BREAKING THE ADDICTION OF
VC FUNDING

MEDICAL FUNDING PROFESSIONALS

BREAKING THE ADDICTION OF VC FUNDING

Founders of companies find it difficult to resist the myth of venture capital. The VC route to extraordinary wealth – the expectation that every company can become a unicorn (a business valued over $1 billion) – is promoted and perpetuated by a business media reluctant to expose Wall Street's version of the emperor without clothes.

The likelihood of receiving VC funding for most businesses is slim and none:

- **Marc Andreessen,** founding partner of the VC firm Andreessen Horowitz, admitted to a Stanford Graduate School Business Class that "VC to an extent is a numbers game" and the chance of getting an equity investment from his VC was less than 1%.

- **Rafat Ali,** Founder and CEO of Skift, described his company's attempts to raise capital from VCs as a "cycle of self-flagellation" in his article How We Got off the Addiction to Venture Capital and Created Our Own Way to Profits. The entrepreneurial guru who began the Lean Startup movement, Steve Blank, complains that "I've watched the industry become a money-hungry mob. VCs today aren't interested in the public good. They're not interested in anything except optimizing their own profits and chasing the herd, and so they waste billions of dollars that could have gone to innovation that actually helps people." [i]

Founders of healthcare companies are often surprised to find no interest from VCs unless their business is in the sliver of the industry dedicated to technology, i.e., digital healthcare or medical devices. Mara Zepeda, co-founder and CEO of Switchboard, told the New York Times[ii] in 2019 that "The tool of venture capital is so specific to a tiny, tiny fraction of companies. We can't let ourselves be fooled into thinking that's the story of the future of American entrepreneurship. The more we believe that myth, the more we overlook tremendous opportunities."

Venture Capital Funding Drawbacks

Discussions with founders seduced by the lure of VC funding invariably include regrets about the process and their lack of understanding about the impact on themselves and their companies. Areas of frustration and conflict include:

- **Dilution.** While every investor wants a return on their investment, VCs are exceptionally greedy, expecting returns of 25%-35% annually. Consequently, VCs typically demand minimum ownership of 20%-25% for their first investment, reducing founders from 100% to 75%. Each subsequent round of funding further reduces the founder's and early shareholders' proportion of ownership.
- **Loss of control.** VCs typically demand board representation, whatever the proportion of shares owned. When they collectively own more than 50% of the shares through future fundings, they control the company's direction, including the founders' replacement. Research published in the Harvard Business Review found that their VC partners replaced 20%-40% of founders.
- **Process time for funding.** Raising money from VC firms is incredibly difficult, frustrating, and time-consuming (three to nine months) with no guarantee of success.
- **Lack of funding success.** Venture capitalists point out that they receive about 1,000 proposals for every three or four companies they fund.[iii]

- **Scaling expectations.** A VC's goal for its investments is to grow aggressively — faster than the competition, faster than regulators, faster than most normal businesses would consider prudent - then sell or go public. "Venture investing is a high-stakes game in which companies are typically either wild successes or near total failures." [iv] Joel Gascoigne, co-founder and CEO of Buffer, elected to buy his VC investors out to avoid the problems of unmanaged growth: "The VC path forces you into this binary outcome of acquisition or IPO, or pretty much bust." [v]

The Overlooked Alternative to VC Funding

Founders often overlook or do not understand the funding opportunities created by the JOBS Act in 2015 and subsequently expanded in 2021. Rather than trying to attract and negotiate with reluctant, skeptical VC managers, many entrepreneurs are turning to Regulation A+ offerings, which is often called a "mini-IPO." A company can raise up to $75 million in a 12-month period, year after year, and investors can freely sell their shares anytime since there is no lockout period. The ability to cash out at any time, rather than wait 5 to 7 years for a sale or IPO, means that investors are typically willing to take less equity than a VC, i.e., less dilution of founders' shares.

Control of the Fundraising Process

Reg A+ offerings eliminate some of the worst aspects of VC funding and offer advantages to founders and owners unavailable from venture capital funds. The most obvious benefit to a business owner is control of the offering process. The ability to manage one's destiny is a strong incentive to consider a Reg A+ funding. An added advantage is the opportunity to turn customers into shareholders.

Advantages of Regulation A+ Offerings

In addition to less dilution for existing shareholders, control over company operations continues to reside with the owners. There are no requirements that shareholders serve on the board or control any aspect of company operations. The registration process for a Reg A+ offering averages 110 days versus the three to nine months of a VC funding. Like all public offerings, registration statements are required (though less extensive than a traditional IPO). Still, their preparation is less extensive than a VC's due diligence process.

Growing Popularity of Regulation A+ Offerings

Since 2015 Reg A+ offerings have raised over $7.4 billion with over $3.4 billion raised in 2021 alone – a 130% year-over-year increase.

Final Thoughts

While venture capital has its place in the entrepreneur ecosystem, they eliminate most startups and early-stage companies for consideration. It is not surprising that Janice Taylor, a partner of E99 Ventures, advises, "Founders need to leave the old model behind and final alternative ways to get their startups into the world." [vii]

Regulation A+ offerings should be included in the toolbox of every founder, owner, CFO, and Treasurer in the United States. Their use provides significant upside potential with little downside risk. To learn more about the advantages of Regulation A+ for your company, Contact Us for a free analysis.

To learn more about VC funding or Reg A+ offerings for your company, Schedule a call, and let's talk!

Schedule A Call

References:

[i] Duhigg, C. (2020) How Venture Capitalists Are Deforming Capitalism. The New Yorker. (November 23, 2020) Access through https://www.newyorker.com/magazine/2020/11/30/how-venture-capitalists-are-deforming-capitalism

[ii] Griffith, E. (2019) More Start-Ups Have an Unfamiliar Message for Venture Capitalists: Get Lost. The New York Times. (January 11, 2019) Access through https://www.nytimes.com/2019/01/11/technology/start-ups-rejecting-venture-capital.html

[iii] Shirshikov, D. (2019) 10 Venture Capital Advantages & Disadvantages. FitSmallBusiness.com. (May 15, 2019) Access through https://fitsmallbusiness.com/venture-capital-advantages-and-disadvantages/

[iv] Griffith (n ii)

[v] Griffith. Ibid.

[vi] Anonymous. (2021) Reg A+ Offerings Are Having a Moment: SPACs got most of the headlines in 2020, but it was also a breakout year for another IPO alternative: Reg A+. CFO.com (February 11, 2021) Access through https://www.cfo.com/capital-markets/2021/02/reg-a-offerings-are-having-a-moment/

[vii] Munk, C. (2021) The Venture-Capital Trends to Watch. Wall Street Journal. (May 9, 2021) Access through https://www.wsj.com/articles/the-venture-capital-trends-to-watch-11620578655