

# VENTURE CAPITAL WORLD

## Role of the venture capital lawyer in the fundraising process

*By Michael Thompson, Partner, Steptoe & Johnson*

As most people are aware, entrepreneurs and start-ups are finding the fundraising process increasingly difficult these days. Venture capitalists are only just beginning to recover from dot.com mania and, for most venture capitalists, it is now time to tidy up their existing portfolio and concentrate on those investments which will make a return for them.

As a result of this, most venture capitalists have substantially slowed down the investment process - if not totally suspended it for the time being - and are concentrating on existing investments.

Although this is not the news entrepreneurs seeking funds want to hear, this retrenchment also creates opportunities for entrepreneurs. Pro active lawyers more than ever want to assist companies in raising capital. While a year ago advisers were inundated with business plans, now lawyers can focus on assisting those clients who want to battle through the funding obstacles. Even in these quiet times, most venture capitalists receive over 100 business plans per week.

Even though venture capitalists receive a large number of business plans direct, venture capitalists still look to other service providers to screen business plans in the first instance. The screening function works because the venture capital lawyer only makes money by providing services when companies get funded. An experienced lawyer has an eye for the type of company which will attract funding having negotiated numerous venture capital deals and sat in on many presentations over the years. Furthermore, the venture capital lawyer understands that their relationship with venture capitalists is critical to their clients being considered for investments.

The "smart" lawyer ensures that the company they recommend is ready to be presented and has a good chance of being funded.

Experienced entrepreneurs seek out venture capital lawyers to help them at the idea or formation stage of the company. Usually the entrepreneur will meet with their lawyer for a short meeting to talk about their concept and business plan. This meeting is usually the "freebie" part of the lawyers marketing efforts and results in the entrepreneur receiving a brief outline on what it takes to be financed in the current economic climate as well as a realistic initial assessment of the fundability of the concept.

Using their experience of working in the venture capital world, the lawyer also helps the entrepreneur to be realistic in their expectations, especially with regard to how much money can be raised at the current stage of the company's existence and the amount of dilution of equity that the founders might have to suffer.

Usually at the first meeting or the follow-up meeting the lawyer will discuss the following with the entrepreneur:

- (i) the best structure for the company;
- (ii) the initial capitalisation of the company;
- (iii) the equity that should ultimately go to the funders;
- (iv) employee share option plans;

- (v) the need for shareholder agreements and revised articles of association; and
- (vi) new service agreements for key employees.

Venture capital lawyers know the structure that angel investors/venture capitalists expect to find when they invest in a company. Ensuring that the structure is set up right from the start can eliminate funding headaches. The last thing an entrepreneur wants or needs is a financing round failing or being postponed because the structure does not meet the expectations or requirements of the angel/venture capitalist. The aim of the entrepreneur seeking angel or venture capital funding should be to eliminate as many issues as possible so the discussion with the venture capitalist revolves around the valuation of the company and the size of the investment.

While the short-term investment picture looks bleak, the long term view for venture investment in the UK remains bright. There is risk capital available which needs to find a home.

Now is the time for the entrepreneur to meet with the experienced venture capital lawyer to ensure that they are taking all steps possible to ensure that their company is ready for the moment the venture capital environment shifts back to investment in companies which need external funds to grow to the next stage.



The author is **MICHAEL THOMPSON**, a venture capital lawyer specialising in emerging growth companies in the internet, telecoms, IT, technology, retail, leisure and healthcare sectors. Michael is a partner in the London office of **Steptoe & Johnson** and can be reached on **020 7367 8000** or via e-mail at [mthompson@steptoe.com](mailto:mthompson@steptoe.com)

December 2002

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