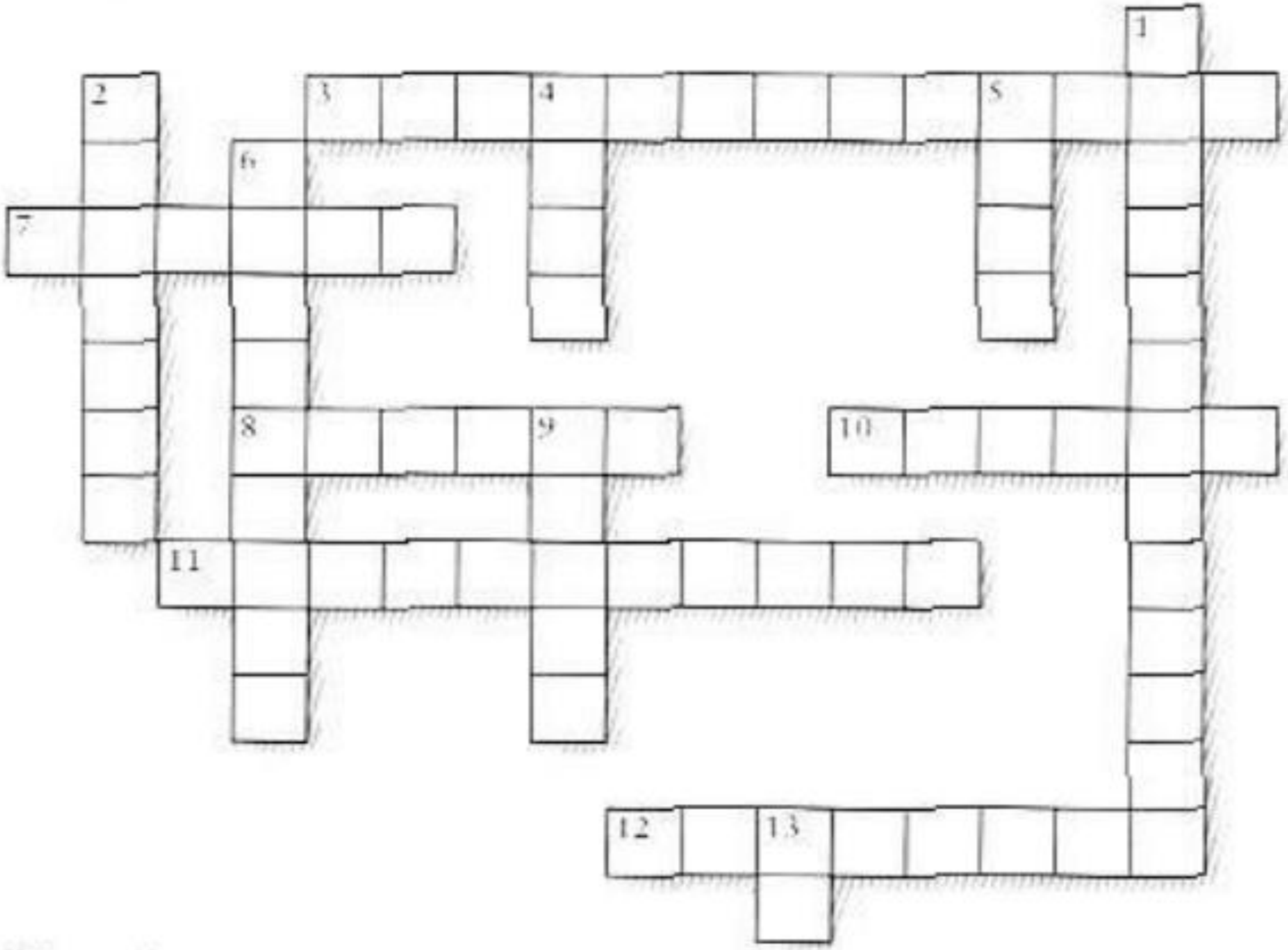
'Venture capitalists like ourselves expect **entrepreneurs** – people with an idea to start a new company – to provide us with a **business plan**. (See Unit 50)

Because of the high level of risk involved, investors in start-ups usually expect a higher than average **rate of return** – the amount of money the investment pays – on their capital. If they can't get a quick return in cash, they can buy the new company's shares. If the company is successful and later becomes a **public company**, which means it is listed on a stock exchange, the venture capitalists will be able to sell their shares then, at a profit. This will be their **exit strategy**.

Venture capitalists generally invest in the early stages of a new company. Some companies need further capital to expand before they join a stock exchange. This is often called **mezzanine financing**, and usually consists of **convertible bonds** – bonds that can later be converted to shares (see Unit 33) – or **preference shares** that receive a fixed dividend. (See Unit 29) Investors providing money at this stage have a lower risk of loss than earlier investors like us, but also less chance of making a big profit.'

BrE: preference shares; AmE: preferred stock

Complete the crossword. Look at A and B opposite to help you.



Across

3 A firm listed on a stock exchange is a .... (6,7)

7 Individuals who lend money to new companies are sometimes called .... (6)

8 Banks that are risk- .... usually don't want to finance new companies. (6)

10 The amount of money made from an investment is its rate of .... (6)

11 New businesses often have to get finance from .... companies. (4,7)

12 The people who start companies. (8)

Down

1 People who have ideas for setting up new businesses. (13)

2 .... capital firms specialise in financing new companies. (7)

4 Many banks don't want to .... money to new businesses. (4)

5 People who want to borrow money to start a company write a business .... (4)

6 Money invested in a company just before it joins a stock exchange is sometimes called .... financing. (9)

9 and 13 down A new company is often called a .... (5-2)

13 See 9 down.

Match the two parts of the sentences. Look at A and B opposite to help you.

1 Banks are usually reluctant
2 Start-ups often get money
3 New companies can grow rapidly
4 Risk capitalists usually expect
5 Venture capitalists need an exit strategy – a way
6 Mezzanine financing is a second round of financing

a a higher than average return on their money.
b and so are potentially profitable.
c before a company joins a stock exchange.
d to get their money back after a few years.
e to lend money to new companies.
f from specialized venture capital firms.