Study Plan

Chapter 14

Learning Objectives

After studying this chapter you should be able to:

- Describe how the financing of entrepreneurial growth companies differs from the financing techniques used by more mature, publicly traded corporations;
- Explain why venture capitalists almost always use convertible preference shares as their investment vehicle and employ staged financing techniques to fund a developing company;
- Discuss how western European venture capital processes, practices, funding sources, and target industries differ from those in the United States, and describe the profitability of venture capital investments in these two major economies; and
- Describe why a vibrant market for initial public offerings is a vital prerequisite for a healthy venture capital industry.

Summary and Conclusions

- Entrepreneurial finance requires specialized financial management skills because entrepreneurial growth companies are unlike other private or publicly traded companies. In particular, EGCs must finance much higher asset growth rates than other firms and tap external financial markets much more frequently.
- In addition to providing risk capital to entrepreneurial growth firms, professional venture capitalists (VCs) provide managerial oversight, coupled with technical and business advice, assistance in developing and launching new products, and valuable help recruiting experienced management talent.
- U.S. venture capital investments are highly concentrated, both geographically and industrially.
- U.S. venture capitalists endeavor to make intermediate-term (3–7 years), high-risk investments in entrepreneurial growth firms. Then, they exit these investments, either by selling the portfolio companies to another firm or (preferably) by executing an initial public offering. During recent years, VCs have, on average, achieved their target compound annual returns of over 30 percent.
- Phenomenal growth in venture capital fund-raising and investment has occurred over the past decade in the United States, Western Europe, and in certain Asian countries, but not in Japan or in most developing countries. In recent years, the two largest venture capital markets, the United States and Europe, have seen significant convergence in contracting practices, investment patterns, and returns.
- The funding of European venture capital is moving rapidly toward greater reliance on pension funds (rather than commercial banks). Today, a higher fraction of European venture capital investment is being targeted toward early-stage investment than in the past. More of Europe's total

funding is also being directed toward high technology, rather than management buyouts, again mirroring practices in the United States.

- After a long period of relative underperformance, returns on European private-equity investment have increased steadily in recent years. However, the recent collapse of Germany's Neuer Markt has temporarily closed what once was the most promising exit route for European venture capitalists.
- Although Canada and Israel successfully promoted venture capital funding and investment, growth in venture capital in Asia, Latin America, and Africa has lagged behind that of Europe and North America. Venture capital funding and investment in developing countries has been growing from its low base during recent years.